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# 2019-20 LEGISLATOR'S GUIDE to the issues

Edited by
Bill Peacock & Carine Martinez-Gouhier
Texas Public Policy Foundation



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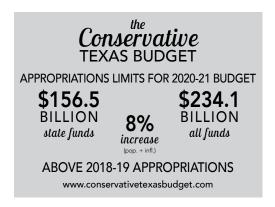
# Spending

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# Conservative Texas Budget

#### The Issue

Conservative Texas Budget is a budget that does not increase by more than the change in the key metric of population growth plus inflation. Limiting the state's budget growth to this key metric allows legislators to fund government while not overly burdening Texans with higher taxes. If the 2017 budget increases remain below population growth plus inflation, joining the 2015 budget, the Texas Legislature has a grand opportunity to pass a historic third consecutive Conservative Texas Budget in 2019.



The Legislature starts each legislative session with an estimate of how much tax revenue is available to appropriate. Although legislators cannot appropriate more than projected taxpayer dollars collected based on the Texas Constitution's balanced budget amendment, spending ultimately determines taxes collected. Because taxes matter to Texans' economic activity, spending restraint is preferable.

Legislators practiced some budget constraint in 2003 and 2011 when spending increases were less than corresponding increases in population growth plus inflation. However, subsequent legislatures in 2005 and 2013, respectively, increased spending substantially, erasing all of the gains from the prior session. These types of past excessive spending trends have led to a state budget that has increased 7.3% above increases in the compounded growth of population and inflation since the 2004-05 budget. This failure to practice consistent fiscal discipline has led to overspending (i.e., higher taxes) of \$15 billion during the 2018-19 biennium, which amounts to a Texas family of four paying on average \$1,000 more in taxes this year.

In 2017, the Legislature passed total appropriations of \$216.8 billion in all funds with state funds accounting for \$144.9 billion of that total. Both balances increased by less than population growth plus inflation. In 2019, the Legislature could have \$2.79 billion available for a supplemental bill to sustain a 2018-19 conservative budget. A supplemental bill should cover the delayed \$1.8 billion Proposition 7 transportation payment and will likely cover underfunded amounts in Medicaid, other programs, and Harvey recovery efforts, potentially from the Economic Stabilization Fund (ESF). We intend to exclude from our Conservative Texas Budget calculations Harvey recovery appropriations as necessary.

#### 2019-20 LEGISLATOR'S GUIDE TO THE ISSUES

While the Legislature has occasionally passed conservative budgets, Texas needs to end the historical cycle of following conservative budgets with massive spending hikes. The member organizations of the <u>Conservative Texas Budget Coalition</u> recommend that the Legislature pass what could be the third consecutive conservative budget so that legislators will be good stewards of taxpayer dollars.

These Conservative Texas Budget limits represent maximum amounts for the Legislature to use when determining the cumulative amount appropriated. The Legislature could easily spend less while ensuring payment of government provisions and providing tax relief. Nonetheless, if the Legislature stays within these limits, it will have taken a substantial step toward reining in the excessive growth of Texas government spending since 2004.

As a result, Texas will be better equipped to deal with economic downturns and other circumstances. Ultimately, conservative budget reforms will provide Texas with the best opportunity to empower Texans to reach their full potential and allow the state to remain a free market model for others to follow.

#### The Facts

- Texas' total state budget growth is \$15 billion higher in the 2018-19 budget than
  if it had been limited to the pace of the key metric of population growth plus
  inflation since the 2004-05 budget.
- A Texas family of four is paying, on average, \$1,000 more per year to fund government than if the budget had been limited to this key metric.
- The 2015 and 2017 legislatures passed what could be the first consecutive Conservative Texas Budgets in recent history.

#### **Recommendations**

- Adopt a third consecutive Conservative Texas Budget.
- Increase the 2020-21 total budget by less than the estimated increase in the rate
  of population growth plus inflation based on actual data in fiscal years 2017
  and 2018.
- Pass a 2020-21 budget that increases by no more than 8 percent for a maximum total budget of \$234.1 billion and state funds of \$156.5 billion.

#### Resources

*The 2020-21 Conservative Texas Budget* by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (Forthcoming ).

*The 2020-21 Real Texas Budget* by Talmadge Heflin, Bill Peacock, and Vance Ginn, Texas Public Policy Foundation (Forthcoming).

*HB 208: Texans Deserve a Conservative Spending Limit*, Testimony before the House Appropriations Committee by Vance Ginn, Texas Public Policy Foundation (July 27, 2017).

<u>TEL It Like It Is: Why Texas Needs Spending Limit Reform</u> by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (Dec. 2015).

# Tax and Expenditure Limit

#### The Issue

Texas has done better economically and fiscally than most states for <u>decades</u>. However, an area needing improvement is consistently controlling the state's budget growth. Because government spending ultimately drives taxation, especially when Texas must balance its budget, limiting budget increases is essential for a competitive economy that supports prosperity.

The 2018-19 initially appropriated amount of about \$217 billion is up 75% since the 2004-05 budget. Comparatively, the key metric of population growth plus inflation compounded over time is up an estimated 63% during this period. Adjusting the total budget for this key metric shows that total budget growth is up 7.3% above the pace of population growth plus inflation since the 2004-05 budget. This excessive increase has burdened Texans with higher taxes and fees to sustain elevated spending levels and slowed economic growth.

While historically the Legislature has occasionally passed conservative budgets that increase by no more than this key metric, Texas needs to keep costly past budget cycles from repeating. This can be accomplished by adopting a stronger state spending limit. The weaknesses of the current spending limit derives from:

- Not covering most of the budget. In Article VIII, Section 22(a) of the Texas Constitution, the only appropriations subject to the spending limit are those derived from "state tax revenues not dedicated by this constitution," which is about half of the 2018-19 total budget. By capping only half of the budget, the rest can grow unabated.
- Not providing a reliable indicator for the budget's growth rate. The Texas
   Constitution requires that the limit be based on the growth in the state's
   economy, which is statutorily identified as personal income growth. Research
   finds that this measure's instability leads to costly fiscal volatility and uncertainty.
- Not relying on actual measures of economic growth. Given that several groups submit estimates of personal income growth to the Legislative Budget Board in November before a regular legislative session for the next two fiscal years, the projections are for almost three years. The difficulty of predicting this growth rate leads to discrepancies between actual and projected.

