



POLICYMAKER'S GUIDE TO CORPORATE WELFARE



TEXAS PUBLIC POLICY
FOUNDATION

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Texas Public Policy Foundation



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What is Corporate Welfare?

The Issue

Conservatives have long questioned whether welfare is the best way to help the least fortunate among us. This concern was highlighted in the 1995-96 welfare reform debate that led to a significant transformation of America's welfare system.

In his 1992 book *The Tragedy of American Compassion*, Marvin Olasky found that the culture of entitlement fostered by the welfare state eroded the traditional American virtues of seeking to better oneself and helping to better one's neighbor. Self-improvement morphed into dependency while charity gave way to complacency. Social mobility gave way to a seemingly permanent underclass that more and more has to turn to the government for help.

More recently, a debate over a different type of welfare has taken hold. Today, conservatives are challenging whether what is often called "corporate welfare" achieves its stated goal of boosting economic growth. And, as in the case of traditional welfare, the debate extends beyond the effectiveness of corporate welfare to the impact it has on the principles on which this country was founded—particularly that of liberty.

Corporate welfare, also known as economic development, is widely used throughout Texas and the nation. From local tax abatements to the Export-Import Bank, governments provide billions of dollars each year in benefits to businesses in an attempt to improve the outcomes of the marketplace. In Texas alone, tax abatements, renewable energy subsidies, development incentives, and direct payments total more than \$2 billion annually.

The Arguments

There is a spirited debate about what to do with some of Texas' economic development programs. Proponents of government economic development programs claim that they have a proven track record of growing the economy and creating high-paying jobs. While there are multiple responses to this claim, advocates for reform start by pointing out that Texas has proven there is even a better path to economic development—the Texas Model.

Since the beginning of the Great Recession, Texas has added 1.3 million jobs, far more than any other state and 39 percent of all non-farm U.S. jobs created during that time. Texas has also become the nation's top exporting state. Its \$289 billion in exports in 2014 accounted for more than 17 percent of the U.S. total. And Texas' adjusted poverty rate is second lowest among the 12 largest states.

The evidence that the Texas Model outperforms corporate welfare is compelling. But it is also important to understand that corporate welfare has the same corrosive effects as welfare for individuals and fails to live up to the core American ideal of protecting "life, liberty, and the pursuit of happiness."

For instance, if a large corporation used its expertise to break into the bank accounts of Texans and transfer millions of dollars into its own account, everyone would condemn this action as theft. Those who ordered and conducted the raids would be prosecuted and locked in jail. However, let the government take the money from Texans' bank accounts and then give it to the same company and it is called economic development.

Additionally, proponents of corporate welfare suffer from a false belief in central planning. They believe that either they or government planners can best determine what technology has the best chance of success, which jobs and products best supply society's needs, and where best to expend scarce supplies of capital. They believe that they just can't sit back and let the economy take care of itself; they have to take money and property from citizens in order to solve the citizens' problems for them.

Recommendations

Texas is the national leader in increasing prosperity for its citizens. It has arrived at this point because it has relied on the free market model of economic development and protected the rights of its citizens while largely rejecting the government approach. Building upon this approach, Texas should reduce or eliminate current economic development programs, restrain growth in overall government spending and regulation, and reduce taxes. Relying on markets is the best way to promote liberty and boost the economy.

Resources

Liberty or Economic Growth? We Can Have Both if We Rely on the Free Market by Bill Peacock, Texas Public Policy Foundation (April 2016).

Rivalry Helps Drive Florida and Texas to Economic Success by Bill Peacock, Texas Public Policy Foundation (May 2016).

Spotlight: The Texas Enterprise Fund by Bill Peacock, Texas Public Policy Foundation (Dec. 2015).

Why Texas Rocks, Economic-Freedom Style by Kathleen Hunker and Bill Peacock, Texas Public Policy Foundation (Aug. 2015).

Growing the Economy without Growing Government: Eliminating Taxpayer-funded Corporate Subsidies by Bill Peacock, Texas Public Policy Foundation (Sept. 2014).

The Texas Model

The Issue

Texas is a national leader in relying on the free market to increase prosperity within its borders. It has arrived at this point because it has relied on the Texas Model of economic development—lower taxes and spending, less regulation, fewer frivolous lawsuits, and reduced reliance on the federal government—more than the collectivist approach where government planners decide what is best for the economy.

The results of the Texas Model speak for themselves, with low spending Texas (Texas state government spends \$4,098 per capita versus \$5,711 for the average state) leading the nation in just about every economic category. And Texas isn't alone. States that cut taxes and return surpluses to taxpayers have much stronger economic growth than states that use government spending to grow an economy. Some examples:

- Texas ranks third in the Fraser Economic Freedom Index and the PRI Small Business Index;
- *Rich States, Poor States* ranks Texas first among all states for economic performance;
- *Chief Executive* ranks Texas as the best place for doing business;
- *Forbes* rates the Houston metropolitan area as the most affordable place to live in the United States; and
- States that don't have an income tax rank higher in GDP and employment growth than the states with the highest income tax rates.

Texas has long embraced the Texas Model. In addition to our overall approach to less government intervention, Texas also ranks 49th among the states in state economic development spending. While Texas has always embraced this approach, it really started separating itself from the pack in 2003 as the country was still recovering from the dot-com bust. Texas' relatively restrained fiscal, regulatory, and tort policy over the ensuing years put Texas at the forefront of economic growth in the country. During this time, job creation in Texas has grown at almost five times the rate of the rest of the country.

However, Texas isn't the only state that pursues relatively restrained fiscal policy. Other states are also using the Texas Model in their way, which after all is simply the most recent expression of the founding principles of this country. In general, these states also are experiencing above average economic growth.

The Arguments

Collectivist economic development does more harm than good. Not only does it fail to achieve its goal of increased economic growth, it often tramples the rights of citizens who don't share the vision of enlightened central planners.

There will always be experts, though, who claim that collectivist economic development programs are good for the economy. For instance, one study claims that Texas' \$7 billion subsidy for the wind industry through the building of the Competitive Renewable Energy Zone (CREZ) electricity transmission lines will

provide “an additional \$3.8 billion in gross product per year and generate more than 40,000 jobs.” Studies like this always assume that the collectivist development experts can make better decisions than Texans about where to invest their money. Yet, these claims are deeply flawed because, in addition to the use of questionable assumptions and economic multipliers, they mostly ignore the benefits that Texas would have gained if Texans had invested that \$7 billion themselves through the free market. A quick look at economic development spending in the states proves this point.

There is in fact a strong positive connection between heavy economic development spending by state governments and poor job growth in the 20 most populous states. From 2007 through 2014, Ohio averaged \$402 per capita in economic development spending while jobs declined by 3.6 percent. The biggest spending states averaged \$281 in per capita economic development spending, while sporting a meager 1.9 percent job growth.

Meanwhile, Texas tops the group of states with low economic development spending. Texas’ \$92 per capita economic development spending from 2007 through 2014 is second to last not only among the biggest states but among all states. This lack of reliance on collectivist economic development hasn’t hurt Texas any. No other large state comes close to its robust 19.4 percent increase in jobs since 2007. Though 10 states out of the 20 largest states that spend the least on economic development still averaged 5.5 percent job growth.

Large states that spend more on collectivist economic development programs have less job growth. It would be difficult to find a more compelling argument against the technocratic development model.

Recommendations

- Slow spending growth by adopting a Conservative Texas Budget for 2018-19 that increases spending by less than population growth plus inflation.
- Eliminate the margin tax.
- Require local government entities to get voter approval for increasing property tax revenue more than 4 percent or population growth plus inflation, whichever is less.
- Eliminate state and local economic development programs.

Resources

Growing the Economy without Growing Government: Eliminating Taxpayer-funded Corporate Subsidies by Bill Peacock, Texas Public Policy Foundation (Sept. 2014).

The 2018-19 Conservative Texas Budget by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (June 2016).

continued

The Texas Model (cont.)

The Real Texas Budget: Why Texas Needs to Ratchet Down Spending Growth by Talmadge Heflin, Vance Ginn, and Bill Peacock, Texas Public Policy Foundation (June 2016).

The Failure of Texas' Business Margin Tax by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (Dec. 2015).

Why Texas Needs Spending Limit Reform by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (Dec. 2015).

“Why Entrepreneurship Is Essential for Economic Development” by Shawn Ritenour, Institute for Faith, Work & Economics (July 3, 2014).

Makems and Takems

The Issue

The people of Sunderland in England have been building, or making, ships on the River Wear as far back as the 14th century. Since that time, their neighbors to the north in Newcastle upon Tyne have been taking the ships from Sunderland and using them to ship goods from the Port of Tyne.

Somewhere along the way the relationship between these good-natured rivals was captured by the term of mackems and tackems, or makems and takems. Each sees their role as superior; but the key point is that these roles take place voluntarily in a free market. When we look at these terms, however, in the context of what is happening in the United States today, they take on a much darker meaning.

What has set the United States apart from every other nation in the history of mankind is that the liberty afforded Americans created a country of makems. The Pilgrims overcame near starvation on their way to making a new life in cold, hostile environment. Later, other pioneers made their way into the wilderness to expand the boundaries of the colonies. The work ethic empowered by liberty kept on for over two centuries as America made itself the world's greatest economic power.

Of course, there were many problems along the way as takems decided they wanted to share in American prosperity without doing the work themselves. For instance, the English Parliament and English merchants tried to take profits from the colonists through the Stamp Act and the Tea Act and in the process provoked the American Revolution. But for the most part, America grew strong and prosperous as a country of makems.

Today, it seems, the takems have the upper hand. But these aren't the takems of Newcastle who prospered by employing the ships of Sunderland in the marketplace. Instead, takems in 21st century America have turned to the government to acquire what they can't in the free market through their own toil. The result is sustained economic malaise in America.

Texas Stands Out

As noted, the problem of takems is not new to our country or to the 21st century. But it has taken on a scale unprecedented in the United States. The reason for this is simple, explained by Milton Friedman, "The smaller the unit of government and the more restricted the functions assigned government, the less likely it is that its actions will reflect special interests rather than the general interest."

A relatively small government, which America had for its first 125 years or so, has a limited ability to be used by special interests—our takems—to take wealth from the general public. However, when progressives got hold of government in the late 19th century, the ability of government to plunder its citizens on behalf of the takems began to rapidly expand. Income taxes at the state and federal level gave government the resources it needed to take on its new role, while

continued

Makems and Takems (cont.)

the courts in the hands of the progressives overturned years of precedence in order to allow the transformation to occur. Despite a few bright spots—notably Calvin Coolidge, William F. Buckley, Jr, and Ronald Reagan—throughout the last century progressivism continued to take its toll on liberty and prosperity by giving takems control of our lives.

In the midst of liberty's decline in the U.S., Texas stands as a relative beacon of freedom. One way to measure how Texas is doing when it comes to liberty and prosperity is simply by watching the choices people make for themselves about where they want to live. And more people want to live in Texas than almost any other state. In a typical year, more people come to live in Texas than any other state except Florida, and its net migration rate ranks seventh in the country. Texas is a place people want to live, just like it was when Davy Crockett, Sam Houston, and Stephen F. Austin came here almost 200 years ago. And they come here today for the same reasons they did then—for opportunity and freedom.

Recommendations

Thus the recipe for continued prosperity in Texas is rather simple—more makems and less takems. To this end, we offer a few simple, though challenging to implement, recommendations:

- Stop the excessive growth of state and local governments: Texas government is big enough; if it needs to do something new, it can stop doing something else. For as long as government continues to grow, it also increases its capacity for being used by special interests, i.e., takems, to undermine liberty.
- Stop local governments from eviscerating property rights: Local governments use zoning, eminent domain, and economic regulation to shut down profitable businesses, make cities less affordable, and take away the rights of citizens to use their property. We need to allow makems (and everyone else) to use their property to their benefit and the benefit of others.
- Strengthen Texas' standing as a Right-to-Work State: Few things have been more important to maintain Texas economic leadership than being a right-to-work state. But unions are making inroads in certain sectors of our economy. We must stop the unions' assault on the secret ballot and stop the government from being a dues collector for unions.
- Eliminate corporate welfare: Texas has long since proven that the best economic program isn't corporate welfare, it is lower taxes and spending, fewer regulations, less frivolous lawsuits, and reduced reliance on the federal government. More of this approach, i.e., the Texas Model, is what Texas needs to lead America and the rest of the world to a more prosperous future in the years to come.
- Get Texas out from under federal duress through programs like Medicaid and federal regulations on the economy and environment: This is a tough one, but

still very necessary. Every time Texas does something to improve the lives of its citizens, the federal government seeks to undermine or reverse our gains. Whether it is interstate compacts, an Article V convention, or just saying no, Texas needs to continue its work with other states to stand up to the federal assault on our liberties.

Resources

Liberty or Economic Growth? We Can Have Both if We Rely on the Free Market by Bill Peacock, Texas Public Policy Foundation (April 2016).

