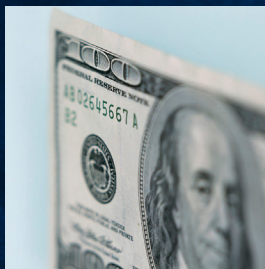


Keeping Texas Competitive 2013

A Roadmap to Keep Texas at the Forefront of
Prosperity, Job Creation, and Economic Growth



October 2012
Texas Public Policy Foundation

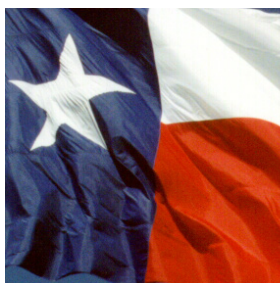


Table of Contents

Overview	3
Adopt Real Texas Budget Solutions and Keep Taxes Low	4
Protect Our Health, Environment, and Energy Economy, Texas-style.....	12
Build a Higher Quality, More Efficient Education System.....	18
Foster a Free Market Economy and Protect Property Rights	23
Maintain Strong and Effective Criminal and Civil Justice Systems	28

Keeping Texas Competitive Overview

Adopt Real Texas Budget Solutions and Keep Taxes Low

Last session's budget gimmicks and constant calls for more government spending will make it challenging for those who wish to balance the 2014-15 Texas budget without new revenue. To keep spending and taxes under control, Texans should:

- Limit increases in state and local spending to the lesser of population growth plus inflation, the growth in gross state product, or the growth in personal income.
- Phase out the Texas margin tax by 2018.
- Consolidate and eliminate state agencies and programs.
- Make state and local government employee pension systems more sustainable and accountable.
- Move from a strategy-based budget to a program-based budget to promote greater transparency.

Protect Our Health, Environment, and Energy Economy, Texas-style

Special interests in Washington, D.C. and Austin want to promote centralized, bureaucratic control of health care, environmental protection, and energy production. To ensure a Texas-style approach to these issues, Texans should:

- Require the Texas Health and Human Services Commission to apply for a waiver that would deliver Texas' Medicaid funding through a block grant.
- Require the Texas Commission on Environmental Quality to conduct a regulatory impact analysis of all proposed rules.
- Increase the capacity and reliability of the Texas electricity market by eliminating renewable energy subsidies, price controls, and regulatory overreach and maintaining Texas' energy-only market.

Build a Higher Quality, More Efficient Education System

Rapid growth in education spending has failed to improve Texas schools. Parental choice and accountability combined with local control is what is needed to improve education quality and reduce costs. To this end, Texans should:

- Increase the ability of citizens and parents to transform a traditional ISD into a home-rule school district.
- Enact a "parent trigger" that allows parents to transform local schools into campus or program charters.
- Require universities to post online and give applicants performance information on: student academic performance, graduation rates, post-graduate earnings, evidence of post-graduate earnings, etc.

Foster a Free Market Economy and Protect Property Rights

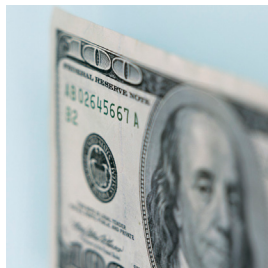
People want to live, work, and do business in Texas because liberty fosters prosperity. To increase economic growth, create more jobs, and protect consumers, Texans should:

- Eliminate the "must pass" provision of sunset review legislation and allow the Sunset Commission to only abolish/eliminate agencies, committees, boards, and statutes.
- Increase property rights by applying the Private Real Property Protection Act to Texas cities and by eliminating eminent domain takings not for a public use.
- Reduce regulation and increase competition in all Texas markets, including telecommunications, insurance, and consumer finance.

Maintain Strong, Effective Criminal and Civil Justice Systems

Texas leads the country in reshaping its criminal and civil justice systems. To keep these moving in the right direction, Texas should:

- Stop the excessive criminalization of business activities by reducing occupational licensing and sunseting the 1,800 criminal offenses outside of the Penal Code unless they are incorporated into the Penal Code.
- Protect Texas' civil justice system from attacks that would increase lawsuit abuse.



Adopt Real Texas Budget Solutions and Keep Taxes Low

Last session's budget gimmicks and constant calls for more government spending will make it challenging for those who wish to balance the 2014-15 Texas budget without new revenue. To keep spending and taxes under control, Texans should:

Limit increases in state and local spending to the lesser of population growth plus inflation, the growth in gross state product, or the growth in personal income

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

Phase out the Texas margin tax by 2018

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

Consolidate and eliminate state agencies and programs

- Reduce state mandates and burdensome education programs by expanding and improving Home Rule Districts and Campus Charters. Higher education funding should be shifted toward student-centered funding.
- Texas needs to get out from under federal health care and other welfare mandates. However, federal mandates for Medicaid and other programs dramatically limit the ability to identify savings in this area.
- Eliminate or reduce subsidies to businesses and consumers to reduce taxes, cut prices, and increase economic growth.
- Shift scarce resources toward reducing congestion and away from areas and uses—like rail—that fail to address the state's congestion problems.
- End the practice of using special fund balances to certify the budget.

Make state and local government employee pension systems more sustainable and accountable

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

Move from a strategy-based budget to a program-based budget to promote greater transparency

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

Texas' Tax & Expenditure Limit

KTC Recommendation

Limit increases in state and local spending to the lesser of population growth plus inflation, the growth in gross state product, or the growth in personal income.