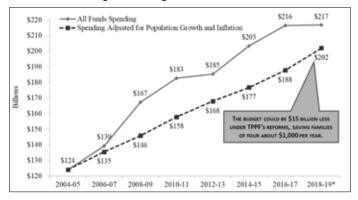
Fortunately, the 2018-19 budget meets the needs of Texans while potentially achieving the historic milestone of two consecutive state budgets held below population growth plus inflation. Now is the time to strengthen the state's weak spending limit.

The following graph presents the budget adjusted for population growth plus inflation over time to consider what the budget would look like if the Legislature had implemented a spending limit based on this metric in 2003 and followed it from the 2004-05 to 2018-19 budgets. Taxpayers would be asked to support a substantially smaller budget of \$202 billion, \$15 billion less than the current two-year budget.

#### The Facts

- Texas' total state budget growth is up an estimated 7.3% above the compounded growth of population plus inflation since the 2004-05 budget.
- The current spending limit is weak because it excludes a majority of the budget, is based on the estimated growth of future personal income, and can be avoided rather easily by lawmakers.

Texas' Government Budget Growing Faster than Reformed TEL Since 2004-05



Source: Legislative Budget Board's Fiscal Size-Up and authors' calculations.

The Texas Senate passed <u>SB 9</u> (85-R) that covered more than half of the budget, based the growth rate on population and inflation, and computed the growth rate with past and projected data.

#### Recommendations

- Pass a conservative state spending limit that makes the following changes, where applicable, to Article VIII, Section 22(a) of the Texas Constitution and to Section 316 of the Government Code:
  - Apply the limit to Texas' total government budget; and
  - Base the limit on the *lowest* growth rate of the Census Bureau's measure of <u>state population</u> plus the Bureau of Labor Statistics' measure of inflation for the <u>consumer price index for all items</u>, the Bureau of Economic Analysis' measure of <u>total state personal income</u>, or the Bureau of Economic Analysis' measure of <u>total gross state product</u> for the two fiscal years immediately preceding a regular legislative session when the budget is adopted.
- Change Article VIII, Section 22(a), such that a supermajority vote of two-thirds of the membership in each chamber—instead of a simple majority—is required to exceed the spending limit.

#### Resources

Texans Deserve a Conservative Spending Limit – Testimony before the House Appropriations Committee in support of HB 208 by Vance Ginn, Texas Public Policy Foundation (July 27, 2017).

<u>Strengthening Texas' Appropriations Limit – Testimony before the Senate Finance Committee for SB 9</u> by Vance Ginn, Texas Public Policy Foundation (March 27, 2017).

<u>TEL It Like It Is: Why Texas Needs Spending Limit Reform</u> by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (Dec. 2015).

<sup>\*</sup>indicates estimate

#### Sales Tax Reduction Fund

#### The Issue

The initially appropriated 2018-19 state budget of \$217 billion is up 74% since the 2004-05 budget. However, the key measure of estimated compounded growth of population plus inflation is up only 63% in that period. Had the budget followed this key measure since the 2004-05 budget, Texans would be paying \$15 billion less in taxes and achieving greater prosperity.

Fortunately, the 84th and 85th Texas legislatures passed budgets that increase by less than population growth plus inflation, but there is more work to do. One way to continue correcting past budget excesses is to cut ineffective budget items.

While legislators attempt to reduce spending on specific programs by offering budget amendments in the appropriations process, this normally does not lead to lower overall spending. Such amendments simply set aside the money cut from one program and make it available for legislators to appropriate elsewhere.

To correct this problem of an incentive to spend every available dollar, a mechanism should be created that allows dollars cut from one area of the budget to be transferred to a special fund that allows legislators to actually reduce the bottom line of the budget. Dollars in the fund would accumulate until the appropriations bill is adopted. The Texas Comptroller would then determine the rate decrease and period of reducing a state tax such that the fund would be depleted. After the determined period, the tax rate could automatically revert to its original level or legislators could permanently fund a lower tax rate.

The broadest, most visible, and easiest-to-administer tax in Texas is the state's sales tax. Therefore, this mechanism is called the Sales Tax Reduction (STaR) Fund. The many influential members of the American Legislative Exchange Council's Tax and Fiscal Policy Task Force passed a version of it last year as model legislation. A summary of the <u>Tax Reduction Fund</u> language follows:

The Tax Reduction Fund is a special fund that consists of money transferred to it by the legislature and any interest earned on money in the fund that can be used to temporarily reduce a state's tax rate. The goal of the Tax Reduction Fund is to lower the bottom line of the budget by transferring funds that may be available in the budget that would otherwise be spent and returning those dollars to taxpayers by reducing the broadest state tax.

After creating the STaR Fund, the Legislature could fund it by (1) appropriating dollars that are from a budget surplus or saved dollars from less spending on state programs, and (2) directly allocating funds in excess of the Economic Stabilization Fund's (ESF) cap rather than into general revenue. For the 2018-19 biennium, the ESF cap is \$16.9 billion. Although the expected ESF balance of \$11.9 billion will be below the cap at the end of fiscal 2019, it could soon reach the cap.

Every taxpayer dollar spent should be scrutinized such that it only funds the preservation of liberty. When there are surplus dollars, those funds should be returned to taxpayers and not caught up in the appropriations process. A valuable way to reduce spending levels through the appropriations process is to include taxpayers as one of the funding constituents.