Rivalry Helps Drive Florida and Texas to Economic Success by Bill Peacock, Texas Public Policy Foundation (May 2016).

Spotlight: The Texas Enterprise Fund by Bill Peacock, Texas Public Policy Foundation (Dec. 2015).

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State Subsidies

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The Texas Enterprise Fund

The Issue

Texas' low-tax, low-regulatory model continues to attract a highly skilled labor force. According to the Texas Workforce Commission, the state added 166,900 new jobs in 2015, despite a weak energy sector and bottom-level oil prices. Nevertheless, there remains a faction in government who worry that Texas will be unable to compete with its sister states unless the government takes a more proactive approach and offers an incentive package for businesses willing to relocate.

The Texas Enterprise Fund is one such program. Established in 2003, the Texas Enterprise Fund provides cash grants to business projects that promise a significant amount of high-income job creation. Dubbed at the time of its enactment as Texas' "deal closer," the grants only apply when "a single Texas site is competing with another viable out-of-state option." The overarching goal is to ensure that Texas does not lose its competitive edge, should another state offer an incentive package of its own.

Texans frequently jibe that "everything is bigger" in their state. This expression, although a slight exaggeration in and of itself, has some truth to it, especially with respect to corporate subsidies. The Texas state government touts on its website that the Texas Enterprise Fund is the largest deal closing program in the nation, allocating an aggregate \$595,526,696 as of June 2016. The awards vary in size. Maverick Arms received a \$75,000 grant in 2014, while Texas Instruments secured \$50,000,000 back in 2003. The state employs an analytical model uniformly to each applicant, which takes into account the number of jobs to be created, the project's expected timeframe, and average wages to be conferred before determining an appropriate amount. The state assures that, through this formula, Texans will see a full return on its investment, without exception.

Because of the amount of money involved, the Texas Enterprise Fund has multiple mechanisms in place in an attempt to safeguard taxpayer funds. The analytical model is one, but there are other standards and prerequisites that projects must meet. For example, applicants must have significant local support from the prospective Texas community. This is demonstrated in the form of local economic incentive offers. Applicants must show that they are a well-established and financially sound enterprise, operating in a mature industry that could potentially locate to another state or country. In addition, to narrow the net further, the final decision is left to the governor, lieutenant governor, and speaker of the Texas House. All three must unanimously approve of a project before it secures funding.

The final mechanism is not a precondition. Instead, it is the power the state retains after the project was approved and the money allocated. The contract signed by the company and the state creates a legal obligation for the company to fulfill its job target. Non-compliance entitles the state to claim damages as laid out in the agreement. This procedure is referred to as "clawback" and is designed to indemnify the taxpayer against a bad investment, while still rewarding the company for what verified job creation it managed to stir.

The Arguments

In light of the “clawback” process and its other safeguards, the Texas Enterprise Fund is often cited by its supporters as an exemplar for others to follow—a corporate incentives program done right. They agree that the Texas Model has made the state an attractive site to do business but argue that other states could bridge the gap by offering a monetary inducement. The Texas Enterprise Fund, they assert, allows Texas to level the playing field in a targeted and controlled manner with little risk to the taxpayer. As evidence, supporters cite the number of jobs created: 77,269, according to a 2015 report by the Office of Economic Development and Tourism.

On a surface level assessment, the case in favor of the Texas Enterprise Fund seems to hit all the right notes. That melody, however, quickly turns discordant once all the talking points are pulled back. For example, in September 2014, the State Auditor’s Office released a report that raised numerous questions as to the Texas Enterprise Fund’s management and the standards used to determine awards. The report noted that many early recipients never submitted a formal application, but obtained sizeable grants nonetheless. The Texas Tribune reported that the unrequested amount tipped upwards of \$170 million.

Although time would allegedly smooth over these early examples of mismanagement, the Texas Enterprise Fund suffered from an inadequate control structure throughout its existence. The 2014 audit observed that because of insufficient documentation and monitoring, “it was not always possible to determine whether award decisions were supported, or to determine the number of jobs that . . . the Texas Enterprise Fund created.”

Likewise, the state only tentatively employed its “clawback” authority. Administrators, the report noted, had collected \$14.5 million in “clawback” penalties between 2004 and 2012. The report, however, observed that the weak verification process “impair[ed] the Office’s ability to consistently identify recipients’ noncompliance with job-creation requirements.” It suggested that an untold number of other companies could be in non-compliance and identified multiple instances where administrators altered the bargain so as to reduce a company’s penalties.

Critics correctly argue that the procedural changes recommended by the State Auditor’s Office would not be enough to overcome the inefficiencies incumbent to the program. By its very nature, the Texas Enterprise Fund must pick winners and losers. It must decide who deserves public investment and who does not. Established companies will always have a step up in navigating that process. In addition, the size of the offered grants means that many companies will apply in the hopes of striking it rich despite knowing that they do not quite meet the standard.

Texas assumes this risk under the idea that when the board is rigged, Texas must follow suit if it is to compete with other states. But when there is no upper limit, when each subsidy justifies the next, shouldn’t lawmakers take a step back? The interstate subsidy race represents an ever spiraling stairway to more government intervention in the market. The solution is to step off and focus on the mechanism proven to create the most amount of growth without extra cost to the taxpayer: the Texas Model.

continued

The Texas Enterprise Fund (cont.)

Recommendations

- Eliminate the Texas Enterprise Fund.
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Resources

Spotlight: The Texas Enterprise Fund by Bill Peacock and Cody Ross, the Texas Public Policy Foundation (Dec. 2015).

An Audit Report on the Texas Enterprise Fund at the Office of the Governor, Report No. 15-003, State Auditor's Office (Sept. 2014).

Texas Enterprise Fund: 2015 Legislative Report, Office of Economic and Development (Dec. 2014).

The Event Trust Funds

The Issue

The Event Trust Funds aim to help local governments attract certain events to the state of Texas, with the premise that they can have a positive economic impact and increase tax revenues. Revenues from some taxes—general sales and use, hotel occupancy, motor vehicle rental, and alcoholic beverages—estimated to be generated in excess of what would be levied absent these events are used to subsidize the organization of these events.

In 1999, the 76th Texas Legislature created two funds to help the state attract the Olympic and Pan-American Games, the first of several trust funds dedicated to subsidizing event organization in the Lone Star State. The Major Events Trust Fund (METF), the Motor Sports Racing Trust Fund, and the Events Trust Fund (ETF) were all created by subsequent legislatures in the 2000s. In 2015, the 84th Legislature renamed the METF the Major Events Reimbursement Program (MERP), and moved the administration of the funds from the Comptroller of Public Accounts to the Office of the Governor’s Economic Development and Tourism Division.

Among several requirements for eligibility, events and their site selection organizations have to be listed in statutes to receive funds from the MERP, while participation in the ETF requires an event to be held not more than once a year in Texas or an adjoining state. In both cases, the selection of the site must go through a competitive process in which Texas competes with other states.

Once a site has been selected, the endorsing municipality or county submits an application with an economic impact study estimating the number of out-of-state visitors, and their spending, to be generated by the event. The study and additional research are used by the economic development and tourism division to estimate the amount of incremental tax revenues that the event will generate during “economic impact windows” (30 days for the ETF and one year for the MERP), and hence the amount of disbursement available.

An event must generate an estimated amount of incremental tax revenues of at least \$1 million. Local governments must contribute to the funds to participate; the state matches each dollar that counties or municipalities contribute with \$6.25. Recipients are also required to certify the number of out-of-state visitors after the event has ended. The certification is used to adjust the calculation of incremental tax revenues and the eventual disbursement.

Allowable expenses (reimbursed up to 100 percent if sufficient tax receipts are deposited in the trust funds) include costs to prepare and conduct the event and principal or interest on notes used to build or improve facilities to host the event.

The Arguments

Supporters of the programs argue that hosting certain events will attract out-of-state visitors who not only will attend the local events but will spend time and money locally and stimulate the economy. According to economic impact studies that support this vision, out-of-state visitors create direct, indirect, and induced positive effects on the economy. In turn, growth in the economy means growth in tax revenues.

continued

The Event Trust Funds (cont.)

This serves to justify taxing visitors and using the revenues to subsidize certain events that might not have taken place in Texas without government support.

There are several problems with this vision, some of them detailed in two official reports: a 2014 report to the 83rd Legislature on the event trust funds by the Texas Comptroller of Public Accounts, and an audit report on the METF by the State Auditor's Office.

The first problem lies in economic impact calculation. Both reports question the accuracy of such calculation, because the data required—the actual number of out-of-state visitors, the length of their stay, and their expenditures—is not easily available. According to the state auditor's report, “the Comptroller's Office lacks assurance that the attendance information is valid,” notably because the office did not review or approve the methodology used to reach the attendance number certified.

The calculation of incremental tax revenues is also problematic. It does not take into account possible negative effects, such as the crowding out effect—some local economic activity is reduced due to the event—nor does it take into account the expenses associated with administering the program, estimated to be more than 8,000 hours of staff time annually. The State Auditor's Office found out that the economic modeling system used for the calculation in some cases took into account more taxes than the categories allowed in statutes, probably leading to inflated payments to support some events.

The Comptroller's report questioned whether ETF funds were a *sine qua non* condition in some cases, since some events took place in Texas before the fund was created—and hence happened without subsidies. The report adds that “many cities and counties choose to not participate in the ETF, and those cities should not be placed at an intrastate disadvantage in recruiting and retaining events.”

Finally, the goal behind the Event Trust Funds, even if well-intentioned, points to a misunderstanding of how economies work. A bill analysis for HB 26—which changed the name of the Major Events Trust Fund to the Major Event Reimbursement Fund—explained that “the purpose of the funds is to attract visitors from out of state who will increase state and local tax revenue by spending money at local businesses and restaurants. By hosting major events and using the programs to encourage organizations to look to Texas for possible locations to hold their events, we stand to continue our growth in revenue.” Economies do not prosper through central planning. In fact, central planning is far less efficient than the market in allocating resources based on consumer preference and thereby enhancing economic growth. By subsidizing some events over others with little knowledge of how successful these events will be, the funds actually contribute to reduced economic growth.

Recommendations

- **Repeal the funds.** Private event organizers are not different from other private businesses: any venture undertaken needs to ultimately bring more revenues than it costs. Events will go where they are most profitable; the state of Texas can only help in this area by limiting its taxes and regulations to a minimum.

Taxpayers, including visitors, should not be forced to support events that could be more profitable if conducted elsewhere, if at all.

- **Cut taxes.** When government imposes a tax on a service or product, the consumer often ends up buying less of it than he would have liked to. Using the hotel occupancy tax as an example, it means visitors might end up staying for fewer days and spending less locally than they would absent the tax, which in turn means the economy is growing less than it could. Decreasing or repealing some of the taxes used to finance these funds can help grow the economy and create jobs.
- **Increase accountability.** As long as the funds are in place, issues mentioned in both the Comptroller's and the state auditor's reports, including on accuracy of the data used, calculation problems and mistakes, negative effects of events not being taken into account, should be addressed to bring more transparency on how taxpayer money is spent.

Resources

“Event Trust Funds,” Texas Wide Open for Business (accessed July 18, 2016).

“The Rules of Attraction: An Overview of State Events Trust Funds,” Statewise (Winter 2010).

An Audit Report on the Major Events Trust Fund by John Keel, State Auditor's Office (Sept. 2015).

HB 26 Bill Analysis, Senate Research Center, 84th Texas Legislature (2015).

Report on Events Trust Funds, Texas Comptroller of Public Accounts (Dec. 2014).

Film Subsidies

The Issue

The moving image industry in Texas has a rich history dating back nearly 100 years. Only in the last decade or so has the state government directed public tax money to the industry as a means of economic development. The 79th Texas Legislature established the Texas Moving Image Industry Incentive Program (TMIIP) in 2005. The stated aim was to build a more hospitable business climate and allow Texas to effectively compete with other film destinations, such as New York and Illinois, where subsidies were already common practice. There was a concern that incentive programs had upended the way that location decisions were made. Lawmakers, at the time, did not want to lose what they considered “an established industry” in Texas simply because they refused to actively court upcoming projects.

Appropriations for the incentive program, however, did not start until 2007, when the 80th Texas Legislature allocated \$20 million for distribution. This initial amount was perceived as too small to be competitive when compared with the incentives offered by other states. As a consequence, the Legislature increased the program’s budget to \$60 million in 2009. An additional \$2 million was appropriated each biennium to cover the program’s administrative costs. The TMIIP would then hit its peak in 2013, when the Legislature granted it access to funds from the hotel occupancy tax, which brought the program’s budget to \$95 million. Since that time, confidence in the TMIIP has ebbed. The 84th Texas Legislature cut funding in 2015 to \$32 million—about one-third of the previous budget. Even that amount was a near miss; the Senate originally voted on a proposed budget of \$10 million.