The Issue

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

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

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

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

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

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

Texas' TEL is weak and should be improved to protect taxpayers and ensure that any growth of government is responsible. And with some minor but important changes, like those outlined above, the Legislature can do just that.

The Facts

- Eighty-four percent of Texas voters approved the Texas Tax Relief Act in 1978 demanding government control its' spending.
- Despite such overwhelming support, Texas' TEL has failed to meaningfully rein in the growth of government spending. Between fiscal 1990 and 2012, state spending rose 310 percent, while the sum of population growth plus inflation grew just 132 percent.
- The reasons that the TEL is ineffective are many, but include: its exclusion of certain appropriations; the measure used to restrict the growth of government spending; and the ease with which lawmakers can get around the TEL.
- Texas' TEL fails to adequately limit expenditures because it can be easily avoided with enabling legislation.

Recommendations

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

Resources

- *Real Texas Budget Solutions: 2013 and Beyond* by Texas Public Policy Foundation (Mar. 2012).
- *Texas' Constitutional Tax and Expenditure Limit: Testimony before the House Appropriations Committee* by James Quintero, Texas Public Policy Foundation (Apr. 2011).
- *Strengthening Texas' Tax and Expenditure Limit* by The Honorable Talmadge Heflin and Katy Hawkins, Texas Public Policy Foundation (Oct. 2010).
- *Trends in Texas Government: State Government Spending* by The Honorable Talmadge Heflin and Katy Hawkins, Texas Public Policy Foundation (Oct. 2010).

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The Margin Tax

KTC Recommendation

Phase out the Texas margin tax by 2018.

The Issue

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

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

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

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

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

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

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

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

The Facts

- Texas' margin tax is complex, costly, and difficult to comply with, giving rise to a less competitive business climate in the state.
- The margin tax has consistently underperformed. With the exception of fiscal year 2012, collections have fallen below expectations every year since its inception, partially resulting from legal tax avoidance strategies, a common issue with complex tax schemes.
- The state's business tax is contradictory to the idea of a limited liability entity.
- The margin tax is collected irrespective of a business' profitability.
- Texas does not have a revenue problem. From fiscal 1990 to fiscal 2010, the state's total revenue grew by 270.3 percent, much faster than inflation increases, 66.8 percent, or population growth, 48 percent, over the same period.

Recommendations

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

Resources

- *The Margin Tax Debunked: Dispelling Three Common Myths About Texas' Restructured Business Tax* by The Honorable Talmadge Heflin, James Quintero, and Lauron Fischer, Texas Public Policy Foundation (Nov. 2011).
- *The Texas Margin Tax & Its Impact on the State's Economic Competitiveness* by The Honorable Talmadge Heflin, James Quintero, and Robert McDowall, Texas Public Policy Foundation.
- "Fixing" the Texas Margin Tax by the Honorable Talmadge Heflin, the Honorable Chuck DeVore, and James Quintero, Texas Public Policy Foundation.

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State Budget

KTC Recommendation

Consolidate and eliminate state agencies and programs.

The Issue

In January 2013, the next legislative session will convene amid a period of great budget difficulties. Current estimates suggest that the state will have to contend with an estimated \$3 billion to \$4.5 billion budget deficit for the current biennium, and a \$10 billion to \$13 billion projected budget shortfall for the next. Virtually all of the deficit and shortfall are the result of a surge in obligations under the Medicaid program.

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

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

The Facts

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

Recommendations

- **Revamp Public & Higher Education.** While public education spending needs to be accountable to taxpayers, the top-down approach of running classrooms from Austin isn't working. We need to scrap many state mandates, burdensome education programs, and the school funding system so we can start from scratch to increase efficiency, capture cost savings, and most importantly, improve educational achievement. One way to do this is to make Home Rule Districts and Campus Charters easier to create, give them more freedom from state mandates, to pursue blended learning models, and to give parents more control over their creation and operation. When it comes to higher education, funding should be shifted toward student-centered funding.
- **Reduce Social Welfare Spending.** Social welfare spending is exploding as new Federal mandates and caseloads increase each year. Spending on Medicaid alone in 2014-15 could increase by over \$10 billion. Texas needs to decrease these costs and get out from under federal health care and other welfare mandates. However, federal mandates for Medicaid and other programs dramatically limit the ability to save in this area.
- **Cut Overregulation, Unnecessary Programs, and Subsidies.** Overregulation, unnecessary programs, and subsidies to businesses and consumers cost Texans billions of dollars each year while reducing economic growth. Eliminating or reducing these will reduce taxes, cut prices, and increase economic growth.
- **Prioritize Transportation Spending on Relieving Congestion.** Shift scarce resources toward reducing congestion and away from areas and uses—like rail—that fail to address the state's congestion problems.
- **Move Future State Employees into Defined-contribution Retirement Plans.** To protect taxpayers and state employees, future state employees should be incentivized to move into a defined-contribution 401(k) plan, the same plan the vast majority of non-government workers use.

- Strengthen Texas' Tax and Expenditure Limitation. Allow all state and local spending to increase only by the sum of population growth plus inflation, the growth in gross state product or personal income, whichever is less.
- Shift to Program-based Budgeting. The general appropriations bill each session should specify the amount of the proposed appropriation for each program which is being funded, rather than the current practice of appropriating funds based on "strategies." Letting taxpayers know the flow of money to programs is common sense.
- End the Practice of Using Special Fund Balances to Certify the Budget. There are many government funds, like the System Benefit Fund, that hide money from taxpayers in order to certify the budget. But the money cannot be spent for general purposes, so this practice essentially results in deficit spending.