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With excess past spending and a rising amount available in the ESF, a priority must be to reduce the bottom line of the budget through a vehicle like the STaR Fund such that the good tax climate that has resulted in long-lived economic prosperity in Texas will continue.

#### The Facts

- The House's current appropriations process does not allow for funds cut from programs to reduce the budget's bottom line. Instead, these funds are available to be appropriated to other programs.
- The Texas Comptroller projects that the ESF will be roughly \$11.9 billion by the end of FY2019, reaching toward the cap of \$16.9 billion, and could soon reach it.
- By including taxpayers as a funding constituent, more funds available by reducing the bottom line of the budget can be used to provide tax relief.

#### Recommendations

- Create the STaR Fund in 2019 to provide a means for reducing the bottom line of the budget while returning those dollars to the taxpayers by reducing taxes.
- By appropriating dollars that were earmarked for budget growth directly into the STaR Fund along with excess dollars in the ESF to provide tax relief, legislators can restrain the growth of government.

#### Resources

Budget Cutting Through the Sales Tax Reduction (STaR) Fund by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (Feb. 2017).

<u>Tax Reduction Fund—Model Legislation</u>, American Legislative Exchange Council (Sept. 2015).

<u>Protecting Texas Taxpayers: the Sales Tax Relief Fund</u> by Talmadge Heflin and Vance Ginn, Texas Public Policy Foundation (April 2014).

# Transparency and Budgeting

#### The Issue

egislators should appropriately account for spent tax dollars, eliminate state budget inefficiencies, and determine why each agency and its programs are necessary.

Today, the General Appropriations Act (GAA), the bill creating the state budget, is constructed using a strategy-based budgeting format. This format lays out programs under broad strategies that make them difficult to track and evaluate. The budget should be written with each agency's revenue and expense listed by program, as well as listing the revenue source next to each line item. Changing to a program-based budgeting format would simplify the process for taxpayers, leading to more transparency and a greater chance to cut inefficiencies. This would help hold the Legislature accountable for its budget practices while helping educate and empower taxpayers.

Changes to the proposed budget should be available online in as close to real time as possible during the legislative process. Fortunately, after the 83rd Legislature, the Legislative Budget Board (LBB) took steps to create an online application that displays the state budget by program. Taxpayers can now search for program-level spending information, a short explanation of the program, and its statutory authorization. This application is a good first step, but currently the information provided is only informational and not frequently updated.

Another issue is that the current budgeting approach too often assumes that all previous expenditures are justified and necessary. Legislators then simply add automatic spending increases on the previous budget. This budget inertia is a highly inefficient use of taxpayer dollars. A helpful tool to improve efficiency and budget transparency would be the use of zero-based budgeting.

Texas essentially practiced zero-based budgeting from 1973 until the strategy-based budgeting started in 1991. Zero-based budgeting is a complete review of each agency's budget starting from scratch to determine the necessity of programs. This method requires an in-depth analysis that takes much time and effort, but it is well worth the cost to increase budget transparency and help legislators assure taxpayers they are being good stewards of their tax dollars.

As an example, Texas faced a projected \$10 billion shortfall in 2003. Gov. Rick Perry sent the Legislature a budget with zeros next to each agency's line item and publicly stated that he would be against any budget with a tax increase. The Legislature did a detailed examination of what had become traditional spending patterns. Ultimately, the Legislature bridged the \$10 billion budget shortfall primarily by eliminating inefficiencies within agencies using zero-based budgeting and avoided raising taxes.

Essential to successfully performing zero-based budgeting is a review of all aspects of an agency or program, including its purpose, goals, and determined metrics to gauge success. Done correctly and often, zero-based budgeting would help restrain budget growth so taxes and fees can be lower than otherwise.

#### The Facts

- The current strategy-based budgeting format, which links appropriations to strategies and goals rather than programs, contributes to rising spending and less transparency.
- The LBB increased budget transparency by developing an online <a href="application"><u>application</u></a> offering the state budget by program after the 83rd Legislature.
- Zero-based budgeting is a more thorough budget analysis than the current approach.

#### **Recommendations**

- Switch from the current strategy-based budgeting format to a program-based budgeting format.
- Post budget information throughout the budget process online so that it will be available to Texans and legislators in near real time.
- Adopt zero-based budgeting to about one-third of the budget every biennium so that each portion is reviewed every third biennium. This was <a href="mailto:implemented">implemented</a> for 16 agencies in Senate Bill 1 and proposed as a change in statute in <a href="House Bill 114">House Bill 114</a> during the regular session of the 85th Legislature.

#### Resources

<u>Testimony before the Senate Finance Committee on Transparency and Accountability</u>, by Vance Ginn, Texas Public Policy Foundation (April 24, 2017).

*The Real Texas Budget* by The Honorable Talmadge Heflin, Vance Ginn, and Bill Peacock, Texas Public Policy Foundation (March 2015).

<u>Testimony before the Senate Committee on Government Organization on</u>
<u>Budget Transparency</u>, by The Honorable Talmadge Heflin, Texas Public Policy
Foundation (June 18, 2014).

# **Understanding Federal Funds**

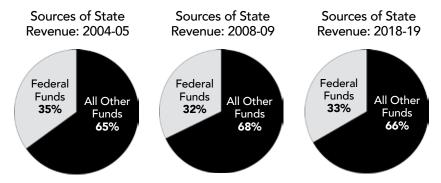
#### The Issue

About one-third of Texas' state budget depends on federal funds, which include grants, payments, and reimbursements from the federal government to state agencies. As written in the U.S. Constitution, states should be able to act as independent and sovereign entities. With more federal aid funding the state's budget, legislators lose their independence to act responsibly for their constituents, and all Texans lose in the process.

With massive federal budget deficits and the national debt exploding, Congress must eventually find ways to slow spending. This change would likely affect how much Texas receives in federal aid, potentially putting pressure on the state's budget without preparing in advance by increasing transparency and identifying ways to reduce the use of federal funds.