Despite the fluctuating budget, TMIIP’s core structure has remained largely unchanged these last few sessions. Qualifying productions can apply for a cash grant, which is based on the amount of in-state spending the project incurs. Each category has multiple tiers, with the state willing to fund a larger percentage of the project’s expenditures as the size of the project increases. Accordingly, the TMIIP will reimburse 5 percent of a film’s production costs if the responsible parties spend anywhere between \$250,000 and \$1 million. That percentage climbs to 10 percent if spending is between \$1 million and \$3.5 million, and 2 percent if spending reaches \$3.5 million or more. Commercials, video games, and reality television all have their own respective threshold amounts. None of the categories have a ceiling on the incentive amount an individual project may receive.

The Arguments

Arguments in favor of the TMIIP echo many of the points made on behalf of other economic development programs listed in this guide. Supporters contend that the money spent is merely an investment in Texas’ economic infrastructure, which will reap dividends in new jobs, increased spending, and an overall boost to local markets, which play host to favored projects. The Texas Association of Business (TAB) underscored this argument repeatedly in the two reports it had commissioned from the Bureau of Business Research, an initiative of the University of Texas at Austin. There, investigators concluded that the initial allocations in 2007, 2009, and 2011 generated \$640.7 million in direct moving image produc-

tion spending, along with a sizeable multiplier effect in supportive industries, such as food services and healthcare.

The Texas Comptroller, to some degree, agreed with TAB's observations. It found that estimated spending in the moving image industry had gone up from \$330.3 million in 2006 to \$505.8 million in 2009, which, it conceded, could be a result of the added incentives. However, the Comptroller also voiced several reservations, noting that most of the jobs created by the TMIIP in the film/TV/commercial sectors are "either temporary, part-time (walk-on) roles, or leave the state upon project completion." The funds, in other words, did not build the foundations for future economic growth. They instead represented a short-lived fix, highly concentrated in only select regions of the state. Money would have to be continuously pumped into the industry for Texans to convert their experience on set into a supportable career.

In addition, the impact that the TMIIP has on the state's broader economy—that is to say, the multiplier effect it triggers as additional income filters down market—is not unique to this one particular industry. The state government could just as well have cut taxes or spent the money elsewhere and have gotten a similar result. The Tax Foundation has repeatedly warned about the opportunity costs associated with film production subsidies, which have their own economic multipliers. Hence, the decision to retain the TMIIP should not be based on the fact that the subsidies stir economic activity in one industry sector. Rather, the existence of the program should be examined in light of the lost opportunities elsewhere in the economy. Texas did not become an economic powerhouse because it mimicked the corporate welfare policies of New York and California. It succeeded because of its willingness to carve its own pathway and implement policies that trusted competitive markets and the appeal of low taxes.

Recommendations

- Eliminate the Texas Moving Image Industry Incentive Program.

Resources

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The Agricultural Loan Guarantee Program

The Issue

The Agricultural Loan Guarantee (ALG) Program, a project of the Texas Agricultural Finance Authority, is designed to offer farmers and ranchers financial assistance for the establishment of agricultural operations or the improvement of existing ones. The ALG Program provides aid primarily through loan guarantees, though it also grants interest rebates to select borrowers.

Any of Texas' 248,800 agricultural enterprises can apply for a loan guarantee from the program so long as they meet minimum financial requirements. Borrowers must possess a credit score no less than 650 and loan equity of at least 15 percent. In addition, the ALG Program requires debt service coverage at a minimum of 1.25 and a debt to equity ratio no higher than 2:1. Once these parameters are met, the amount guaranteed depends upon the terms of the loan, with three available options:

Guarantee Amounts

<p>\$250,000 or 90% of loan amount, whichever is less</p> <p>\$500,000 or 80% of loan amount, whichever is less</p> <p>\$750,000 or 90% of loan amount, whichever is less</p>

The ALG Program has guaranteed 63 loans under these parameters since 2010, the majority of which have gone toward the purchase of real estate and livestock. As of June 2016, 57 of the loans remained open, totaling \$12.8 million in guarantees.

Recipients of a loan guarantee from the program may also qualify for an interest rebate on their loan. The ALG Program awards a rebate equivalent to a reduction in the loan's interest rate, though it faces a series of limits on the rebate's size. According to the program's stipulations, the effective interest rate on the loan cannot be reduced below the WSJ Prime rate or by more than 3 percent. Payouts exceeding \$5,000 are also prohibited. These restrictions further attempt to limit the amount of money that the Texas Agricultural Finance Authority can dole out to agricultural borrowers.

The Arguments

As an initiative of the Texas Agricultural Finance Authority, the ALG Program ostensibly seeks to bolster Texas' agricultural market by encouraging new investment. Proponents believe that the farming and ranching communities require government loan support to achieve sufficient growth. Furthermore, they can point to the ALG Program's numerous caps and eligibility requirements as safeguards against undue cost or risk. From their perspective, the program offers a more robust Texas agricultural market at minimal cost to the Texas taxpayer.

However, a more critical examination of the ALG Program reveals that it suffers from critical shortcomings. First and foremost, the loans guaranteed—amounting to 63 over the past six years—can only hope for a tiny impact on a marketplace containing 248,800 farms and ranches. Individual farmers receiving the benefits

of the program's largesse might witness positive change, but the rest of Texas experiences a negative effect; Texans would have profited more from keeping those tax dollars to themselves and spending them on what they see fit. This is a far more efficient way to boost an economy than relying on central planners to redistribute wealth.

The practice of offering loan guarantees to some farmers introduces distortions into the marketplace. Beneficiaries receive a leg up that could potentially give them an edge over their less governmentally favored rivals. Banks also face limited incentive to ensure that farms can repay their loans, knowing that the state is on the hook in the case of failure. As a result, the ALG Program creates an uneven playing field and inclines banks to invest in farming endeavors that may not be worthy of financial support. The program, in sum, interferes with Texas' markets while fostering economic loss.

Recommendations

- Eliminate the Agricultural Loan Guarantee Program and other agricultural subsidy programs.

Resources

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The PUC Energy Efficiency Program

The Issue

In 1999, SB 7 introduced a landmark restructuring of Texas' electricity marketplace along free-market lines. Included as a part of this legislation, however, were mandated "Goals for Energy Efficiency" applying to all Transmission Distribution Utilities (TDUs) and overseen by the Public Utility Commission (PUC) of Texas. The goals call for a certain percentage reduction in electricity demand growth for residential and commercial customers each year, with the current requirement set at 30 percent.

Utilities achieve the PUC's percentage target through two types of programs, collectively known as the PUC Energy Efficiency Program. The first subset, consisting of Standard Offer Programs (SOPs), is designed for residential and small commercial customers. Utilities offer contractors rebates through SOPs to install energy-efficient appliances and provide other energy-saving services. The remaining type of programs, Market Transformation Programs (MTPs), instead address the marketplace overall, working to reduce alleged market barriers to energy efficiency.

As a whole, Texas utilities spent upwards of \$123 million in payments and administrative costs associated with the PUC Energy Efficiency Program during the 2015 calendar year. In theory, these expenditures translate increased energy efficiency into consumer savings, but the reality is that the program serves to increase energy costs for Texans while providing subsidies for businesses.

The Arguments

The PUC Energy Efficiency Program is touted as a cost-effective means of overcoming market failures and other inherent obstacles to energy-efficient technology. The intervention in the market under this program is justified, proponents claim, because electricity prices fail to take into account all the potential savings that could be achieved if certain energy efficiency technologies were adopted.

The Energy Efficiency Program's defenders claim that consumers operate under a lack of essential knowledge. Since the benefits of energy efficiency are spread out across the future, electricity customers might have difficulty comprehending their present value—and thus could underestimate the worth of energy-efficient investments. Government rebates are supposedly necessary to remedy this ignorance, or "knowledge problem," on the part of consumers.

However, the PUC's program actually turns the concept of energy efficiency upside down. Energy efficiency has traditionally been about making energy less expensive to use. The public benefit of energy efficiency is that we are able to use more, less-expensive energy that in turn produces greater economic growth. Instead, the PUC's program is actually designed to decrease energy use, generally by increasing the cost of energy.

These higher costs are hidden in Texas as the costs of the program are severely understated. Texas employs the Program Administrator Cost Test (PACT) to measure the financial viability of programs including the PUC Energy Efficiency Program, making it one of the only states to do so. However, the PACT method

contains several flaws; most critically, it fails to take opportunity costs into account, instead focusing on administrative and customer incentive costs. It also ignores the funds consumers spend on subsidized technologies in its accounting. As a result, its total cost to consumers is much greater than stated, and offset its savings.

Furthermore, the Program faces a significant free rider problem. Studies of similar initiatives across the United States indicate that one can reasonably expect 33 percent of participants to take part in free riding. That is, approximately one-third of program beneficiaries would have purchased energy-efficient technology regardless of the incentives offered. A 2008 survey conducted by metering and consulting firm Itron suggests that in Texas, the number may be closer to one half. Energy efficiency, it seems, is popular enough without government prodding.

Taken as a whole, the evidence suggests that the PUC Energy Efficiency Program's costs are greater than its benefits and that the market, contrary to official doubts, provides ample incentive for consumers to adopt energy-saving measures. The laudable goal of energy efficiency is best served when left to the people.

Recommendations

- Eliminate the PUC Energy Efficiency Program.

Resources

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

A Legislator's Guide to the Issues 2013-2014: Energy Efficiency, Texas Public Policy Foundation (2012).

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The Texas Emissions Reduction Plan

The Issue

Texas has long generated more robust economic growth than most other states. Less well known is the state's dramatic, ongoing environmental improvement, especially in air quality. The Environmental Protection Agency's (EPA) eight-hour National Ambient Air Quality Standard (NAAQS) for ozone has long challenged Texas urban areas, particularly those around Houston and Dallas. At odds with most predictions, the Houston area actually achieved the ozone NAAQS in 2010 and 2011 on the basis of a stringent, targeted, innovative, science-based State Implementation Plan (SIP). And the Dallas/Fort Worth (DFW) region came close to attaining the ozone standard. Despite this progress, EPA has since tightened the ozone standard twice in the last few years on the basis of increasingly implausible scientific grounds.

In 2001, the Texas Legislature created the Texas Emission Reduction Program (TERP) in Senate Bill 5 to create a fund to provide generous grants for the retrofit or purchase of new diesel powered engines, equipment or vehicles. TERP's original purpose was to reduce ozone producing emissions from mobile sources. These mobile source emissions from vehicles and off-road construction equipment were considered key contributors to ozone formation but direct regulation of these sources is pre-empted by EPA's exclusive regulatory authority over mobile sources. The state has authority to regulate stationary sources like a power plant or a refinery. Yet, attainment of the federal ozone standard is impossible without also reducing emissions from mobile sources.

In a rare departure from typically tight-fisted, top-down federal regulation, the EPA agreed to give emission credit in the Texas SIP amounting to one ton of reduced nitrogen oxides for every \$5,000 expended through TERP grants. The TERP fund is generated by surcharges on new vehicle titles, registration of truck-tractors and commercial motor vehicles, and emission inspection fees, as well as a percentage of the tax on the purchase or lease of both diesel equipment and heavy-duty motor vehicles. Revenue from title fees is deposited into the Texas Mobility Fund and matched by the State Highway Fund in equal amount. These contributions are combined and funneled into TERP.

As originally enacted, TERP funding is administered by the Texas Commission on Environmental Quality (TCEQ) to award grants for the retrofit or replacement of heavy duty diesel fueled vehicles and engines. Since 2001, TCEQ has awarded more than 1 billion dollars in TERP grants for upwards of 17,500 projects. The price of individual grants widely vary from as much as \$45 million to replace switcher engines in rail yards and \$20 million for new construction equipment.

In a growing, prosperous and thus "car-buying" state, the revenue generated by TERP fees has consistently exceeded the amount originally appropriated by the Legislature. Over TERP's 15 years, the Legislature has regularly expanded the eligible uses for TERP grants. TERP is now comprised of nine different programs that represent a wide variety of uses. At times, hundreds of millions of TERP dollars sit unused or have been used to balance the state's budget

The Arguments

TERP is heralded by many as a smart program that brings cleaner air to Texas without heavy-handed regulation. TERP supporters argue that the program offers a painless way to attain the federal ozone standard without draconian penalties and regulations, such as setting “no-drive days” or limiting hours of operation for road building. And it is possible that in the TERP program’s early years, the grants may have gleaned genuine benefits, especially for the DFW area whose ozone levels are dominated by mobile sources.

It remains unclear, however, whether the billion dollars of TERP grants have meaningfully reduced emissions because the reduced emissions originate on paper and are not measured. Additionally, even the claim that TERP’s incentive to purchase newer, cleaner diesel engines leads to fewer emissions is suspect—the cleaner engines to which TERP funds were originally dedicated are now required by federal engine standards in full effect. The natural turnover in the market is already eliminating older vehicles and equipment. There is little evidence that TERP does anything to produce cleaner air in Texas; at best what can be proven about TERP is that \$1 billion in corporate subsidies provided by the program have helped keep the EPA off our back.