Resources

- *Real Texas Budget Solutions: 2013 and Beyond* by Texas Public Policy Foundation (Mar. 2012).

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Reforming Texas' Public Pension Systems

KTC Recommendation

Make state and local government employee pension systems more sustainable and accountable.

The Issue

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

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

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

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

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

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

During the past several years, state and municipal pension systems have implemented changes designed to rein in excessive liabilities. Modifications such as an increased minimum retirement age and readjusted benefit calculations have bought some time for the plans, but these adjustments do little to change the long-term cost trajectory. Much more substantive changes are needed to retain solvency and keep the state's pension systems above water.

Such changes could include:

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

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

The Facts

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

Recommendations

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

Resources

- *Reforming Texas' State and Local Pension Systems for the 21st Century* by Arduin, Laffer, & Moore Econometrics, Texas Public Policy Foundation (Apr. 2011).
- *Reforming Texas' Public Pension Systems: Testimony before the Committee on Pensions, Investments, and Financial Services* by The Honorable Talmadge Heflin, Texas Public Policy Foundation (Apr. 2011).
- *Changing Public Pensions from Defined Benefit to Defined Contribution: Testimony before the Committee on Pensions, Investments, and Financial Services* by Donna Arduin, Texas Public Policy Foundation (Apr. 2011).

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Budget Transparency

KTC Recommendation

Move from a strategy-based budget to a program-based budget to promote greater transparency.

The Issue

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

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

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

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

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

That's why legislation is needed to change the layout of the budget so that revenues and expenditures for each program are easily identifiable.

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

The Facts

- The state's budget is currently prepared using a strategic planning and budgeting system.
- The current budgeting system, by which appropriations are linked to strategies and goals rather than programs, obscures how government agencies are spending money and why.
- House Bill 2804, proposed during the 82nd Regular Session, would have helped clarify state agency by program. However, the bill was unsuccessful.
- On February 21st, 2012, Legislative Budget Board Director John O'Brien testified before the House of Appropriations committee that the LBB was in the process of developing a way to offer program-specific budget detail along with its legislative recommendations. This illustrates the need for program level budget transparency.

Move from a strategy-based budget to a program-based budget to promote greater transparency.

Recommendations

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

Resources

- *Bill Analysis: House Bill 2804* by the Honorable Talmadge Heflin and Bill Peacock, Texas Public Policy Foundation (Apr. 2011).
- *Make the Budget Process More Transparent: HB 2804 and SB 1653* by the Honorable Talmadge Heflin and James Quintero, Texas Public Policy Foundation (Mar. 2011).
- *House Bill 2804*, Rep. Erwin Cain et. al, 82nd Regular Legislative Session, Texas Legislature Online (Mar. 2011).

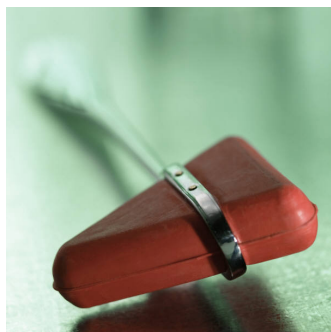
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Protect Our Health, Environment, and Energy Economy, Texas-style

Special interests in Washington, D.C. and Austin want to promote centralized, bureaucratic control of health care, environmental protection, and energy production. To ensure a Texas-style approach to these issues, Texans should:

Require the Texas Health and Human Services Commission to apply for a waiver that would deliver Texas' Medicaid funding through a block grant

- The state should continue to pursue Medicaid funding block grants, in order to give the state greater certainty in the Medicaid budget from year-to-year, as well as greater flexibility to run the program. This includes petitioning the state's Congressional delegation to represent these needs in the U.S. Congress.
- Texas should apply for a waiver to use a sliding scale that ties the out-of-pocket cost of medical care to the recipient's income.

Require the Texas Commission on Environmental Quality to conduct a regulatory impact analysis of all proposed rules

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

Increase the capacity and reliability of the Texas electricity market by eliminating renewable energy subsidies, price controls, and regulatory overreach and maintaining Texas' energy-only market

- Maintain Texas' energy-only market; do not adopt capacity payments.
- Eliminate wholesale price caps.
- Eliminate the ability of the PUC to disgorge revenue.
- Do not adopt Sunset Commission proposals to increase PUC fines and give the PUC emergency cease and desist authority.
- Define more clearly the concept of market power and market power abuse.
- Eliminate Renewable Portfolio Standard and support elimination of the federal production tax credit.

Medicaid

KTC Recommendation

Require the Texas Health and Human Services Commission to apply for a waiver that would deliver Texas' Medicaid funding through a block grant.

The Issue

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

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

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

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

The Facts

- Medicaid is an entitlement program—Texas must provide medically necessary care to all eligible individuals who seek services as long as the state participates in the program.
- Health and human services spending, some 70 percent of which goes to Medicaid, represents roughly 32 percent of the state budget.
- For the 2012-13 biennium, the Legislature appropriated approximately \$41 billion and will likely spend more than \$47 billion in All Funds for the Medicaid program alone, making it the second largest single item in the state budget.