As a percentage of the 2018-19 budget, federal funds constitute approximately 33%, or \$72 billion, of the \$217 billion in total appropriations. This is about \$350 million below estimated federal aid expenditures in the 2016-17 budget. Of the \$72 billion in federal aid, Health and Human Services (Article II) was the biggest recipient with an estimated \$43.8 billion, or almost two-thirds of the total. Appropriations supported by federal funds for general government (Article I) functions increased the most by 18% over the previous budget.

A valuable measure of state dependency on federal funds is the percentage of the budget from federal aid. The figures below show that federal aid went from 35% of the 2004-05 budget, declined to 32% in 2008-09, and then increased to its current share of 33%.



Source: Legislative Budget Board

This one percentage-point increase in the share of federal aid from just a few budget cycles ago further burdens state legislators with more red tape and less independence from the federal government and burdens Texans in the process. From 2000 to 2015, this share averaged 33.7% in the Lone Star State, which ranks as the 15th highest share nationwide with the national average of 31%, according to the Pew Charitable Trusts. In addition, federal dollars per Texan increased 32% from about \$1,970 in 2004-05 to \$2,600 in 2018-19.

As Milton Friedman said, "There is no such thing as a free lunch." The common misconception that federal-aid is free is not true. There are ample examples of ways that the federal government controls the choices made by the state and threatens fiscal federalism in the process. As more federal aid makes legislators more dependent on national policies, these policies crowd out the ability for state lawmakers to enact legislation that affects Texans. Specifically, growing federal-aid dependency drives more state spending as legislators try to maximize federal funds, handicaps state decisions as lawmakers focus on federally funded programs and lose control of the growth of the budget, and slows economic growth and job creation as private sector funds are redistributed.

#### The Facts

- Federal funds constitute approximately 33%, or \$72 billion, of the 2018-19 budget.
- Federal funds per person went from \$1,970 in 2004-05 to \$2,600 in 2018-19, a 32% increase.
- From 2000 to 2015, the federal funds share of the budget averaged 33.7% in the Lone Star State, ranking Texas as having the 15th highest federal share nationwide.

#### <u>Recommendations</u>

- Prepare for the next federal budget crisis by identifying and measuring the cost of the mandates attached to federal funds.
- Evaluate the economic and fiscal impacts of a rising share of federal funds when writing the budget; minimize any increase in federal aid or reduce it.
- Rising federal-aid funding for transportation and other state-level projects suggest legislators should consider ways to return more state dollars to fund projects without strings attached.

#### Resources

Through a Glass Darkly: On the Need for Greater Transparency Regarding Federal Funds Going Directly to Texas Local Governments by Thomas Lindsay, Texas Public Policy Foundation (Nov. 2016).

Which States Rely the Most on Federal Aid? by Liz Malm and Richard Borean, Tax Foundation (Jan. 2015).

<u>Budget Driver: Federal Funds</u> by Talmadge Heflin, Texas Public Policy Foundation (Feb. 2010).

# **Controlling Federal Funds**

#### The Issue

n addition to the large share of state appropriations that come from federal funds—around 33%, or \$72 billion, of appropriations in the 2018-19 budget—the federal government uses conditional federal grants to deputize state and local governments to perform tasks beyond the authority of the federal government. Unlike federal funds accounted for in the state budget, this money goes directly from the federal government to local governments, with no real opportunity for oversight by or accountability to the state Legislature.

As states have begun to push back on the conditions attached to federal grants and even reject some grants on policy grounds, the federal government increasingly looks to strike deals directly with local governments, thus subverting the policy decisions made by state legislatures. Federal funds sent directly from the federal government to political subdivisions of the state have all of the problems associated with federal funds in the state budget—such as less financial stability and diminished state and local autonomy over policymaking—as well as their own set of problems, related to a lack of transparency in how these funds are authorized for receipt within the state. While we can at least refer to the percentage of the state budget attributable to federal funds, there is no reliable repository of data on federal funds given directly to local governments.

It can be incredibly difficult to track such deals (to say nothing of preventing them) because legislators currently have no formal mechanisms to gain awareness of attempted federal/local circumventions of state policy decisions. In spite of the efforts of transparency advocates like Adam Andrzejewski, whose OpenThe-Books project provides "the world's largest private repository of public spending," the highly decentralized nature of federal appropriations makes providing a full account of these funds next to impossible without the establishment of a comprehensive system for reporting and reviewing, at the state level, federal funds received by political subdivisions of the state.

The federal government's deteriorating fiscal condition makes reductions in federal funds to state and local governments inevitable and imminent. Utah, a leader in the "Financial Ready" movement, has been developing contingency plans for scenarios in which 5% and 25% of federal funds to the state are suddenly cut off, in order to prepare itself for such reductions. Given these concerns, unaccounted-for federal funds to political subdivisions put the state in a precarious financial situation on two fronts.

First, when federal funds to local governments are cut, local governments often turn to the state to backfill their losses. So under the current system of no oversight, any reduction in federal funds given directly to political subdivisions would increase their need of state support.

Second, since any reduction of federal funds to political subdivisions would also imply reductions of federal funds in the state budget as well, such a call for more support would come at precisely the time when the state budget is least able to accommodate such requests. Indeed, such a scenario would require a Texas version of Utah's Financial Ready contingency plans. But without an accurate picture of federal funds—one that includes federal funds to political subdivisions of the

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state—the Legislature will remain incapable of preparing a comprehensive contingency plan for the increasing possibility of severe reductions in federal support for state and local governments.

#### The Facts

- Federal funds account for 33%, or \$72 billion, of appropriations in the 2018-19 Texas budget.
- In spite of the work of transparency advocates, to date there remains no reliable
  estimation quantifying the extent of federal fund appropriations to political
  subdivisions of the state of Texas, either in total or as a percentage of total appropriations by political subdivisions.