The State Auditor’s Office 2010 report on TERP revealed fundamental problems with grantee accountability. The report concluded that actual usage of grant-funded vehicles and equipment, as reported by grantees themselves, was significantly lower than what was projected in original grant agreements. For example, an application which represented that some diesel-powered off-road construction equipment would be operated for 30 hours per week might operate only 20 hours per week. This disparity between projected and actual hours in operation provides further support that the environmental purpose of TERP is not being accomplished. It might also lead to inflated program benefits being reported to the Legislature; the sheer number and variety of TERP grants preclude consistent evaluation of contract compliance or environmental benefit.

Proponents might respond to this by claiming that TERP is a helpful market incentive that expedites the purchase of new, cleaner-burning engines. However, a grant program that diverts hundreds of millions of Texas taxpayers’ money away from the market into a government fund for select businesses is not a market incentive. At its best, TERP subsidizes the goal of pollution abatement without meaningful measurement of that outcome. The state auditor’s report found that between December 2006 and July 2010, TCEQ determined that 593 grantees—representing more than \$62 million of lost grant funds—failed to comply with requirements specified in the grant agreements.

Recommendations

- Eliminate the TERP program and all related fees, surcharges, and taxes.
- Use any surplus balances in the TERP program to reduce the Texas margin tax.

continued

The Texas Emissions Reduction Plan (cont.)

Resources

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Medicaid Expansion

The Issue

In 72-point font, newspaper headlines exclaim: “Doesn’t Texas care about poor people?” “Texas MUST expand Medicaid!” “Why is Texas rejecting all that free money?” There is pressure from some individuals and advocacy groups for Texas to expand our Medicaid program as mandated by the 2010 Patient Protection and Affordable Care Act (ACA). In 2012, the mandate became optional when the Supreme Court struck down that component of the ACA. To date, Texas has declined the option to expand Medicaid.

Expansion would raise the financial eligibility threshold for Medicaid enrollment from 100 percent of poverty line to 138 percent. It is estimated that if Texas expanded Medicaid, enrollment could increase from 4.4 million to 4.8 million. The ostensible purpose of such expansion is to reduce the number of the uninsured citizens, remembering that only those with legal resident status are eligible for government-supported health insurance coverage.

The federal government has promised to pay 100 percent of the cost of new enrollees but only for those who become newly eligible under expansion, not for new enrollees who met pre-expansion eligibility requirements. The latter individuals comprise an unquantified but undoubtedly large fraction of the newly insured. They will present a large financial burden to the state, as the costs they incur will not be covered by federal support.

During the years following Medicaid expansion, ACA law reduces the federal matching rate from 100 percent to 90 percent.

According to data from the Urban Institute, by expanding its Medicaid program Texas could receive as much as \$4.5 billion in additional Medicaid funds from the federal government. However, states that have expanded their Medicaid programs have reported ... delays in the federal government actually delivering the money it promised to pay.

The Arguments

Advocates for Medicaid expansion claim that it will:

- Offer an opportunity to provide health insurance coverage to more Texans. Texas has the highest uninsured rate—16 percent—in the United States.
- Remediate the massive and growing cost of uncompensated care due to the unfunded mandate created by the Emergency Medical Transport and Active Labor Act of 1986 (EMTALA).
- Infuse a large number of “free” federal dollars into the Texas state budget.

Proponents of expansion argue that the new federal dollars will defray bills for previously uncompensated health related goods and services, and would increase productivity when sick people get the care they need when they need it, making them able to return to work instead of staying at home or in hospital because of illness.

continued

Medicaid Expansion (cont.)

Experience in our neighboring state of New Mexico shows that despite an infusion of 3.2 billion new (!) federal dollars into their state coffers, their Medicaid budget experienced a shortfall of \$416 million for 2017. This forced New Mexico to cut its already low reimbursements to Medicaid providers by an additional 3 to 8 percent. In other words, while expansion increased revenue, it increased costs more. Expansion actually reduces the care available to patients

A 2013 study by Families USA suggested that the new money from Washington would boost our economy by producing 70,500 new jobs within Texas. These jobs are predominately to implement federal healthcare “BARRC”—bureaucracy, administration, rules, regulations, and compliance. Healthcare tax dollars will go to pay bureaucrats, not nurses, doctors, or other care givers.

Rather than a net gain for the Lone Star State, creation of bureaucratic jobs in healthcare meets the very definition of dollar inefficiency and provides an excellent demonstration of wasteful spending: money consumed by the healthcare system that produces no health *care*.

In fact, Medicaid expansion is a particularly egregious form of corporate subsidy. The corporation is the government and those dependent on it, especially hospitals. If Texas did expand its Medicaid program and did receive federal funds, where would the money go? By federal (not Texas) law, the money would pay for actuaries, accountants, administrators, billers and coders, compliance reviewers, consultants, information technology systems, insurance agents and companies, IRS agents, forensic accountants, outreach, oversight officers, navigators, websites, etc. Each federal dollar spent on healthcare bureaucracy is a dollar that cannot be spent on health care services, or on education, infrastructure, economic expansion, military, etc. The Commonwealth Fund reported, “They [Washington] are claiming that every state gains more in federal funds than they pay in taxes, a clear violation of the laws of [simple] arithmetic.”

Most projections of economic growth assume that there is a large unused capacity in healthcare. There isn't. Economic studies also presume that doctors will accept the large influx of new Medicaid patients. They won't. One third of Texas physicians did not accept new Medicaid patients before Obamacare. By reducing the reimbursement schedule even further, Medicaid expansion is certain to decrease the number of physicians who can afford to see these patients. As Robert Moffitt of Heritage Foundation testified before Congress, “You can't get more of something by paying less for it.”

Medicaid reimbursement rates to care providers are already quite low, averaging 53 percent of what private insurance pays. Keep in mind these are all predetermined (fixed) fee schedules. The bills you see with a doctor's charges have nothing to do with what he or she is paid. Payment is decided by the federal government, not by state government and most definitely not by the seller of services.

Reducing payments to doctors forces them to see more patients if they hope to keep their doors open. As a result, patients have longer wait times, get less time with the doctor, get lower quality of care ... and those are the lucky ones who can even find a doctor willing to see them.

Medicaid expansion tends to crowd out private insurance companies. Some people who now have private insurance will qualify for Medicaid with expanded eligibility and will switch to Medicaid coverage since it looks cheaper.

Superficially, Medicaid expansion may look good, but careful analysis and evidence of effect prove that it is a bad deal for Texas and for Texans. Adding Medicaid enrollees would actually reduce access to care. It would also be a large financial drain on the Texas budget. Extrapolating from the New Mexico experience, with expansion Texas Medicaid might experience a \$5.4 billion budget deficit on top of the current projected \$1.8 billion shortfall. Finally, losses from uncompensated care are likely to increase due to low and dropping Medicaid reimbursement rates.

Recommendations

- Do not expand the Texas Medicaid program: Texas will lose money and Texans will lose access to care.

Resources

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Renewable Energy Subsidies

The Issue

Federal policies that subsidize increased installation of wind and solar power undermine the competitive Texas energy market. The International Energy Agency defines energy subsidies as “any government action that affects . . . the competitiveness of each fuel or technology,” including grants, tax abatements, federal loans, loan guarantees, and Renewable Energy Credits (RECs).

According to Subsidy Tracker, total subsidies given only to the largest wind operators amount to \$176 billion. General Electric—the biggest manufacturer of wind turbines—has received \$159 billion in federal loans or loan guarantees. NextEra Energy—the country’s largest wind power producer—has received \$5.5 billion in subsidies.

Those countries that most aggressively have rushed to renewables have experienced ballooning subsidies that have driven conventional generators out of production and led to average retail rates in Germany as high as three times the average U.S. electric rates. Many German industries have relocated to other countries with lower-priced and more reliable electricity. In July 2016, Germany cut major renewable subsidies because they were unsustainable.

The full cost of renewable energy is masked by generous subsidies and because the many ancillary services such as back-up generation, grid adjustments, voltage and transmission are not calculated by officials or renewable energy promoters.

The largest share of renewable subsidies comes from the federal government. Local governments also provide tax abatements and incentives for renewables. The Competitive Renewable Energy Zones (CREZ), a major indirect subsidy, is a massive new system of transmission lines that carries wind power hundreds of miles from West Texas to population centers bordering Interstate 35. It cost Texas rate-payers \$7 billion.

Enacted in 1992, the federal Production Tax Credit (PTC) is a per-kilowatt subsidy for electricity generated using select renewable sources. The PTC was initially created as a way to jump-start emerging renewable technology. Instead, it has been extended nine times. The Congressional Joint Committee on Taxation estimates the recently extended PTC will cost U.S. taxpayers around \$12.4 billion through 2019.

The PTC is now \$23 per megawatt-hour of electricity generated, allowing wind operators to sell their power at a discounted or even negative price (below the wholesale price). In the winter of 2015, peak wholesale electricity prices in Texas averaged \$21 per megawatt-hour. The depressed market prices force conventional generators to go offline, while renewable producers remain profitable as a result of the subsidy. This is a threat to the fundamental competitiveness of the Texas electric market.

The Texas Legislature imposed a Renewable Portfolio Standard (RPS) in 1999. The Texas RPS acts as an indirect subsidy for renewable generators by requiring that retail electric providers meet a minimum annual renewable requirement,

either by owning renewable capacity or by purchasing RECs from renewable generators. The RPS mandated installation of 5,000 MW of renewable energy capacity by 2015 and 10,000 MW by 2025. Supported by federal subsidies, Texas surpassed the 2025 mandate in 2010.

The goal of the Texas RPS has long since been met. The question the Texas Legislature now faces is whether to extend RPS and build more infrastructure for renewable industries that would not exist at the current scale without federal subsidies. Congress extended the major federal subsidies for wind and solar power in December 2015. This assurance that the federal subsidies will continue for the next five-seven years has catalyzed aggressive installation of new wind and solar facilities. But there is no guarantee that the next deadline will be greeted as kindly by Congress.

The Arguments

Proponents of renewable energy attempt to justify subsidies for the industry arguing that the fossil fuel industry also receives large amounts of federal support. However, U.S. renewable industries receive the lion's share of direct federal subsidies while their output of electric power is far less than that of conventional generators. In 2015, wind power received 72 percent of direct subsidies, yet generated only 4.7 percent of U.S. electricity. Conventional energy sources received about 11 percent of total subsidies and provided 78.5 percent of total production.

This points to the falseness in claims that renewable energy is cost competitive with traditional fuels. Without the hundreds of billions of dollars described above, very few renewable sources of energy would be in operation today. In addition to the inherent problem renewable fuels have with fuel density, the amount of energy stored in a given fuel per unit volume or mass, renewables are also more expensive due to their intermittent, seasonal, and variable nature, making them unable to meet fluctuating and unpredictable demand.

Renewables supporters' resistance to passage of Senate Bill 931 in the 84th Legislature, which would have made Texas' system of RECs voluntary, suggests that the renewable industry understands its dependence on government subsidies to stay in business. Despite the challenges the renewable energy industry might face under such reforms, Texans would be much better off under these reforms that would steer Texas toward a market-driven system with lower electricity costs for consumers.

Recommendations

- Eliminate the mandatory Texas' Renewable Portfolio Standard.
- Support elimination of the federal production tax credit, grants, and loan guarantees.
- Require the Texas PUC to calculate full direct and indirect costs of renewables.

continued

Renewable Energy Subsidies (cont.)

Resources

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The Skills Development Fund

The Issue

Developing new skills allows workers to competitively sell their man power in the workplace. It is also in a business's best interest to have a well-trained workforce to successfully compete in the marketplace. This is why many employers offer professional training to their employees.

Despite the existence of private, professional-training options, the Texas Workforce Commission (TWC) stepped in "to increase skill levels and wages of the Texas workforce." Since 1996, the Skills Development Fund (SDF) has financed the training of existing or newly hired employees of large (mainly) and small businesses.

The Skills Development program encourages individual businesses, business consortia, and trade unions with specific training needs to partner with a public community or technical college, the Texas A&M Engineering Service (TEEX), or a community-based organization in partnership with a public community or technical college or TEEX, to assess their training needs, build a fully customized training plan for existing or soon-to-be-hired employees, and apply for a grant. If the application is approved, the TWC authorizes a grant to the partner educational institution to fund the training program.

The Fund also supports three other initiatives: Skills for Small Business allows businesses with fewer than 100 employees to meet their training needs through a selection of courses in the same kind of educational institutions; Skills for Veterans aims to help post-9/11 veterans; a dual credit program supports courses offered for joint high school and college-level credit.

In 2015, the SDF received 54 applications for grants totaling nearly \$23 million. Forty-seven of them were funded, supporting 67 businesses, with an average award of \$450,315 to train a total of 3,664 newly hired employees and 9,431 employees in existing jobs. Micro employers (less than 21 employees) received 0.1 percent of the total amount of funds awarded, small employers (21 to 99 employees) received 3.5 percent, medium employers (100 to 499 employees) received 9 percent, and large employers (500 and more employees) received 87.4 percent of the funds awarded.