- Medicaid is jointly financed with federal tax revenue and state tax revenues according to the Federal Medical Assistance Percentages (FMAP), which varies between states and usually changes from year to year. Historically, Texas pays roughly 40 percent of Medicaid costs and the federal government roughly 60 percent. But even small fractions of change in the FMAP result in significant losses or gains in the amount of federal funding that comes to the state as a result.
- In 2009, Medicaid covered almost 3.7 million Texans, including 2.7 million children.
- Children have increased as a percentage of total Medicaid enrollment due to the economic downturn, but the ABD population is expected to increase consistently with the aging of the Baby Boom generation.
- In 2007, 56 percent of live births in Texas were paid for by Medicaid.
- Never, in the history of the Texas Medicaid program, has state spending (general revenue) on Medicaid declined from one year to the next. Only in 1982 did total Medicaid spending decline from the previous year as the result of reductions at the federal level.

Recommendations

- Texas should reject federal funds for the purpose of expanding Medicaid
- The state should continue to pursue Medicaid funding block grants, in order to give the state greater certainty in the Medicaid budget from year-to-year, as well as greater flexibility to run the program. This includes petitioning the state's Congressional delegation to represent these needs in the U.S. Congress.
- Texas should apply for a waiver to use a sliding scale that ties the out-of-pocket cost of medical care to the recipient's income.
- The state should also reject efforts to extend the period of Medicaid eligibility—including eligibility for children's Medicaid benefits.

Resources

- [Letter to Commissioner Albert Hawkins](#) commenting on Medicaid reform proposal from Mary Katherine Stout, Texas Public Policy Foundation (Nov. 2007)
- *Medicaid: Yesterday, Today, and Tomorrow; A Short History of Medicaid Policy and Its Impact on Texas* by Mary Katherine Stout, Texas Public Policy Foundation (Mar. 2006).
- *Final Notice: Medicaid Crisis* by Dr. Jagadeesh Gokhale, Texas Public Policy Foundation (Dec. 2010).
- *Medicaid Reform: Constructive Alternatives to a Failed Program* by Arlene Wohlgemuth, Brittani Miller, and Spencer Harris, Texas Public Policy Foundation (Feb. 2011).
- *Fiscal Size-Up: 2012-2013 Biennium*, Legislative Budget Board (Dec. 2009).

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Regulatory Impact Analysis

KTC Recommendation

Require the Texas Commission on Environmental Quality to conduct a regulatory impact analysis of all proposed rules.

The Issue

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

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

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

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

Court decisions seem to validate this interpretation of current law. In *Brazoria County v. Texas Com’n on Environmental Quality* (App. 3 Dist. 2004)128 S.W.3d728, the court held that TCEQ’s rules implementing requirements for vehicle inspection and lawn-maintenance did not trigger the statutory requirement for a Regulatory Analysis for a Major Environmental Rule since the TCEQ was attempting to meet, not exceed, a relevant standard set by federal law.

Texas environmental agencies generally avoid most of the excesses and inefficiencies typical of the federal agencies. State and local governments are connected to the regulated entities and the communities in which regulated business operates. The state’s far more hands-on knowledge and practical understanding of real-world effects tend to accelerate, rather than delay, meaningful environmental protections. And TCEQ has wisely striven to resist unwarranted, counterproductive, unlawful dictates of federal agencies. Yet, the state of Texas, whose population is larger than many countries and whose economy is larger than most countries, has a regulatory purview that is, indeed, vast. However well-honed now, efforts to streamline regulatory design and to measure effectiveness should remain a constant focus of Texas state agencies.

Straightforward RIA should help regulators design the most efficient regulation: targeted, effective at the least cost to the state, regulated entities and Texans. Proposed rules with extremely high cost and minimal or immeasurable environmental effect should send the rule maker back to the drawing board to design a more efficient rule. Alternative defi-

nitions of standards, requirements and methods of compliance can yield greater environmental outcomes or effect at lower cost. With over 80 steps in TCEQ’s internal rulemaking process, this straight-forward cost-effectiveness analysis of a select few “major” rules need not add time or expense to the agency’s work.

The Facts

- Texas does not currently require state agencies to perform a cost-benefit analysis for new regulations in most circumstances.
- A current requirement that regulatory impact analysis be performed for “major” new environmental rules has been invoked only once in 14 years.
- During the 82nd Legislative Session, Rep. Ken Legler introduced HB 125, which would have implemented RIA requirements for new TCEQ regulations. HB 125 passed the House but did not make it to the Senate floor in time for passage.

Recommendations

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

Resources

- “Taming the Fourth Branch of Government,” *The Daily Caller* by Kathleen Hartnett White, Texas Public Policy Foundation (Sept. 2011).
- *Time for Regulatory Transparency* by Kathleen Hartnett White, Texas Public Policy Foundation (May 2009).
- *Basic Good Governance: Regulatory Transparency* by Kathleen Hartnett White, Texas Public Policy Foundation (Apr. 2009).

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Electric Competition and Resource Adequacy

KTC Recommendation

Increase the capacity and reliability of the Texas electricity market by eliminating renewable energy subsidies, price controls, and regulatory overreach and maintaining Texas’ energy-only market.

The Issue

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

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

Another external source leading to reduced investment has been various forms of price regulation. Despite the obvious benefits of the deregulated Texas market, some still support price controls. However, regulations priced based on the theory that making profit off energy are wrong, is harming the electricity market. The problem with the cap, for example, is that it reduces prices at times of peak demand, when electricity is the most expensive to produce. If generators can't sell electricity at a profit at times of peak demand, they won't build generation plants that will supply electricity when we need it most

Calls to "fix" Texas' electricity market with more government and ending our "energy only," i.e., free-market, approach to generating electricity won't help—in fact, they will make electricity more expensive for consumers. The solution to Texas' energy issue is not to regulate the market more, but to regulate it less.