#### Recommendations

- Reporting Federal Funds to Political Subdivisions of the State. Require
  all political subdivisions in Texas to report to a state fiscal entity in real time
  all federal funds received directly from the federal government and didn't go
  through a state agency. Political subdivisions should also identify the purpose
  of those funds, whether the subdivision is required to match such funds, and
  what funds are used for such matching. This state fiscal entity would produce
  an annual report detailing, at a minimum, the amount, duration, purpose,
  matching, and policy conditions attached to such funds.
- State Oversight of Federal Funds to Political Subdivisions of the State. Establish a system of state oversight for federal funds given to political subdivisions of the state. Such a system of oversight would empower state-level officials to reject federal funds found to be incompatible with existing state law, the Texas Constitution, or the Tenth Amendment to the U.S. Constitution. We recommend the following design for such a system:
  - If a political subdivision receives grant funds directly from the federal government (as opposed to funds passed through by a state agency), those funds should be placed in escrow until completion of a state review process.
  - During such a review process, a political subdivision would submit information on the grant to the state fiscal entity described above. The grant information provided should include, at a minimum, the amount, duration, purpose, and policy conditions attached to such funds.
  - Once the state fiscal entity receives the grant information from the political subdivision, it should be given 10 business days to complete an analysis of the grant. As part of this analysis, the state fiscal entity would request from the office of the attorney general a review of the compatibility of the grant's policy conditions with existing state law, the Texas Constitution, and the Tenth Amendment to the U.S. Constitution.
  - Once the state fiscal entity completes this grant analysis, it would transmit the analysis to a panel of designated state elected officials, who would

continued

# Controlling Federal Funds (cont.)

have 10 business days to register an objection to the political subdivision's receipt of the grant funds.

• If an objection by the LBB is raised within the 10 business days, the grant funds would remain in escrow until either the objection is withdrawn or the political subdivision returns the grant funds. The locality may appeal the objection to the LBB. If no objection is raised within the 10 business days, the grant would be considered approved and the political subdivision could then immediately spend the funds for their intended purpose.

#### Resources

"About Us," OpenTheBooks (2016).

Federal Receipts Reporting and Plan of Potential 5% and 25% Federal Receipts Reductions, Utah Department of Administrative Services, Division of Finance (2014).

<u>Summary of the Conference Report for Senate Bill 1</u>, Legislative Budget Board (May 2017).

# **Transportation**

#### The Issue

Texas' population has been growing at about double the national rate for more than a decade; this, combined with increased international trade, places heightened demands on infrastructure, creating congestion and maintenance challenges. As a modest countervailing offset, Americans drive fewer miles due to internet shopping, entertainment, and communications, with 9,812 miles per capita driven in December 2017, compared to the peak of about 10,091 in June, 2005, a decline of 3%.

Texas' strong growth is reflected in the 2018 Unified Transportation Program totaling \$71.2 billion in projects over 10 years through 2027.

Texas' \$0.20 per gallon tax on gasoline and diesel generates about \$3.5 billion annually—a quarter of which goes to public schools—and does not produce enough revenue by itself to completely fund transportation spending. Thus, state policy-makers have supplemented transportation spending with funding secured from other sources, such as a claim on the state's oil and gas taxes (Proposition 1) and sales taxes (Proposition 7), with debt financing and new toll road authorizations being deemphasized as policy priorities change. Proposition 1 revenues rise and fall with the oil and gas market and are expected to generate about \$1.7 billion in 2018-19 and increase to \$2 billion or more in 2020-21. Proposition 7, based on sales taxes and vehicle sales is more stable, generating \$4.7 billion in 2018-19, rising to \$5.8 billion in 2020-21. The Legislature has earmarked some Proposition 7 funds to pay for debt service on Proposition 12 bonds, totaling some \$613 million in 2018-19.

In recent years, almost 42% of the Texas Department of Transportation's (Tx-DOT) funding has come from the federal government with federal funds generated by taxes on fuel and other transportation items supplemented with \$70 billion in general revenue transfers. The Trump administration has proposed significantly increasing infrastructure spending. Pending action in Congress, this spending could take the form of added general revenue spending with Congress dictating priorities or it could reflect the president's proposal to use loan guarantees and favorable tax treatment to encourage infrastructure spending by private parties and state and local governments. A requirement of this initiative would be the securing of a revenue stream. To the extent the latter happens, Texas' recent aversion to toll roads will either have to be overcome or state and local revenue sources must be dedicated to pay for the project's local share costs.

HB 20 (84-R) contained several reforms of note, requiring the Texas Transportation Commission (TCC) to implement performance-based planning to generate metrics for the executive and legislative branches to measure performance and prioritize projects using objective criteria. But the TCC was given wide latitude to ignore its project ranking criteria by allowing for discretionary funding decisions up to 10% of TxDOT's biennial budget. Since new project starts make up less than half of the overall TxDOT budget, granting 10% discretionary authority allows the TCC to ignore much of its own ranking process by allocating about 25% of spending on new projects that didn't make the prioritized project list. The

continued

# Transportation (cont.)

Legislature should follow up on this measure and review the TCC's project ranking and objective criteria.

#### **Design-Build Contracting**

Design-build differs from traditional design-bid-build contracting in that, in the former, a contractor is responsible for designing and building the project while in the latter, a different party, usually the government, designs the project and then bids it out to a contractor to build. Design-bid-build typically results in a longer, more expensive process.

In the six-year period ending in 2014, TxDOT awarded five design-build contracts totaling \$3.85 billion. This method of procurement is estimated to have saved Texas taxpayers some \$1.08 billion, or 22% of the total spent. However, HB 20 raised the threshold of value for design-build contracts from \$50 million to \$150 million. This appears to have reduced TxDOT's design-build activity, which was the intent of the clause. Further, a design-build contract may not extend a maintenance agreement as part of the award for a term of longer than five years. This discourages design and construction techniques that can cost more on the front end but end up saving money on the back end through reduced maintenance costs—roads and bridges typically cost more to maintain over their lifetimes than to build.