The SDF is funded by appropriations from the Texas Legislature, with \$58.8 million in appropriations from the General Revenue Fund for the 2016-2017 biennium. In 2005, the Employment and Training Investment Assessment (ETIA), a 0.10 percent tax on wages paid by employers and levied as part of the Unemployment Insurance Tax, was created to help fund the program up to the level appropriated by the Legislature. But transfers of ETIA revenues to fund the SDF occur only when the Unemployment Compensation Trust Fund is above 100 percent of its floor, which rarely happened.

The Arguments

The Skills Development Fund is part of the state of Texas' economic development

continued

The Skills Development Fund (cont.)

strategy. According to supporters of the program, providing training opportunities to Texas workers empowers them to earn higher wages and supplies the state with a highly skilled labor, helping Texas retain and attract businesses. According to its annual report for FY 2015, the SDF helped 4,141 employers create 104,850 jobs since 1996, while increasing the average wage paid to trainees of the program from \$10.33 an hour in 1996, to \$27.10 in 2015.

This is hardly the Texas way to success though. The Texas Model won its spurs through a mix of limited government and free-market policies: low taxes, few regulations, and letting the market prevail—not allowing government to pick winners and losers with taxpayer money. The Skills Development Fund, however, supports the policy of transferring taxpayer money to financially support certain businesses. There are several problems inherent to such corporate welfare programs.

Such programs give preferential treatment to some businesses. In 2015, the SDF transferred in the form of training grants nearly \$23 million of taxpayer money to 67 businesses—nearly 90 percent of which were large businesses, choosing which businesses were more deserving than others of public money. Non-subsidized businesses are left with the unfair disadvantage of having to subsidize their competitors' training needs, sometimes leaving no room to fund their own.

Professional training is an investment. Businesses that decide to spend resources—time and money—in training programs do so because they expect a return on their investment. They alone can assess the pertinence of, and they should bear the responsibility and risks inherent to, such a choice. Taxpayers should not be forced to shoulder the cost of such an investment while some private businesses cash in on the rewards.

Lest we forget, before being redistributed, tax dollars have to be levied, leaving individual taxpayers, including workers, and businesses with less to spend, save, or invest as they see fit.

Recommendations

- **Repeal the margin tax.** Eliminating this costly, inefficient tax will allow businesses to keep more of the money they generate to invest, including in training needs for their employees.
- **Repeal the Employment & Training Investment Assessment.** The ETIA is currently redirected to the Unemployment Compensation Trust Fund when the Fund is at or below 100 percent of its floor. But the rate of the replenishment tax, which is a flat tax paid by all employers to replenish part of the Unemployment Compensation Trust Fund, is reduced by the amount of the ETIA to offset the training assessment. Most years, the ETIA serves only as a pretense of businesses self-financing their training needs through the assessment. Getting rid of the ETIA will bring more transparency to taxpayers to understand how the Skills Development program is really funded.

- **Abolish the Skills Development Fund.** Government subsidies are prone to the waste of resources because they transfer taxpayer money to a few recipients, without the knowledge necessary to “pick winners.” They are inconsistent with a free-market system and a limited government, both of which are the conditions to a thriving Texas.
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Texas Universal Service Fund

The Issue

In terms of its telecommunications policy, Texas has continuously walked a couple of steps ahead of the national curve. The Legislature passed major telecom reform legislation in 1995 and 2005, both times significantly increasing competition in the market. Competition brought lower prices; for instance, interstate long distance rates fell 68 percent from 1984 to 2003, while intrastate rates fell 56 percent. Senate Bill 980, passed in 2011, opened up the market to competition from newer technologies, such as VoIP, broadband, and cable, providing consumers access to even more cost-effective services.

Despite these advancements, there remains one area of telecommunications policy where Texas falls behind—that is the taxes and fees laden on top of subscribers' monthly service bills. According to the Tax Foundation, the federal and state governments levied a combined 17.99 percent charge on Texans' wireless bill. The state portion amounted to 11.53 percent. As a comparison, the sales tax (state and local rates combined) is typically capped at 8.25 percent.

The Texas Universal Service Fund (TUSF) represents one key reason why the state levy is so high as compared to other services. Established in 1987, the TUSF assesses a 3.3 percent fee on the in-Texas portion of taxable communications receipts, which is then used, in the Texas Public Utility Commission's words, "to implement a set of programs to assist Texas residents, as needed, in obtaining basic telecommunications services."

Funds within the TUSF go toward a medley of programs, many of which are specially tailored to meet a single consumer's specific need. Relay Texas, for example, provides telephone access to the hearing impaired, while Lifeline alternatively offers discounts to qualified, low-income subscribers. A sizeable portion of the TUSF, however, is also given way to private companies in order to subsidize some of their infrastructure. Indeed, the largest outlays in FY 2015, a combined \$232.4 million, are described by the Texas Administrative Code as "financial assistance to telecommunications providers" and ostensibly offset the costs of delivering services in so-called high-cost rural areas.

There is a growing sense amongst Texas policymakers that the need for telecom subsidies has abated. Two of Texas' largest companies, AT&T and Verizon, have phased out their reliance on the TUSF and, as of January 1, 2017, will stop receiving the subsidy for high-cost services completely. In addition, the other large companies that qualified, CenturyLink and Windstream, were obliged to file their "financial need" with Texas Public Utility Commission by December 31, 2015 or face a 25 percent reduction. Smaller outfits have a similar "financial need" requirement, but the law gives them until December 31, 2016 to file their petition for continued support.

Total expenditures consequently have fallen by a significant degree, from \$335.9 million in FY 2013 to \$251.4 million in FY 2015, which has translated into savings for the Texas consumer. The Texas Public Utility Commission has reduced the TUSF by 41 percent since 2005 when the levy added 5.65 percent to custom-

ers' bills. There was an attempt in the 84th Legislature to expand the TUSF to include broadband, but the effort failed. In fact, based on the Tax Foundation's findings, Texas was the only state in 2015 to reduce their state's USF. Texas remains on a glide path toward lower rates.

The Arguments

Justification for the TUSF converges on two key observations: 1) the public good is served when all citizens have access to basic telecommunication services, and 2) the cost of providing such services in rural communities may be prohibitively expensive for consumers and/or companies to absorb on their own. At one point, telecommunication providers could diffuse that cost network-wide by weaving it into the rates for other services, such as long distance calls. After the Texas Legislature increased competition in the market, that model became unsustainable. The TUSF was seen as an alternative mechanism that could bridge the gap between the government's policy objective and contemporary technology.

Times have since changed. Even if the TUSF was once necessary, competition and improvements in technology have made access to some form of basic telecommunications services much more obtainable for rural communities. Connected Texas, a public/private initiative, estimates that 98.26 percent of Texas households in 2014 had available broadband of speeds of at least 1.5 Mbps/200 Kbps; this percentage increases once smaller bandwidths are taken into account as well as mobile services and older technologies. Access has improved to such a degree that recent policy debates over the TUSF have not centered on whether residents can connect to the wider world but whether the Legislature should expand the scope of TUSF to include pusher services. The TUSF—along with its federal counterpart—serves largely today as a subsidy to keep small, rural, inefficient telecom companies in business.

A common criticism of public subsidies is that stakeholders always have an incentive to extend the program's longevity even when the need has abated and the objective has either become moot or long since achieved. Such is the case with the TUSF; residents in the Texas countryside have near universal access to some form of telecommunications services, and that access grows ever closer to becoming self-sustaining. To expand TUSF's scope right at the moment when it should be scheduled for elimination would be an unneeded and expensive redundancy that stands in sharp contrast with Texas' decades-long commitment to a competitive telecommunications market.

Recommendations

- Do not expand Universal Service Fund subsidies or fees to new services or technologies, e.g., broadband.
- Examine ways to further reduce the Universal Service Fund and keep Texas on a glide path towards the subsidy's elimination.

continued

Texas Universal Service Fund (cont.)

Resources

[*Record High Taxes and Fees on Wireless Consumers in 2015*](#) by Joseph Henchman and Scott Mackey, Tax Foundation (Nov. 2015).

A Glide Path to Market-Based Universal Service by Bill Peacock, Texas Public Policy Foundation (April 2015).

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

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Local Tax Incentives

Local Tax Incentives

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Chapter 311: Tax Increment Financing

The Issue

Tax increment financing (TIF) allows local governments to use future tax revenues to pay for projects within a geographic area. Every state and the District of Columbia has enabled legislation for TIF, with the exceptions of Arizona. California was the first to enable TIF, but discontinued use of the tool in the face of repeated lawsuits. Most states justify TIF on the theory that it helps redevelop blighted areas that would not otherwise see private investment, and thereby increases total economic growth in the city.

Here's how TIF works: A city or county draws a boundary around an area that meets the criteria for redevelopment and forms a TIF district. At the moment a TIF district is created, the sales or property taxes generated in that district are frozen as the baseline level of revenue that will continue to fund local government services over the life of the district. But any increase in revenue over the baseline level—referred to as the “tax increment”—due to new development or increased property values in the TIF district are captured by the redevelopment entity. Consequently, local governments can sell bonds secured by the incremental tax revenue to finance development projects in the district.

In Texas, a TIF district is called a Tax Increment Reinvestment Zone (TIRZ), and the creation and use of TIRZs are outlined in Chapter 311 of the Tax Code. Three features distinguish Texas' TIRZ legislation from the TIF legislation of other states.

First, in most states only cities or other governmental entities can designate a TIF district. In addition to allowing cities and counties to create TIRZs, Texas allows owners of properties making up at least 50 percent of the appraised property value in the proposed district to petition to create a TIRZ, subject to city council approval.

Second, Texas addresses concerns that TIF districts simply capture revenue from overlying taxing entities (school districts, special purpose districts, counties) and redirect them toward city infrastructure projects, all while the overlying districts have no say in how funds are spent. After a TIRZ Board is formed to manage and operate the TIRZ, it must invite overlying taxing districts to share their tax increments for the proposed redevelopment projects. Importantly, these other taxing entities can opt out just by choosing to do nothing. If they wish to participate, they negotiate a contract over what portion of the tax increment they want to share with the TIRZ Board. Further, each participating taxing entity is entitled to name at least one TIRZ Board member.

Finally, Texas' statutory criteria for creating TIRZs are expansive, pushing beyond the narrower finding of blight required in other states. The primary limitation provided in Section 311.005 of the Tax Code is that the area's present condition must substantially impair the city's growth, retard the provision of housing, or constitute an economic or social liability to the public health, safety, morals, or welfare. This limitation has been interpreted broadly, so that tax increment money has been used in middle-income areas and to upgrade areas around downtown that already show signs of gentrifying.

The Arguments

TIF supporters assert that the projects are “self-financing,” as the redevelopment projects within the district are allegedly what create the higher property values that pay for the projects. However, the truth of this claim is difficult to establish. In a normal market, property values would fall low enough that eventually people would begin to buy and invest for redevelopment without a public subsidy. It's unclear to what extent TIF is responsible for redevelopment, and to what extent it captures redevelopment that would have occurred anyway. Further, some studies suggest that TIF is a zero-sum game, meaning that TIF does not increase the total amount of development in a region, but instead transfers development from one part of the region to another. One study of Chicago's use of TIF districts indicates that they are actually negative sum—in other words, the city grew slower than it otherwise would have grown because of the TIF.

The use of TIF to fund public projects invites many questions and ideas for reform, but perhaps the most basic involves transparency. Right now, TIRZs, as well as many other types of special districts, are not required to make publicly available online financial information about their operations. This includes how much TIRZs are collecting, what they are spending those funds on, and the purpose for those expenditures. It's important that, at the least, state lawmakers take action in the next legislative session to require greater government transparency of these entities, so the public can more accurately determine what their value is.

Recommendations

- Require TIRZs to publish their financial information, meeting agendas, and agenda minutes on entity websites that are accessible to all.
- Require a finding of blight before the creation of a new TIRZ. Tax increment financing should be a last resort to finance redevelopment in areas that private investors would otherwise not enter, not a way for cities to finance development in already well-to-do areas.

Resources

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Chapter 312: Property Tax Abatements

The Issue

Cities, counties, and special districts often use tax abatements as a way to attract new businesses and keep existing ones. Since the early 1980s, local governments in Texas have put in place “more than 1,000 tax abatement agreements.”

The Texas Legislature authorizes local governments to administer property tax abatements under section 312 of the Tax Code, which was renewed in 2009 to allow tax abatements through September 1, 2019. In order to offer tax abatements under section 312, a local government must first pass a resolution to “opt in” to the tax abatement and then pass a set of guidelines for their tax abatement policy, which in turn must be renewed every two years. These guidelines are allowed to be as broad as the local government desires, ensuring a great deal of flexibility on what kind of abatements may be offered.

Tax abatements are only able to be offered in a “reinvestment zone,” which may encompass a number of properties. However, these boundaries are often drawn to only include the property of a single private entity for which abatement is being sought. A Chapter 312 abatement may last up to 10 years in duration and must be conditioned upon improvements being made to the property. Tax abatements are only valid for increases in the value of the property, and cannot include existing value of the property prior to improvement.