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

This combination means that capital for new generation is harder to find in Texas, and what can be found is more expensive. In large part this is because capital is leaving Texas to other states where governments provide compensation via fiat, rate of return regulation, capacity payments, etc. By moving capital to other states, not only can the generators avoid regulatory uncertainty here, but they can often avoid market risk. But, capacity markets still have resource adequacy concerns; implementing capacity payments here will not solve our problems. If we let it work, the world-class Texas electricity market will power Texas' future.

The Facts

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

Recommendations

- Maintain Texas' energy-only market; do not adopt capacity payments.
- Eliminate wholesale price caps.
- Eliminate the ability of the PUC to disgorge revenue.
- Do not adopt Sunset Commission proposals to increase PUC fines and give the PUC emergency cease and desist authority.
- Define more clearly the concept of market power and market power abuse.
- Eliminate Renewable Portfolio Standard and support elimination of the federal production tax credit.

Resources

- *Texas' Electricity Market Can Power Our Future* by Bill Peacock, Texas Public Policy Foundation (July 2012).
- *HB 2133: Don't Ruin the Texas Electricity Market* by Bill Peacock, Texas Public Policy Foundation (May 2011).
- *Competition in the Texas Electricity Market* by Bill Peacock, Texas Public Policy Foundation (Mar. 2011).
- *Texas' Renewable Energy Experiment* by Bill Peacock, Texas Public Policy Foundation (Dec. 2010).

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Build a Higher Quality, More Efficient Education System



Rapid growth in education spending has failed to improve Texas schools. Parental choice and accountability combined with local control is what is needed to improve education quality and reduce costs. To this end, Texans should:

Increase the ability of citizens and parents to transform a traditional ISD into a home-rule school district

- Remove the 25 percent voter turnout requirement in local elections.
- Empower parents to drive the charter process by enabling them to create and have their charter petition placed directly on a local election ballot without working through their local school board.

- Remove seat time requirements to encourage online and blended learning models in home-rule districts.
- Remove the 22:1 class-size cap for home-rule districts.
- Do not require home-rule districts to use bilingual education as their default provision for English language learners. Rather, allow them to choose a program that best suits the needs of their student body, such as sheltered English immersion.

Enact a “parent-trigger” that allows parents to transform local schools into campus or program charters

- Sec. 12.052, Education Code, should be changed to require a board of trustees of a school district or the governing body of a home-rule school district to grant a campus charter or a program on a campus charter to the parents of a majority of students on the campus.
- Requiring 50 percent of the teachers at a school to approve the campus charter should be made optional, rather than mandatory.

Require universities to post online and give applicants performance information on student academic performance, graduation rates, post-graduate earnings, evidence of post-graduate earnings, etc.

- Building on the foundation laid last year by HB 736 (Sect. 9), improve information systems by giving students better access to student academic performance, graduation rates, post-graduate earnings, percentage of classes taught by part-time faculty, evidence of post-graduate earnings (from sites like PayScale.com, etc.). Make this information available on a statewide site with a common format, with the site to be administered by the Texas Higher Education Coordinating Board.

Home-rule School Districts

KTC Recommendation

Increase the ability of citizens and parents to transform a traditional ISD into a home-rule school district.

The Issue

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

1. There are too many roadblocks in the existing law. School boards, rather than parents, control the charter process; voter turnout and petition requirements are too high.
2. The law imposes many of the same mandates on home-ruled districts that traditionally run school districts face. Texas could make a number of changes to the home-rule code to make the home-rule district a much more inviting alternative to traditional ISD.

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

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

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

The Facts

- The current process for creating a home-rule charter requires that voters work through their local school board, rather than allowing them to petition to get a home-rule charter placed directly onto the election ballot.
- To pass a home-rule charter, 25 percent of the district’s electorate must participate in the election. This is an extremely high turnout for any type of local election.
- Home-rule schools have the same rules regarding the hiring and termination of instructors that traditional ISDs operate under.
- Home-rule schools are subject to the state’s 22:1 K-4 class-size.
- Home-rule schools have identical attendance and seat-time requirements to traditional independent school districts.
- Home-rule school districts must offer bilingual education to English language learners, rather than being able to offer alternatives such as sheltered English immersion. This rule is also identical to that which governs traditional ISDs.

Recommendations

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

Resources

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

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Campus Charters: A Parent-trigger for Texas

KTC Recommendation

Enact a “parent-trigger” that allows parents to transform local schools into campus or program charters.

Parent-trigger laws are designed to empower parents to make significant education reforms at the campus level.

The Issue

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

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

- a) In accordance with this subchapter, the board of trustees of a school district or the governing body of a home-rule school district may grant a charter to parents and teachers for a campus or a program on a campus if the board is presented with a petition signed by:
 - 1) the parents of a majority of the students at that school campus; and
 - 2) a majority of the classroom teachers at that school campus.
- b) For purposes of Subsection (a)(1), the signature of only one parent of a student is required.
- c) The board of trustees may not arbitrarily deny a charter under this section.

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

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

The Facts

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

Recommendations

- Sec. 12.052, Education Code, should be changed to require a board of trustees of a school district or the governing body of a home-rule school district to grant a campus charter or a program on a campus charter to the parents of a majority of students on the campus.
- Requiring 50 percent of the teachers at a school to approve the campus charter should be made optional, rather than mandatory.