Further, according to a federal study, the national average time savings for project completion in a design-build contract versus a design-build contract is approximately 14%. For example, the DFW Connector Project used design-build, shaving 28 months off the expected timeline versus the traditional bidding process. This saved \$43 million in construction inflation while allowing 180,000 cars to use the DFW Connector earlier than they otherwise would have, saving about \$60 million in commuter costs.

Beyond these design-build limitations, in 2011, the Legislature enacted a little-examined restriction on design-build that significantly hobbles that contracting method's use in that the law requires "a schematic design approximately 30% complete" for the issuance of a proposal request for a design-build project. This restriction increases engineering staff costs at TxDOT and reduces the savings in time and money from design-build procurements by predetermining a critical portion of the design. This reduces the innovation and flexibility that contractors may provide on a project. Lifting this restriction would increase the savings that could be obtained from design-build contracting.

#### The Facts

- Texas restricts money and time saving design-build contracts to no more than three per year and no less than \$150 million. Other large states do not have parallel restrictions.
- Per capita miles driven has been flat since 2006. When combined with increasing fuel efficiency, alternative-fueled vehicles, and inflation, this means the fuel tax becomes less capable of funding transportation, placing a greater reliance on other revenue sources.

#### Recommendations

- Pending new federal transportation legislation, revisit dedicated state and local funding mechanisms, placing limitations on funding sources to protect the taxpayer and guard against costly and inefficient projects that may be subsidized by new flows of federal funds.
- Remove the disincentives to propose long-lasting designs and construction techniques by allowing construction companies to take contractual responsibility for maintenance beyond the current five-year limitation as part of the initial contract award.
- Remove limitations on design-build contracting by striking both the yearly limit of three, eliminating the minimum size of \$150 million, and the requirement for designs to be 30% complete before going out to bid.

#### Resources

<u>Texas Transportation Funding, Including Texas Clear Lanes and Congestion Relief Update</u>, Texas Department of Transportation (March 2018).

<u>Unified Transportation Program 2018</u>, Texas Department of Transportation (Aug. 2017).

*Texas Department of Transportation Annual Financial Report, FY 2017*, Texas Department of Transportation (Dec. 2017).

*The Road Forward: Improving Efficiency in Texas Transportation Spending* by Chuck DeVore, Texas Public Policy Foundation (March 2015).

## **Economic Stabilization Fund**

#### The Issue

Production of crude oil and natural gas has historically fluctuated based on a number of market-driven and geopolitical factors. Because the Texas Legislature collects severance taxes from this volatile production to primarily fund the state's Economic Stabilization Fund (ESF), broadly considered the state's "rainy day fund," the purpose for and use of the ESF must be worthy.

Texas voters approved the ESF with passage of a constitutional amendment in 1988 after an uncertain state revenue period when oil and gas comprised a large share of economic output and was highly volatile in the 1970s and 1980s. The ballot language that Texans approved was "The constitutional amendment establishing an economic stabilization fund in the state treasury to be used to offset unforeseen shortfalls in revenue." The Texas Constitution requires a three-fifths vote in each house to close a revenue shortfall and a two-thirds vote in each house to use it for other reasons.

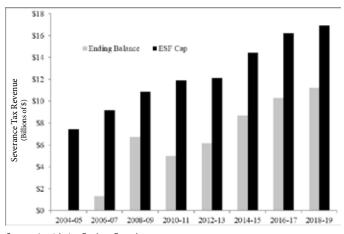
The ballot language sold to Texas is clear that this money is to fill unexpected revenue declines. However, only 27.4%, or \$3.2 billion, of the \$11.6 billion spent from the ESF since inception has been for general deficit reduction. In 2013, \$4 billion of ESF dollars were appropriated to fund expenditures for education and Medicaid above what was appropriated in 2011. Texans approved amendments in 2013 to take \$2 billion from the ESF to pay for water projects and in 2014 to direct a portion of severance taxes to the State Highway Fund (SHF) instead of the ESF. In 2017, the Legislature appropriated \$1 billion from the ESF primarily for state facilities (\$778 million) but also for disaster relief and one-time grants to local entities. Clearly, a more stringent use of the fund outside of its intended purpose is warranted.

Despite the use of severance taxes for one-time and ongoing expenditures, the ESF's balance is expected to be \$11.9 billion at the end of the 2018-19 budget cycle. Given the ESF's constitutional limit of 10% of general revenue (GR)-related funds excluding interest and investment income in the previous budget cycle, the cap this period is \$16.9 billion. The **Figure** (next page) shows ESF dollars are likely to rise to the highest cap share of 70% compared with only 14% in the 2006-07 period.

These funds are a one-time resource to the state. The cap of 10% on biennial GR-related funds is really a 20% annual cap. Every dollar not in the private sector without a clear purpose is wasting potential productivity that could help Texans prosper, so these dollars should be used wisely and not be excessively collected. Moreover, the state's economy and therefore tax revenue is much less reliant on oil and gas activity as previously experienced. Research shows that Texas could have a biennial cap closer to 7%, or annually 14%, to cover the most severe fiscal downturns, which should primarily be solved with spending restraint. Alternatively, if this money is spent each session, the ESF will quickly dwindle, and the state's credit rating could be at risk.

Using one-time funds to pay for ongoing expenditures only delays needed difficult decisions that should be made with general revenue funds and depletes one-time funds available for revenue shortfalls, future emergencies, or tax relief. In addition, using ESF funds for investment purposes that could support a higher

#### Economic Stabilization Fund Reaches Closer to Constitutional Cap



Source: Legislative Budget Board

rate of return to fund unfunded state liabilities without considering major reforms to pensions and reductions to debt first is not recommended. The state should use precious taxpayer dollars to spend within its budget and not tap one-time funds for reasons never approved by Texans.