For example, let’s say a city decides to enact a tax abatement agreement on a particular property in order to encourage a large out-of-town developer to purchase the property and develop it. The city must have previously opted into tax abatements and also must maintain current tax abatement guidelines. The agreement entered into with the developer might look something like this: abatement of 90 percent of new taxable value the first year, 80 percent the second year, 70 percent the third year, and so on until the property is taxed at full value in year 10 of the agreement.

The Arguments

Tax abatements may owe some of their popularity to the common perception that they have no downside and cost taxpayers nothing. Because tax abatements only abate property taxes for improvements on top of existing property value, it may appear to policymakers that the tax abatements are leading to improvements and capturing some value that otherwise would not exist. Put another way, the perception is that abatements are “free”—free to taxpayers and free to the local government.

In spite of this perception, tax abatements have many downsides that are hidden from local officials deciding whether or not to use them, and from the citizens they represent.

First among these is the opportunity cost of tax abatement to attract a particular kind of development to a particular property or properties. By removing the property from the market via targeted abatement strategy to incentivize a firm to build, the local government is in essence declaring that the use of the property is in fact the highest value use. Yet there is no way to measure what the

potential highest value of a property is. What can be known is that by choosing a particular use via political considerations as opposed to market-based means, the city, county, or special district offering the abatement is shutting the door of opportunity for potential higher value uses in the future. Governments do not generally distribute resources more efficiently than the market.

Further, a burden shift occurs with properties benefiting from abatement, which may also be seen as a short-run subsidy. The beneficiary property may not pay the share of taxes needed to cover the services it uses because of the abatement.

It is this burden shift that may be overlooked by local officials eager to attract new businesses to their community. Ultimately, every property under the jurisdiction of a local government has a cost associated with it to cover the essential public safety, transportation, and other governmental functions. As the population and investment in a community grows, governments usually respond by expanding their services to accommodate the new growth. Thus, every taxpayer can be said to bear their “share” of the local government’s revenue stream.

Finally, the Texas Open Meetings Act exempts discussions of economic development matters involving real property from the public meetings requirement, meaning that most of the deliberations regarding tax abatements are done in closed session meetings that are not open to the public. This provides for a less-than-ideal environment that shuts taxpayers out of much of the process.

Recommendations

- Allow a public comment and review period for all economic development agreements before the final vote on passage; at least two weeks after agreement is reached.
- Require that local governments maintain active economic development agreements on the entity’s website that are accessible to all.
- Consider restricting or repealing Section 551.087 of the Texas Open Meetings Act.
- Allow Chap. 312 property tax abatements to expire in 2019.

Resources

Texans on the Left and Right Agree: It’s Time for Transparency in Economic Development by Jess Fields, Texas Public Policy Foundation (March 2015).

An Overview of Local Economic Development Policies in Texas by Jess Fields, Texas Public Policy Foundation (Jan. 2014).

Chapter 313: Texas Economic Development Act

The Issue

In 2001, the Texas Legislature passed the Texas Economic Development Act—known as “Chapter 313”—in response to a large and growing number of economic development incentives offered by other states. At the time, the Legislature reasoned that Texas’ relatively high property tax burden was putting the Lone Star State at a disadvantage in terms of attracting jobs and business activity. As such, lawmakers sought to artificially induce economic growth through Chapter 313, which allows school districts to offer property owners or lessees a temporary tax reprieve on the value of new investment, assuming that certain qualifications are met.

Chapter 313 works by way of an appraised value limitation, which is an agreement between a taxpayer and a school district where the former agrees to make a minimum level of investment in the community and create a certain number of jobs above a particular wage threshold, and the latter offers a multi-year limitation on the taxable value of new investment in real and tangible personal property. However, this limitation only applies to a portion of school district property taxes.

School property taxes consist of two elements: 1) the maintenance and operations (M&O) portion that funds day-to-day operations, and 2) the interest and sinking (I&S) portion that pays debt service on bonds. A limitation agreement may only apply to the former and not the latter.

Companies seeking a limitation agreement send an application to the school district where the project will be located. Limitation amounts are set in state law and vary from \$10 million to \$100 million, depending on the school district’s taxable property values and whether the district is considered rural or non-rural. Further, companies must make a minimum investment in the relevant school district in order to qualify for the limitation amount. This minimum investment varies from \$1 million to \$100 million. Finally, companies must create a minimum of 25 qualifying jobs in non-rural school districts and 10 qualifying jobs in rural districts in order to be eligible for the limitation. However, this job requirement can be waived, and more than half of all applicants have received waivers.

Since 2013, the Texas Comptroller must determine whether a proposed project is likely to generate enough state and local tax revenue to offset the tax losses due to the limitation agreement within 25 years. The Comptroller’s office must also find that the limitation is “a determining factor” in the company’s decision to invest and build in Texas. Without the Comptroller’s certification, school districts cannot enter into limitation agreements.

The Arguments

Over the years, Chapter 313 has won its fair share of supporters; but it has also earned many detractors who argue that the program is too costly, too uncertain, and perhaps even unnecessary altogether.

Some of the latest data illustrates the high cost of the program. In 2013, the Texas Comptroller issued a report suggesting that taxpayers spent a whopping \$341,363 for every new job created by Chapter 313.

Additionally, it's unclear whether the overall economic benefit provided by limitation agreements outweighs the cost. While the Comptroller must determine whether a proposed project under Chapter 313 is likely to generate enough tax revenue within 25 years to offset the loss in revenue due to the limitation, such determinations are often fraught with uncertainty. For example, an assessment from the Comptroller's office demonstrates that among the 13 limitation agreements that expired from 2013 through 2015, actual market values in the last year of the limitation period ranged from 28 percent to 125 percent of the initial market value. This wide range shows the difficulty in making economic projections about potential projects.

Finally, the evidence is suggestive of the fact that tax incentives are wholly unnecessary to attract business investment. The Texas Observer found in its review of more than 360 limitation agreements that many agreements were created even after companies had already announced plans to build in Texas. For example, in December 2012 Beaumont ISD gave Pandora Methanol an incentive deal worth \$5.6 million to refurbish a chemical factory it had bought just four months earlier. Consider the cost of such unnecessary deals: From 2002 to 2014, Texas schools committed limitation agreements that cost the state budget \$5.5 billion.

Further, while the Comptroller must check whether getting the tax break is “a determining factor” in a company's decision to build in Texas, companies have learned how to game the approval process. For instance, in December 2014 Solar Prime applied for a limitation agreement to build a solar array in West Texas and stated that the break would “improve the economic viability of the project.” The Comptroller denied approval. Six months later, Solar Prime reapplied and claimed it required the tax incentive in order to build. This time, the Comptroller approved.

Taking these concerns into consideration, state and local leaders should consider more fiscally sustainable and time-tested alternatives, like creating and maintaining an environment of low tax and limited government. In this way, out-of-state businesses looking to relocate to Texas can be confident that the low tax environment they seek will be one that lasts.

Recommendations

- Eliminate Chapter 313 incentives as unnecessary to attract business investment to Texas.

Resources

“Free Lunch” by Patrick Michels, *The Texas Observer* (March 15, 2016).

“Chapter 313: Attracting Jobs and Investment” by Olga Garza and Annet Nalukwago, *Fiscal Notes*, Texas Comptroller of Public Accounts (April 2016).

Chapter 380: Economic Development Agreements

The Issue

Modern economic development policy in Texas can trace its roots back to when the Legislature passed the Development Corporation Act of 1979. It allowed municipalities to create nonprofit economic development corporations to support economic growth. However, because the Texas Constitution prohibited state and local government funds from supporting private business entities directly, they were privately funded.

Then the floodgates opened in 1987 when voters approved a state constitutional amendment—Proposition 4—allowing public expenditures to be made in the furtherance of economic development activities. The amendment made explicit that: “the legislature may provide for the creation of programs and the making of loans and grants of public money... for the public purposes of development and diversification of the economy of the state.”

Thus, it then became allowable to use public funding for private interests through economic development corporations and other instruments. In 1989, Chapter 380 of the Local Government Code greatly expanded upon this by enabling municipalities to also engage in these activities using a variety of different means.

The Arguments

Chapter 380 has been called the “crown jewel of incentives for local economic development” because it permits cities—both home-rule and general law—to spend on economic development programs so long as it is done for “public purposes.” As virtually anything can be construed as a public purpose, this has effectively given localities an open invitation to offer grants, loans, or other things to private businesses promising economic growth and activity.

As a result of Chapter 380’s broad grant of authority, as well as the expansion of roles and responsibilities in other places of the code, economic development incentives have become the rule instead of the exception for localities seeking to attract new business and investment. This kind of policy environment invites debate over the use and efficacy of public funds, but perhaps more immediately, it also raises a serious concern involving government transparency and accountability.

Under the current system, economic development deliberations are not public information. Under Section 551.087 of the Government Code, which covers the Open Meetings Act, economic development negotiations are excluded from the public meetings requirement. Local governments may not only consider information presented regarding a business interested in relocating, but also fully deliberate. As long as no vote is actually taken, all other aspects of the economic development negotiation process are exempt. The only thing the public will ever know during the process of negotiation is that economic development discussion is posted for closed session.

In addition, all information about economic development negotiations, including any and all offers made by local governments to business prospects, are completely sealed from public view at least until an agreement between the government and the business is reached. Not even an open records request can reveal the details, or even the existence of a particular economic development negotiation. If no agreement is reached, any information about the economic development negotiations, even the fact that they ever occurred, may never be disclosed to the public. The only thing the public has the right to know is that the negotiations are ongoing, because closed session will be posted invoking the 551.087 exemption.

The ability of local governments to conceal the proceedings of economic development negotiations—involving Chapter 380 agreements as well as other incentives—effectively keeps the electorate disengaged from crucial elements of the decision-making process. Elected officials tout when a deal is worked out, proclaiming the new growth that has been created in the community thanks to the governing body's action. What is not seen by the taxpayers, of course, are the negotiations over how much of their money is spent, or what special treatment the business receives. This disconnect significantly lessens any outside scrutiny of the issue, allows elected officials to take credit for whatever jobs or investment are promised, and generally ensures that the public doesn't really know what is going on.

It should be noted that the hidden nature of economic development negotiations also benefits businesses looking to receive economic development handouts. By not having to endure a public process, these businesses avoid much of the negative perception of “crony capitalism” because no one knows the negotiations are going on until the deal is done. Even then, the deal takes a backseat to the promised number of jobs and new capital investment.

At a minimum, addressing the opaque nature of the current system should be a reform at the top of every state and local officials' agenda.

Recommendations

- Require local governments to create an economic development policy that clearly lays out the incentives that its governing body is willing to offer business prospects as part of its economic development negotiations.
- Allow a public comment and review period for all economic development agreements before the final vote on passage; at least two weeks after the agreement is reached.
- Require that local governments maintain active economic development agreements on the entity's website that are accessible to all.

Resources

Texans on the Left and Right Agree: It's Time for Transparency in Economic Development by Jess Fields, Texas Public Policy Foundation (March 2015).

continued

Chapter 380: Economic Development Agreements (cont.)

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Texas Government Code § 552.131.

Section 4A and 4B Economic Development Sales Taxes

The Issue

The Development Corporation Act of 1979 allows cities to create economic development corporations (EDCs) whose purpose is to encourage new growth in the local economy. Before the 1987 constitutional amendment, these entities had to seek private funding. Not long after its passage, the Legislature created the Section 4A and Section 4B sales tax to fund these economic development activities overseen by the board of a corresponding EDC. If approved by voters, the sales tax increase under a section 4A or 4B may be: one-eighth, one-fourth, three-eighths, or one-half of one percent.

The Section 4A sales tax primarily targets manufacturing and industrial development. Specific EDCs can use Type A revenue to fund land, facilities, targeted structures and improvements for projects. Examples of Type A projects include: infrastructure improvements that promote or develop business enterprises, maintenance and operating costs associated with projects and job training classes. Type A sales taxes are mostly restricted to spending for economic development purposes.

The Section 4B sales tax may encompass any project under Type A rules, along with other project types including quality of life improvement projects. Examples of Type B EDCs include: professional and amateur sports and athletics facilities, tourism and entertainment facilities, affordable housing projects, water and sewage facilities and parking and transportation facilities. Type B EDCs may also fund projects that develop and expand business enterprises or retain jobs; however, landlocked cities with populations of 20,000 or less may use Type B sales tax funds to promote or expand business development that does not create or retain jobs. Generally speaking, Type B sales tax revenues have more flexibility in their use.

Cities may adopt either of these taxes or both, as long as they meet the criteria and do not exceed the 2 percent local sales tax cap.

According to the Texas Comptroller, the use of economic development incentives is as strong as ever. New economic development corporations continue to be created, even as many cities have maxed out on their local sales tax cap. In 1997, there were only 336 economic development corporations. In 2011, there were 697, with the number having increased every year.