Resources

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

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Higher Education Quality

KTC Recommendation

Require universities to post online and give applicants performance information on student academic performance, graduation rates, post-graduate earnings, evidence of post-graduate earnings, etc.

The Issue

While most of us expect college students to graduate in four years, the graduation rate after six years at Texas universities is only 49 percent. One prominent cause of this disappointing statistic is that current higher-education funding formulas overwhelmingly encourage universities to enroll students, but not to graduate them. Nor do they encourage them to graduate them with an externally verifiable level of competence.

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

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

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

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

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

Given the role that history, government, and economics play in developing critical thinking—and the fact that Texas students suffer a comparative disadvantage nationally in the number of such courses taken—we in Texas should be concerned that our students, too, have been cast “adrift.” This concern was heightened when, in March 2012, the *Washington Post*, through a freedom of information request, found that the University of Texas-Austin scores in the 23rd percentile among peer institutions on the CLA; that is, 77 percent of UT’s competitors scored higher. None of this denies that Texas boasts some of the most prestigious universities in the world, UT-Austin among them. Nevertheless, the areas described above need improvement.

The Facts

- The six-year graduation rate at Texas universities is only 49 percent.
- By 2020, 60 percent of jobs will require a career certificate or college degree.
- Texas students gain only 2.9 percent of their civic knowledge over the course of their college careers.
- Undergraduates at Texas universities are below the national average in the number of history, government, and economics courses taken during college.

Recommendations

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

Resources

- *Higher Education: Facts at a Glance* by Thomas K. Lindsay, Texas Public Policy Foundation (Jan. 2012).
- *Academically Adrift* by R. Arum and J. Roksa (Chicago: University of Chicago Press, 2011).
- [Texas Higher Education Coordinating Board Data](#).
- *Texas Undergraduates Fail at Civics: ISI’s American Civic Literacy Survey Results* by Gary Scott, Texas Public Policy Foundation (Mar. 2007).
- *Complete College America “Time is the Enemy”* (Sept. 2011).

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Foster a Free Market Economy and Protect Property Rights

People want to live, work, and do business in Texas because liberty fosters prosperity. To increase economic growth and create more jobs, Texans should:

Eliminate the “must pass” provision of sunset review legislation and allow the Sunset Commission to only abolish/eliminate agencies, committees, boards, and statutes

- Eliminate the “must pass” provision of the statute by repealing Section 325.013 and Section 325.015 of the Texas Government Code. This new provision will help reduce the special interest policy initiatives and allow the Commission to concentrate on reducing the size, scope, reach, and cost of government.
- Focus the SAC on abolishing/eliminating agencies, committees, boards, and statutes. Reducing the Commission’s ability to change the scope of agencies will make their mission more about whether or not to eliminate or consolidate agency functions.
- Require all policy related legislation to go through the substantive, jurisdictional legislative committees. This would also allow the SAC staff and members to focus on reducing the size, scope, reach and cost of state agencies, as well as eliminating the access point for those interested in subverting due legislative process.
- Consider assigning the Sunset review process of smaller agencies to the Senate Committee on Government Organization and House Committee on Government Efficiency & Reform. These committees will be responsible to work with the SAC staff to reduce the cost of government for those agencies that are less than 1 percent of the biennium budget.



Increase property rights by applying the Private Real Property Protection Act to Texas cities and eliminating eminent domain takings not for a public use

- The Texas Real Private Property Rights Preservation Act should be amended to apply to municipalities.
- The numerical threshold of what qualifies as a taking under the Act—a 25 percent reduction of the market value of the affected private real property—is an arbitrary number that should be reduced or eliminated.
- Grant property owners the right to repurchase their property if the initial use of the property taken from them is not the public use for which the property was acquired.

Reduce regulation and increase competition in all Texas markets, including telecommunications, insurance, and consumer finance

- Eliminate archaic regulatory relics in the Public Utility Code that stem from the days of monopoly regulations of the Texas telecommunications markets
- Reduce municipal franchise fees to reflect the marginal costs of providing services through the right-of-way.
- Adopt a true file-and-use system for homeowners insurance where only rates in use may be disapproved.
- Shift the focus from blocking “excessive” homeowners insurance rates to guarding against inadequate or discriminatory rates.
- The Legislature should not add further barriers to consumer lending—such as price controls—that restrict access to capital for those in need of short-term loans.

The Sunset Process

KTC Recommendation

Eliminate the “must pass” provision of sunset review legislation and allow the Sunset Commission to only abolish/eliminate agencies, committees, boards, and statutes.

The Issue

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

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

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

Early in its history, the Sunset Advisory Commission was able to eliminate a lot of archaic or duplicative agencies. However, today few agencies are eliminated, or even streamlined for that matter. Instead, the process is generally to grow government. The “must pass” nature of Sunset bills makes them ripe for special interests to attach to them provisions to increase government that never could pass on their own.