#### The Facts

- The ESF is expected to increase to \$11.9 billion by the end of FY2019, which would be a record high.
- Using one-time funds to pay for ongoing expenses is poor public policy.

#### Recommendations

- Raise the threshold to use ESF money "at any time and for any purpose" from the current two-thirds of members present to four-fifths of all members in each chamber.
- Lower the constitutional cap from 10% to 7% of biennial GR-related funds in the previous biennium.
- Use excess state revenue above the ESF cap or from budget reductions for tax relief instead of spending or investing it in riskier assets.

#### Resources

<u>Economic Stabilization Fund Overview</u>, Legislative Budget Board (March 2018). <u>Leaky Umbrella: The Need to Reform Texas' Rainy Day Fund by Vance Ginn</u>,

Talmadge Heflin, and Owen Smitherman, Texas Public Policy Foundation (Oct. 2016).

<u>Weathering the Next Recession: How Prepared Are the 50 States?</u> by Erick Elder, Mercatus Center (Jan. 2016).

### **Public Pension Reform**

#### The Issue

or decades, state and local politicians across the nation have overpromised on and underfunded government-run retirement plans, resulting in the accumulation of trillions of dollars in unfunded liabilities. Unfunded liabilities are the difference between promised benefits to future retirees and money available to fund those benefits. In fact, one <a href="study">study</a> pegged total unfunded state and local pension liabilities nationwide at more than \$6 trillion—or \$18,676 per American.

Texas is not immune. State and local governments employ <u>14%</u> of workers. Most of these workers have a defined benefit pension plan that promises a regular payment to retirees regardless of contribution. Underperforming investments and generational accounting issues are exhausting these plans leaving them with mounting, unsustainable liabilities.

Recent analyses documenting the imminent threat posed by unfunded state pension liabilities contributed to the Texas Legislature making several reforms in the last decade, including raising the retirement age and increasing contribution rates, to the two largest state pension systems—Teacher Retirement System (TRS) and Employees Retirement System (ERS). While these are positive first steps, these pension systems should be reformed from defined benefit to defined contribution plans so they are sustainable for beneficiaries and limit the burden on taxpayers.

The Texas Pension Review Board (PRB), the state agency charged with overseeing state and local retirement systems, shows that among the 93 systems monitored by the agency, unfunded liabilities were \$69.3 billion in March 2018. That is an increase in pension debt of \$3.7 billion since August 2017. The funded ratio—a measure of a plan's current assets as a share of its liabilities—averaged 79.8% across all plans. It is generally agreed that a funded ratio of 80% or more signifies a firm financial footing, a ratio many of Texas' systems do not reach.

The seven state public pension plans include the vast majority of total state and local unfunded liabilities to the tune of \$55 billion. The largest state pension plan is TRS with assets of \$147.4 billion, but it is plagued with unfunded liabilities totaling at least \$35 billion and a funded ratio of 80.5%, assuming an 8% annual rate of return. Given the average market valued investment return of TRS is 5.8% for the last 10 years, unfunded liabilities jump to about \$80 billion with a 6% discount rate. ERS is the next largest plan with assets of \$26.4 billion, but again this plan also has massive unfunded liabilities of \$11.3 billion and a funded ratio of only 75.2% with an expected annual return of 7.5%. With the average annual rate of return for the last decade of 5.5%, a more realistic rate of 6% brings the unfunded liabilities up to \$19 billion.

These concerning statistics are driven by underperforming investments and an aging population that make pension reform vital. Recent modifications have bought some time for these plans, but these adjustments do little to change the long-term cost trajectory. Moving Texas' public pension systems away from the defined benefit (DB) system toward a defined contribution (DC) model similar to a 401(k), that is by definition fully funded, would restore sustainability in the system, benefitting both the taxpayers and state employees.

DC plans put the power of employees' future in their own hands instead of depending on the uncertain fortune of government-directed defined benefit plans. Research finds that this transition could come with little to no transaction cost to make them sustainable for beneficiaries long-term while eliminating potentially higher taxes to fund them.

This DB to DC transition could be done by implementing a hard or soft freeze of the pension systems for vested employees, and a hard freeze on enrollment in the current DB plans while enrolling newly hired or unvested employees in a DC plan. Ultimately, whatever the initial transition cost may be, they will be outweighed by the benefits of lower future costs and certainty for state employees and taxpayers that these pensions will be fully funded. With DC plans, retirees will finally have the opportunity to determine how much risk they are willing to accept. They also reduce the risk that the government will default on their retirement or will fund those losses with dollars from taxpayers who never intended to use these pensions.

Because of the efficiency, simplicity, and fully funded nature of DC plans, the private sector moved primarily to them long ago. Doing the same for public pensions would assure state employees that they will receive their retirement funds and assure taxpayers that more of their money will not be at risk.

#### The Facts

- The state's two major retirement systems, TRS and ERS, are at or below the adequate actuarial funded ratio of 80%.
- Texas' retirement systems are legally liable to pay defined benefits totaling 10 to 20 times state employee contributions.
- Defined contribution systems are more sustainable than defined benefit plans since they are fully funded, which is why the private sector moved in this direction.

#### Recommendations

- Freeze enrollment in the current defined benefit system and at least enroll newly hired or unvested employees in a 401(k)-style defined contribution pension plan.
- Lower assumed rates of return to more realistic rates.
- Avoid increasing state spending on public pensions without major reform.

#### Resources

<u>Unaccountable and Unaffordable</u> by Thurston Powers, Erica York, Elliot Young, and Bob Williams, American Legislative Exchange Council (Dec. 2017).

<u>Reducing the Burden of Texas' State Liabilities on Current and Future Generations</u> by Vance Ginn, Talmadge Heflin, and Melissa Schlosberg, Texas Public Policy Foundation (Feb. 2017).

Are There Transition Costs to Closing a Public-Employee Retirement Plan? by Andrew Biggs, Mercatus Center (Aug. 2016).