The Arguments

Proponents of economic development corporations, which are funded through the use of 4A and 4B sales taxes, often argue that these tools equip communities to be able to attract and retain highly valued industries and businesses that might not otherwise be interested in relocating to the region. Successful recruitment of these businesses promotes job creation, complements a community's quality of life, and more fully develops markets within local communities.

Proponents also contend that the cost of incentives is balanced by the additional tax revenue derived from economic development.

continued

Section 4A and 4B Economic Development Sales Taxes (cont.)

In contrast, critics of Texas' 4A and 4B programs argue that these tools let local governments pick winners and losers in the marketplace. This public policy approach is not only contrary to free-market economics, but also puts existing area retailers at a distinct economic disadvantage since they are both providing the subsidy and competing against the company receiving it.

In addition, economic development programs, like those funded through 4A and 4B sales taxes, can create an environment conducive to “rent-seeking,” a phenomenon whereby companies, organizations, or individuals actively seek financial gains through the political process instead of through productivity increases. Among other things, rent-seeking encourages unproductive behaviors.

Finally, free-market advocates rightfully contend that the best way to attract and retain business enterprises is not through artificial means, like economic development programs, but by adopting the Texas Model which emphasizes low taxes and limited government. This governing approach not only creates a desirable economic environment, but also is more fiscally sustainable over the long term.

Recommendations

- Eliminate the ability of political subdivisions to impose section 4A and 4B sales taxes.
- Discontinue public funding for economic development corporations.

Resources

Texans on the Left and Right Agree: It's Time for Transparency in Economic Development by Jess Fields, Texas Public Policy Foundation (March 2015).

An Overview of Local Economic Development Policies in Texas by Jess Fields, Texas Public Policy Foundation (Jan. 2014).

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The Local Hotel Occupancy Tax

The Issue

The hotel occupancy tax (HOT) is levied at the state and local level on visitors paying for the short-term use (less than 30 consecutive days without interruption of payment) of a room in accommodations such as hotels, motels, tourist houses, bed and breakfasts, or short-term rentals.

The state HOT is a 6 percent mandatory tax on the price of any room, including in private homes, that costs at least \$15 a day. Lodging facilities must collect the tax and remit it to the state. Revenues are administered by the Comptroller's office and deposited in the general revenue fund, with some of them dedicated to specific types of spending such as promotion of tourism.

Municipalities and counties may levy a local HOT on any room that costs at least \$2 a day. The maximum rate can vary between 7 and 9 percent for municipalities, up to 9 percent for counties, and up to 2 percent for sports and community venue projects. The local HOT is administered directly by municipalities and counties.

The combined HOT rate (state and local) cannot exceed 15 percent except when a venue project tax is added. The combined rate can hence range from 6 percent to 17 percent, with El Paso reaching the height of 17.5 percent (the city had reached that rate before the 83rd Legislature passed a cap).

Municipalities and counties can only levy a HOT to foster economic development through tourism or to finance a "venue project." Expenditures of local HOT revenues must directly enhance and promote tourism and the convention and hotel industry and should attract visitors from outside the city or county to the area and its vicinity. Allowable categories of expenditures include funding for construction or maintenance of a convention center or visitor center; paying for advertising and promotional programs that support the tourism and convention center industry; funding the promotion of the arts, historical restoration, or preservation programs; providing signage to sights and attractions; and in certain cases, paying for upgrading certain sports facilities.

The Arguments

The goal of the local hotel occupancy tax lies in how the revenues from the tax are proscribed to be used: "to promote tourism and the convention and hotel industry." The rationale is that by promoting tourism and local attractions, and by helping the convention and hotel industry attract tourists, more visitors will come and spend money locally, which in turn will stimulate the economy and create jobs. Proponents of projects that can be funded by HOT revenues even argue that these projects cost local taxpayers nothing; visitors pay for them when they visit. Attracting more visitors means increasing revenues to fund such projects.

The promotion of specific industries with taxpayer money is problematic in several ways, though. For instance, it distorts the free market system by giving privileges, such as publicly funded marketing campaigns, to some businesses over others. In addition, Texas already benefits from a variety of attractions and, as a result, is a prized destination. In 2014, the Lone Star State could boast the 3rd highest share of domestic travel days. In 2015, total direct travel spending in Texas

continued

The Local Hotel Occupancy Tax (cont.)

reached \$69 billion. Tourism in Texas ranks second only to oil and gas in terms of its contribution to the state's GDP. Why does such a successful industry need government support?

Second, economic impact studies mainly focus on positive effects of building attractions and luring more visitors to Texas. Other, less optimistic effects are better swept under the carpet. The focus on one major event or arena to attract tourists often diverts them away from other leisure activities, or from nearby shops and restaurants, possibly counterbalancing any perceived positive effect on the local economy. This is the crowding out effect.

Another issue lies in the myth that visitors are paying, not local taxpayers. First, outside of their local communities, all Texans are visitors in their own state. When they pay for a room away from home, they pay any added local tax. Finally, each tax added to a product or service makes it more expensive to its buyer, resulting in less of it being bought. A 2011 U.S. Travel Association survey found that 49 percent of travelers changed their plans because of high travel taxes. How many visitors decide to shorten their stay, if they come at all, or spend less, because of the daily cost added by the HOT to the price of their hotel room? The money levied on visitors through the HOT could be spent in the local economy instead, generating additional economic activity.

Recommendations

- **Eliminate the local hotel occupancy tax.** However well-intentioned it may appear, the tax has the double unfortunate result of subsidizing specially connected businesses with taxpayer money and encouraging government spending. Tourism is strong in Texas and does not need corporate subsidies to thrive. Visitors will be left with more money to spend locally, as Texas will become instantly more attractive to tourists in search of less expensive vacation plans. Additionally, the role of a limited government is not to increase tax revenues in order to increase spending, but to frugally restrict spending to its core functions, which should not include financially supporting any industry.

Resources

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Regulatory Favoritism

Regulatory Favoritism

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Title Insurance

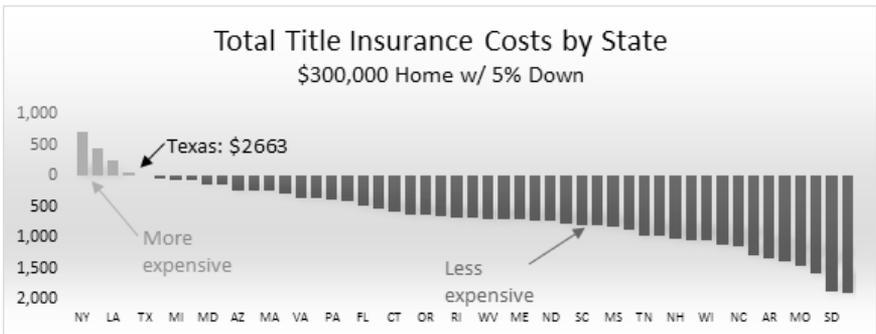
The Issue

The regulations surrounding title insurance represent an alternative approach to the traditional direct corporate subsidies from government. In this case, the government enacts a series of regulations that essentially locks in a guaranteed revenue stream for existing players, all while discouraging new competitors from entering the market. There is no single fee or grant that consumers can point to, but the effect that “regulatory favoritism” exerts on consumers and the market is the same.

Title insurance is perhaps the worst example of regulatory favoritism in Texas law. Not only does the Texas Department of Insurance (TDI) set the price and coverage of residential and commercial title insurance policies, but it also promulgates the division of premiums between title companies and their agents. The government, in other words, designs the contract’s provisions between the parties. Consumers of title insurance have no choice except to accept the decision offered them by the government—to buy one product at one price.

The Texas Legislature’s decision to “completely regulate the business of title insurance on real property” (§2501.002, Texas Insurance Code) stands in sharp contrast to the free market principles that typically govern Texas’ economic policy. It also, for that matter, stands apart from the regulatory regimes thought necessary by Texas’ sister states. A multi-state assessment shows that Texas is one of only three states to engage in price fixing and the only one of these three to take the extra step in demanding that consumers purchase comprehensive coverage. Texas may have a reputation for being on the vanguard of competitive reforms, but in title insurance, the state lags behind the national trend.

There has been much criticism levied at the tightfisted regulations governing Texas’ title insurance market in recent years, their impact on prices in particular. According to a study by the LBJ School of Public Affairs (2011), Texas has the highest title insurance premium for \$200,000 and \$400,000 homes among states that require comprehensive coverage. Research by the Texas Public Policy Foundation concurs. Relying on an apples-to-apples comparison, it found that Texas has the fifth highest total title insurance cost for a \$300,000 home nationwide.



It should be noted that many of the overhead costs incumbent to a policy have declined of late, which has been reflected in part by TDI's latest rate hearings. The controversy swirls around whether Texas' stringent regulations have allowed prices to drop to its fullest potential.

The Arguments

The excuses behind Texas' title insurance regime are varied but overall unconvincing, relying predominately on the argument that there is something different about title insurance that precludes market forces from operating properly. Industry representatives, for example, assert that title insurance plays a unique and important role in the Texas economy because it gives owners and lenders peace of mind that their investment will not be undercut by a competing claim. Complete regulation, it is said, ensures that a subpar product does not accidentally disrupt owners and lenders' expectations. Another strain of argument contends that consumers benefit from the "simple" and "transparent" pricing system—that the law does consumers a favor by taking away the anxiety of having to pick a coverage plan that works for them.

These excuses do not hold up in light of the state's experience under the Texas Model, which deliberately relaxed government regulations in crucial economic sectors, such as electricity and telecommunications, and saw dramatic improvements in price and in product diversity as a result. In fact, the argument that title insurance somehow can't operate under market conditions is the same one made about multiple markets by those who would in some way benefit from excessive regulation.

There is simply nothing unique about title insurance that warrants its exclusion from the forces of competition. In fact, just the opposite is true. Whereas competition forces companies to be customer-focused and conscious of quality, title insurance companies that are relatively insulated from competition are instead largely focused on manipulating regulations.

The heavy cost to consumers of the excessive regulation is readily apparent. Research by the Texas Public Policy Foundation shows that Texas has the 5th highest cost for title insurance among the fifty states. These high prices add up quickly for consumers; according to the LBJ School of Public Affairs, Texans overpay for title insurance by more than \$1 billion per year, or about \$1,663 on average per policy.

Consumers understand the problem of regulatory capture, i.e., when an industry takes control of the regulators, instinctively; a recent poll found that 91 percent of Texans agree that since they can shop around for auto and home insurance, they should be able to shop around for the best deals on title insurance. Texans also understand that allowing competition would provide them more choices and lower prices. They also understand the bigger picture; Texans favor reducing the high price of commercial title insurance because they know it would lower the cost of doing business in Texas and result in a stronger economy and more jobs.

continued

Title Insurance (cont.)

Recommendations

- Increase competition and consumer choice in the title insurance market by adopting the same file-and-use system that is used for auto and home insurance for both rates and forms.
 - Eliminate the authority of the TDI to promulgate or approve the split of premiums between title insurance companies and agents.
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Historical Racing

The Issue

The Texas Racing Act of 1986 authorized pari-mutuel wagering on horse and greyhound races and established the Texas Racing Commission to regulate this particular gambling activity. The Commission enforces the Texas Racing Act with the aim to “ensure a consistent and accurate revenue stream to the state, safe racing facilities, fair and honest racing activities, and accountable use of economic incentives funded through pari-mutuel racing.” The commission licenses racetrack facilities and racing industry occupations, establishes rules for racing, monitors racing activities and enforces racing regulations, and accepts and answers consumer complaints.

When Texas voters approved the Texas Racing Act in November 1987, they acquiesced to the activity of pari-mutuel wagering, described by the Racing Commission as bettors “wagering among themselves, not against the ‘house,’ as with casino-style gambling.” More recently though, faced with declining racetrack attendance and money wagered, the racetrack industry pushed for the authorization of historical or instant racing in racetrack facilities. Historical racing allows gamblers to place bets on races that already took place after watching very short videos of each race. Videos are stripped of any reference that could allow gamblers to identify the race or its participants. The machines used for historical racing very much resemble casino slot machines.

In 2014, in an effort to help the horse racing industry, the Racing Commission allowed historical racing at racetracks in the Lone Star State, bypassing the Legislature and, some argued, acting only by administrative fiat. Members of the Texas Legislature challenged whether the commission had the authority to allow such an activity. That same year, a state district judge ruled that it did not. The commission first persisted but, faced with a Legislative Budget Board that refused to fund the commission as a consequence of its stand, eventually repealed the rule in 2016. Also in 2016, a Texas appeals court threw out an appeal by horse racing associations trying to overturn the 2014 decision.

The Texas Racing Commission is funded by racetrack and occupational license fees and fines and uncashed winning mutual tickets. The commission also receives revenue from racetracks that are statutorily dedicated to support the Texas Bred Incentive Program. The program supports breed registries for the purpose of granting breeders' awards.