The Facts

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

Recommendations

- Eliminate the “must pass” provision of the statute by repealing Section 325.013 and Section 325.015 of the Texas Government Code. This new provision will help reduce the special interest policy initiatives and allow the Commission to concentrate on reducing the size, scope, reach, and cost of government.
- Focus the SAC on abolishing/eliminating agencies, committees, boards, and statutes. Reducing the Commission’s ability to change the scope of agencies will make their mission more about whether or not to eliminate or consolidate agency functions.
- Require all policy related legislation to go through the substantive, jurisdictional legislative committees. This would also allow the SAC staff and members to focus on reducing the size, scope, reach and cost of state agencies, as well as eliminate the access point for those interested in subverting due legislative process.
- Consider assigning the Sunset review process of smaller agencies to the Senate Committee on Government Organization and House Committee on Government Efficiency & Reform. These committees will be responsible to work with the SAC staff to reduce the cost of government for those agencies that are less than 1 percent of the biennium budget.

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Regulatory Takings

KTC Recommendation

Increase property rights by applying the Private Real Property Protection Act to Texas cities.

The Issue

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

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

The Facts

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

Recommendations

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

Resources

- *Regulatory Takings: The Next Step in Protecting Property Rights in Texas* by Ryan Brannan, Jay Wiley, and Bill Peacock, Texas Public Policy Foundation (July 2010).
- *Private Real Property Rights Preservation Act Guidelines*, Attorney General of Texas.
- Article 1, Section 17, Texas Constitution.
- Texas Real Private Property Rights Preservation Act.
- *City of University Park v. Benners*, 485 S.W.2d 773 (Tex.1972).

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The “Buy-back” Provision

KTC Recommendation

Increase property rights by eliminating eminent domain takings not for a public use.

The Issue

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

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

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

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

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

The Facts

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

Recommendation

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

Resources

- *Property Rights in Texas: Heading in the Right Direction* by Bill Peacock, Texas Public Policy Foundation (2011).
- *What’s Next for Senate Bill 18?* by Bill Peacock, Texas Public Policy Foundation (2011).
- *Senate Bill 18: The “Buy-back” Provision* by Ryan Brannan and Bill Peacock, Texas Public Policy Foundation (2011).

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Increase Market Competition and Enhance Consumer Choice

KTC Recommendation

Reduce regulation and increase competition in all Texas markets, including telecommunications, insurance, and consumer finance.

The Issue

For decades state and local governments have chosen to regulate some markets more heavily than others. Examples include telecommunications, insurance, and consumer finance. The reasons for this vary. Sometimes it was because the government had previously forced monopolies on consumers. In other cases, regulators claimed there was something “different” about a market that kept competition from working so the government had to step in.

Whatever the case might have been, today we can see that government regulation more often than not reduces competition and thereby harms consumers. This is especially the case when it comes to price regulation. There is no more reason to regulate prices in the telecommunications and insurance markets than there is in the computer market.

The Facts

- Texas consumers are particularly burdened with high tax rates and outdated regulations on telecommunications services.
- States like Indiana and Florida have surpassed Texas in reducing regulation and increasing competition in their telecommunications markets.
- Texas consumers pay more than \$500 million per year to local governments in the form of franchise or right-of-way fees on telecommunications and other services.
- The Texas Sunset Review Commission’s Report on the Texas Department of Insurance (TDI) concluded that the “Legislature cannot judge the success of the shift to file-and-use rate regulation [in homeowners’ insurance] because the system has not been fully implemented.”
- TDI’s focus on the “affordability” of homeowners’ insurance reduces investment, hinders competition, and puts insurers at risk of insolvency.
- Regulations on consumer lending in other states have forced many such lenders out of business, limiting credit options for those that the laws supposedly were designed to protect.
- An estimated 40 percent of payday loan recipients seek such loans only after rejection by traditional lenders.

Recommendations

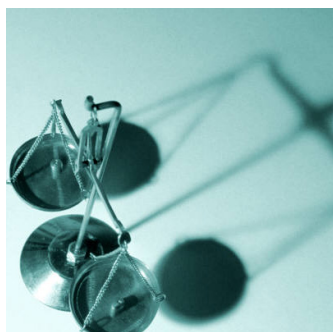
- Eliminate archaic regulatory relics in the Public Utility Code that stem from the days of monopoly regulations of the Texas telecommunications markets
- Reduce municipal franchise fees to reflect the marginal costs of providing services through the right-of-way.
- Adopt a true file-and-use system for homeowners’ insurance where only rates in use may be disapproved.
- Shift the focus from blocking “excessive” homeowners’ insurance rates to guarding against inadequate or discriminatory rates.
- The Legislature should not add further barriers to consumer lending—such as price controls—that restrict access to capital for those in need of short-term loans.

Resources

- *Competition in the Texas Telecommunications Market* by Bill Peacock, Texas Public Policy Foundation (Aug. 2012).
- *Bringing Telecommunications Regulation into the 21st Century* by Ryan Brannan, Texas Public Policy Foundation (May 2011).
- *Consumers, Competition, and Homeowners' Insurance* by Bill Peacock, Texas Public Policy Foundation (2010).
- *Homeowners' Insurance: The Problem with Prior Approval* by Bill Peacock, Texas Public Policy Foundation (2009).
- *Consumer Benefits of Access to Short-Term Credit* by Ryan Brannan, Texas Public Policy Foundation (Mar. 2011).

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Maintain Strong and Effective Criminal and Civil Justice Systems

Texas leads the country in reshaping its criminal and civil justice systems. To keep these moving in the right direction, Texas should:

Stop the excessive criminalization of business activities by reducing occupational licensing and sunseting the 1,800 criminal offenses outside of the Penal Code unless they are incorporated into the Penal Code

- Refrain from creating new criminal offenses, especially those regulating non-fraudulent business activities.
- Don't criminalize voluntary economic transactions using either civil or criminal law.
- Avoid licensing new occupations, and revise laws to eliminate criminal penalties associated with many occupations.