The Arguments

The Racing Commission and racing associations argue that allowing historical racing in racetrack facilities would have a positive effect on both the racetrack industry and the state of Texas. Potential additional revenues generated by the historical racing machines, supporters argue, would help the declining racetrack industry by creating a level-playing field in which Texas can compete with other states that already allow the gambling activity. They would also mean increased revenues for the state coffers.

continued

Historical Racing (cont.)

However, this approach has two problems. The first one is that racetrack betting as allowed in Texas today is essentially a monopoly granted by the state to special interests. The same would be the case for historical racing. The slow decline of the racetrack industry has been prevalent not just in Texas but in the entire U.S. The population's interest in horse and greyhound racing has been declining for years as Americans turned their focus on other areas of entertainment. Texas should not be in the business of expanding monopoly privileges for a few favored businesses.

The second problem is two-fold. Does gambling expansion actually increase state revenues? And even if it does, should it be considered for that reason? Research has questioned whether expansion of gambling actually increased state revenues once the socioeconomic costs linked to such expansion are taken into account. A 2005 study by the Foundation noted that

Costs associated with gambling include: (1) a reduction of approximately 10 percent in state lottery revenues; (2) an investment of approximately 10 percent of revenues in regulatory costs for gambling; (3) criminal justice costs underwriting an 8 to 13 percent increase in crime; (4) lost state and local revenue resulting from diversion of spending from goods and services to gambling; and (5) lost jobs resulting from decreased spending on non-gambling goods and services.

Additionally, increasing Texas government revenues will result in increased spending and regulation by Texas government. But Texas does not need to look for new ways to increase its revenues; it should be looking for ways to reduce them.

Recommendations

- Do not expand gambling through historical racing in Texas.

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Medical Scope of Practice

The Issue

There are too few doctors for too many patients in Texas, especially outside the major metropolitan areas. More than two million Texans live far away from big cities where the doctors and big hospitals are. Out of Texas' 254 counties, 126 are classified as "medically underserved." And 25 Texas counties have no physician at all.

How are rural Texans, for example in Marble Falls (pop. 6,077) or Raymondville (pop. 9,733), going to get the medical care they need, and particularly in time?

There is one practical way to improve access to care for Texans: realize the full potential of nurse practitioners.

The Arguments

Nurse practitioners (NP) could ameliorate the problem of access to care in these areas but only if they choose to practice there, which they don't because of bureaucratic overreach in the service of protecting existing providers.

Most ailments and injuries can be triaged and even treated by an NP, also known as an Advanced Practice Registered Nurse. When you consider what NPs are able to do, they are not simply nurses but really junior doctors. Given their extensive medical capabilities, NPs could play a much, much greater role in addressing inadequate access to care in remote Texas areas.

NPs are paid less than physicians, which would lead naturally to cost savings. When an NP provides the initial medical triage, cost per episode goes down by at least 20 percent compared to a doctor performing the same function. For what it costs taxpayers to educate one medical student (\$160,000), we could educate between three and twelve NPs.

Increased utilization of NPs is not only a cost saver but there are also gains on the revenue side. In 2012, Texas economist Ray Perryman showed that allowing NPs and physicians' assistants to practice to the full extent of their training and without artificial, bureaucratic restrictions could result in an \$8 billion increase in gross product per year; add 97,205 permanent new jobs in Texas; and contribute roughly \$500 million in additional tax receipts to state and local governments.

Texas fails to realize the full potential of nurse practitioners—both in number and scope of practice—because of the Prescriptive Authority Agreement. This agreement, stripped of legal speak, says that an NP can only function by delegation of authority from a physician, not independently; can only order medications through said delegation; and must comply with (and pay for) chart review by a contract with a physician.

The alleged justification for the Prescriptive Authority Agreement is that chart reviews protect the patients. However, chart reviews are all done after the fact, generally months after the patient encounter. How does such review protect the patient from the adverse impact of an NP's presumed medical mistake, one that happened months previously?

If an NP sets up practice in a small community, where the NP may be the only provider within 50 miles, the delegation and review requirement of the Prescriptive Authority Agreement still apply. The NP can only prescribe medicines under the control of a doctor, even though the NP is well trained in diagnosis and treatment as well as physiology and pharmacology. The rural NP must find and pay a physician to review the NP's charts. Eighty percent of NPs pay in the range of \$20,000 per year to their contracting physicians. Some others have to pay as much as \$120,000 per year.

The payment required by the Prescriptive Authority Agreement is a form of regulatory extortion the Texas Medical Board or TMB has mandated the Prescriptive Authority Agreement. This board is made up predominantly of physicians who practice within the Texas market, creating a real conflict of interest.

Because of all of the above, Texas cannot make full use of the potential of NPs.

Recommendations

- Repeal the Prescriptive Authority Agreement. It provides no benefit to patients and is harmful to Texans by discouraging NPs from practicing in rural communities.

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Occupational Licensing

The Issue

Occupational licensing is currently required for 29 percent of U.S. jobs, a dramatic increase from the 5 percent figure of the 1950s. Texas itself mandates licensing for roughly 142 different professions. Of these, 34 commonly serve as stepping stones into the middle class for inexperienced, low-skilled Texans. Although other states cover many more occupations under their licensing regimes, Texas levies more stringent requirements than most. On average, the Lone Star State demands \$304 in fees, 326 days spent in training, and two successfully completed exams from Texans seeking to work in a licensed field. Practitioners must meet stipulations such as these or incur a Class A misdemeanor charge under section 165.151 of the Occupations Code, the penalty for which is up to a year spent behind bars.

In addition to the implications that occupational licensing has for workers in Texas' 142 licensed lines of work, it also significantly affects the economy as a whole. Studies have shown that licensing, while it pushes up the salaries of licensed workers, reduces job growth by 20 percent and results in an estimated economic loss of \$34.8 billion to \$41.7 billion each year. The average household can expect to fork over an additional \$1,033 each year to pay the inflated prices of licensed services. Occupational licensing's impact, whether on the personal or macroeconomic level, is difficult to ignore.

The Arguments

The stated purpose of occupational licensing laws is to protect the health, safety, and pocketbooks of allegedly unwary consumers. By requiring practitioners to meet certain minimum standards, the government in theory ensures that the likelihood of a customer encountering a poor—or worse, injurious—service is low. Otherwise, the information asymmetry existing between the server and the served could allow dangerous and duplicitous enterprises to flourish, or so the reasoning goes.

However, the rise of business-reviewing websites such as Yelp and Angie's List has narrowed the knowledge gap by a considerable amount in recent years. Prospective customers can now receive testimonies of a company's service almost instantly, preventing businesses from escaping the consequences of bad practices. Indeed, by virtue of the power they place in the average consumer's hands, online reviews render the benefits of most licensing null.

Even if occupational licensing's supposed advantages had not been sapped by innovation, it would still pose a series of difficulties worth reckoning with. The larger economic costs associated with licensing—reduced job growth and deadweight loss—negatively affect the living standards of all Texans. Low-income residents find themselves hit especially hard. The sometimes onerous licensing requirements provide an additional burden for them—not only are licensed services more expensive, licensed professions become too costly to enter in terms of both time and money. As a result, entrepreneurship loses some of its long-standing power as a path out of poverty.

While would-be entrepreneurs seeking a gateway to the middle class are adversely affected by occupational licensing laws, there is one group that profits from the existing legal structure—established businesses. In fact, business lobbies represent some of the most enthusiastic supporters of occupational licensing legislation. Legally blocking would-be competitors artificially inflates prices, giving entrenched players in the marketplace incentive to keep them out. Now that technological advances have severely undercut the traditional benefits of occupational licensing, its tendencies towards cronyism and its other potent disadvantages bear greater consideration in the debate surrounding the issue.

Recommendations

- Review every occupational license in Texas and eliminate all but those that demonstrate the highest level of need to protect public health and safety.
 - Reduce education and experience requirements or convert licensing to certification or registration where appropriate.
 - Subject all new occupational license proposals to the following three-step process: 1) the Legislature must pass a law authorizing an agency to review the need for a license; 2) the agency must review the need and report its assessment to the Legislature; 3) following the agency's report, the Legislature may pass a law establishing the new license.
 - Mandate a review, conducted every ten years, to assess the utility, appropriateness, and proportionality of existing occupational licensure.
-

Resources

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Alcoholic Beverage Control

The Issue

Very often governments enact economic regulations under the justification that the restriction on free markets is necessary for the protection of the public. However, as often as not, the regulations are in fact enacted at the behest of entrenched market participants seeking protection from competitors. How should public officials respond when an enacted solution is demonstrated either to have no effect whatsoever or perhaps even to make the situation worse? In an ideal world, the government would repeal the policy and let liberty reign again, but as Texas' restrictions on alcoholic beverages show, entrenched interests often interfere.

Following the repeal of Prohibition, Texas adopted a “three-tier system” for the regulation of alcohol, so called because it isolates the different levels of the industry—manufacturing, distribution, and retail—from one another. The Texas Alcoholic Beverage Code plainly states that it is “the public policy of this state . . . to maintain and enforce the three-tier system.” Thus, as a general rule, businesses of one category cannot share an ownership interest in a company that belongs to another; nor can they coordinate activities. Each tier must remain independent. The rules promulgated and enforcement actions taken by the Texas Alcoholic Beverage Commission (TABC) are intended to maintain these distinctions, but as is so often the case, the enforcement of arbitrary laws becomes arbitrary itself.

Over time, the three-tier system has put Texas distributors in a favored position. The code permits certain breweries to self-distribute their product if they do not manufacture more than 125,000 barrels annually, but otherwise alcohol manufacturers must contract with a licensed distributor if they wish to sell their product or expand their business. The law imposes strict constraints on the form these agreements may take. As per §102.51, Alcoholic Beverage Code, the contract must be exclusive, in that the distributor has the sole right to sell the product inside a given territory; “a manufacturer may not assign all or any part of the same sales territory to more than one distributor.” In addition, this agreement is open-ended. As per §102.74, the manufacturers may not “cancel, fail to renew, or otherwise terminate” their relationship with a distributor “unless the party intending such action has good cause.”

More recently, the Texas Legislature has made it illegal for manufacturers to sell their territorial rights at all. Manufacturers must instead relinquish these rights to distributors free of charge. Distributors, meanwhile, retain the option of transferring their contract to a competitor for a profit. A coalition of Texas brewers challenged this law, arguing that it 1) violates the Texas Constitution's ban on uncompensated takings and 2) pursues an illegitimate government interest in violation of the Texas Constitution's Due Process Clause. A state judge agreed and struck down the law, but TABC is expected to appeal.

There are two other lawsuits of note: *Cadena Commercial USA v. TABC* and *McLane Company v. TABC*. Both involve the state government's penchant for inconsistently applying the three-tier system. To illustrate, in *McLane Company*, TABC went so far as to deny the plaintiff a distributor's license because its par-

ent company, Berkshire Hathaway, has a 2 percent ownership stake in Walmart, which holds retailer permits in Texas through a subsidiary. This standard has become known as the “One Share Rule.” It holds that a company violates the three-tier distinction if it has any interest in a business of a different tier, even if it merely owns a single share. Followed to its illogical conclusion, the One Share Rule would endanger the license of virtually every approved manufacturer, distributor, and retailer in the state since anyone publicly traded or who provides an employee pension fund could find themselves in breach. TABC avoids this absurdity by applying the rule selectively. Established market players receive a pass. Prospective competitors confront a hostile frontline defense.

The Arguments

Multiple justifications for Texas’ three-tier system exist. One is that the three-tier system insulates and protects the market from being dominated by a single supplier. In other words, the argument is that the three-tier system is in fact pro-competition because it prevents vertical integration. No single company can gain full control over the supply chain. The market is instead filled with smaller outfits, who vie for customers with lower prices and innovative products. The result, according to supporters, is a market that is more conducive to responsible and temperate alcohol consumption.

However, even if having a strict division between manufacturing, distribution, and retail thwarted the creation of an industry conglomerate, how does forcing brewers into exclusive contracts with distributors further that interest? Wouldn’t that create a monopoly of a different type? Additionally, the benefits of the free market arise because parties have the right to withdraw their business. This puts pressure on both sides to stay honest and keep attentive of their business partners. How does prohibiting the cancelation or non-renewal of a contract aide in that endeavor? Wouldn’t it remove the distributor’s incentive to do right by both the manufacturer and the consumer? The demand that the manufacturer surrender their distribution rights certainly does not seem necessary or even pursuant to a free and open market. There, the only beneficiary is the middleman who is no longer obligated to pay for the privilege of profiting from someone else’s creation.

Taken altogether, the lopsided restrictions and unequal enforcement suggest that the purpose of Texas’ three-tier system is not anchored to a concern over vertical integration. Instead of being based on the fear of monopoly and the impact such a monopoly would have on responsible alcohol, the regulation of alcohol in Texas is in fact a system of protection for entrenched incumbents that serves as an indirect corporate subsidy to distributors.

Recommendations

- Eliminate Texas’ three-tier system of alcohol regulation.
- Interpret and enforce the regulations controlling alcohol beverages consistently and in manner that does not favor established companies at the expense of competitors.

continued

Alcoholic Beverage Control (cont.)

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