Protect Texas' civil justice system from attacks that would increase lawsuit abuse

Overcriminalization

KTC Recommendation

Stop the excessive criminalization of business activities by reducing occupational licensing and sunseting the 1,800 criminal offenses outside of the Penal Code unless they are incorporated into the Penal Code.

The Issue

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

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

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

The traditional criminal acts found in the Penal Code—from murder to many types of theft—account for less than 300 offenses. This leaves over 1,400 byzantine offenses scattered outside of the Penal Code. Many of these are “regulatory of-

fenses”—those relating to ordinary, non-fraudulent business activities in fields such as agriculture, health care, natural resources, and insurance.

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

The Facts

Examples of excessive Texas criminal laws include:

- Under Agriculture Code, Chapters 76.201(e) and 76.202(b), it is a Class A misdemeanor (up to a year in jail) to use, handle, store, or dispose of a pesticide in a manner that injures vegetation, crops, wildlife, or pollinating insects.
- Chapter 26.3574(s)(16) of the Water Code makes it a second degree felony (punishable by up to 20 years in prison) not to “remit any fees collected by any person required to hold a permit under this section.”
- Occupations Code Section 165.151 makes it a Class A misdemeanor (punishable by up to one year in jail) to violate a rule of a professional licensing board covered under this chapter.

Recommendations

- Stop the excessive criminalization of business activities by reducing occupational licensing and sunseting the 1,800 criminal offenses outside of the Penal Code unless they are incorporated into the Penal Code
- Refrain from creating new criminal offenses, especially those regulating non-fraudulent business activities.
- Don’t criminalize voluntary economic transactions using either civil or criminal law.
- Avoid licensing new occupations, and revise laws to eliminate criminal penalties associated with many occupations.

Resources

- *12 Steps for Overcoming Overcriminalization* by Marc A. Levin and Vikrant P. Reddy, Texas Public Policy Foundation (May 2012).
- “Criminal Law v. Free Enterprise: What’s the Verdict?” audio of panel featuring Texas Rep. Bill Callegari, Cato Institute Criminal Justice Director Tim Lynch, and Texas District and County Attorneys Association Legislative Director Shannon Edmonds at the 10th Annual Policy Orientation for the Texas Legislature (Jan. 2012).
- *Amicus Brief in Shelton v. Sec’y, Dep’t of Corrs.*, No. 11-13515-GG (11th Cir. 2011) by Vikrant P. Reddy, Texas Public Policy Foundation (Nov. 2011).
- *Analyze Before You Criminalize: Checklist for Legislators* by Marc Levin, Texas Public Policy Foundation (Apr. 2011).
- *Time to Rethink What’s a Crime* by Marc A. Levin, Texas Public Policy Foundation (Feb. 2010).

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Civil Justice

KTC Recommendation

Protect Texas' civil justice system from attacks that would increase lawsuit abuse.

The Issue

Since 1995, Texans have embarked on an unprecedented effort to restore justice to its rightful place in Texas courtrooms. The civil justice reforms of the last 11 years are too numerous to fully catalog, but a short listing would include reforms in areas such as venue shopping, product liability, punitive and non-economic damages, frivolous lawsuits, class action law-suits, medical liability, and asbestos and silica litigation.

We've seen dramatic results in Texas from our reforms, particularly when it comes to health care. Fifteen thousand new physicians have moved to Texas and other doctors are returning to practice, taking us from near the bottom to the middle of the states in number of physicians per resident. There has also been an increase in charity care of more than \$600 million per year. Hospitals have invested more than \$3 billion in new medical infrastructure. As a direct result of medical malpractice reform, more than 430,000 Texans have health insurance coverage. Our economic output has increased by \$51.2 billion and 499,000 permanent jobs have been created.

Yet attempts continue to be made to turn back the clock and once again make Texas a judicial hell hole. Texas should stand its ground and thwart attempts to reverse the gains we have made.

The Facts

- Studies by groups like the Pacific Research Institute have consistently ranked Texas as having one of the best tort climates in the United States.
- Due to reforms, the American Medical Association dropped Texas from its list of states that are in a medical liability crisis.
- Five of the largest malpractice insurers in the Texas market have instituted rate cuts that will reduce premiums by about \$50 million.

Recommendations

- The current causation standards for asbestos-related claims should remain at the same level as all other toxic exposure claims.
- The "paid or incurred" provision in current Texas law should remain intact. Unraveling Texas' successful tort reform measures would be done at the expense of patients, medical providers, and taxpayers.
- Do not narrow the scope of litigation managed through the Multi-District Litigation system in Texas.
- Avoid complicating the plain meaning of statutes. Prevent legislation that gives non-substantively codified statutes the same effect and meaning that was or would have been given the statute before its codification.

Resources

- *Tort Reform and Texas* by Brooke Rollins, Texas Public Policy Foundation (Jan. 2010).
- *A History of Lawsuit Reform in Texas* by the Honorable Joseph M. Nixon, Texas Public Policy Foundation (May 2008).
- "The Rise and Fall of Textualism" by Jonathan T. Molot, *106 Columbia Law Review* 1, 3 (2006).
- *Legislative Session Summary*, Texas Civil Justice League, 2009 Session.
- *The Next Step: Strengthening Texas Courts*, Texans for Lawsuit Reform (Nov. 2005) 1.

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