<u>Reforming Texas' State and Local Pension Systems for the 21st Century</u> by Arduin, Laffer, & Moore Econometrics, Texas Public Policy Foundation (April 2012).

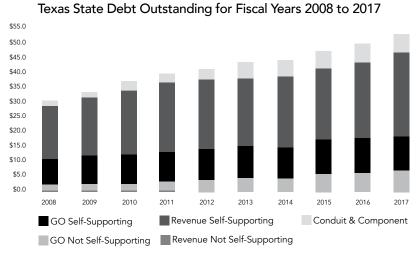
#### State Debt

#### The Issue

Texas has a proven record of financial stability as it ranks fourth best in keeping state debt per capita low among the 10 most populous states. With historically high population growth rates accompanied by economic growth, Texas has remained steadfast even during times of economic uncertainty. Relatively sound fiscal management has provided Texans a certain level of comfort, but increasingly evident signs of vulnerability, such as ranking only 16th nationwide in fiscal health, are raising concerns about the state's financial condition.

Rising state debt and lack of debt transparency will continue chipping away at the public's well-being without key reforms. These issues could jeopardize Texas' AAA credit rating by the three major credit rating agencies since 2013 and place increasing burdens on taxpayers. Providing key reforms to state debt will begin to lessen these burdens and move Texas toward sound fiscal management.

The **figure** below shows that total state debt outstanding increased by 69% to \$53 billion between fiscal years 2008 to 2017, according to the <u>Texas Bond Review</u> Board.



Source: Texas Bond Review Board

This translates into an increase of 66% to \$1,731 owed per person in Texas. Of the total state debt outstanding, there are two types: general obligation (GO) debt and revenue (non-general obligation) debt.

GO debt "is legally secured by a constitutional pledge of the first monies coming into the State Treasury that are not constitutionally dedicated for another purpose" and "must be approved by a 2/3 vote of both houses of the legislature and a majority of Texas voters." This debt may be issued in installments as determined by the legislatively appropriated debt service or by the issuing agency or institution and often has a 20- to 30-year maturity with level principal or level debt-

#### 2019-20 LEGISLATOR'S GUIDE TO THE ISSUES

service payments. Over the last decade, general obligation debt has increased by 73% to \$18.7 billion.

Revenue debt "includes debt that is secured by a specific revenue source and some lease purchase obligations. Generally, non-general obligation debt does not require voter approval and is not considered 'debt' limited by the Texas Constitution." Revenue debt has increased by 69% to \$34.3 billion during the last decade.

If these trends continue, Texans will be burdened with even higher taxes and fees. Out of the top 10 most populous states, Texas has the fourth highest level of state debt but ranks better at seventh in debt-per-capita. Of the top five most populous states, the three most debt-ridden states are New York, Illinois, and California, which all tend to enact big-government policies.

As a percentage of unrestricted general revenue for the previous three years, the constitutional debt limit (CDL) for debt service payable is 5%. The Texas Bond Review Board shows that debt service on outstanding debt is 1.4% and debt service on outstanding debt and on authorized but unissued debt is 0.9%, both falling below the CDL at the end of 2017. Although things look good on the surface, debt service will cut into spending on other programs and may lead to even higher taxes on Texans, slowing economic prosperity.

Debt outstanding does not tell the whole story. While Texas has done relatively well managing its debt principal, debt service outstanding over the life of debt outstanding is substantially higher than the \$53 billion. The Texas Bond Review Board notes that total debt service outstanding is \$87.2 billion—65% more than the reported principal amount.

By controlling spending and increasing debt transparency, Texans can have a better sense of whether state lawmakers are being good stewards of their tax dollars.

#### The Facts

- From FY2008 to 2017, total state debt outstanding increased by 69% to \$53 billion.
- Total debt outstanding per capita in Texas increased over the last decade by 66% to \$1,731 per person.
- The Texas Bond Review Board notes that total debt service outstanding, which
  includes principal and interest owed, is \$87.2 billion, or roughly \$3,160 per
  Texan.

#### <u>Recommendations</u>

- Provide ballot box transparency by requiring inclusions of total debt service outstanding needed to fully pay the proposed debt on time and an estimate of the proposed debt's influence on the average Texan.
- Scrutinize all budget areas by implementing zero-based budgeting to spend taxpayer money from general revenue funds instead of issuing debt.
- Use surplus taxpayer dollars for tax relief instead of paying down state debt.

continued

# State Debt (cont.)

#### Resources

Reducing the Burden of Texas' State Liabilities on Current and Future Generations by Vance Ginn, Talmadge Heflin, and Melissa Schlosberg, Texas Public Policy Foundation (Feb. 2017).

"Fragility of Texas' State Debt and Public Pensions" by Vance Ginn, Texas Public Policy Foundation (Feb. 23, 2017).

Debt Affordability Study by Texas Bond Review Board (Feb. 2017).

# **Taxes**

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# **Property Tax Reform**

#### The Issue

Texas' property tax is big and fast-growing. In 2016, more than 5,100 local tax jurisdictions levied more than \$56 billion in property taxes, making it the single largest tax imposed in the Lone Star State. Of the total levy, school district taxes accounted for the bulk of the burden at \$29.9 billion followed by cities (\$9.2 billion), counties (\$9 billion), and special districts (\$8 billion). On a per capita basis, Texas' property tax is large enough to collect more than \$2,000 from every man, woman, and child in the state or more than \$8,000 from a family of four.

Property taxes in Texas are not only substantial, but the burden is also growing quickly.

Property Taxes by Unit Type, Fiscal Year 2016

|                   | 2015 Property Tax<br>Levy | 2016 Property Tax<br>Levy | % Levy Change<br>from 2015 to 2016 | 2016 %<br>of Total |
|-------------------|---------------------------|---------------------------|------------------------------------|--------------------|
| School Districts  | \$28,176,465,862          | \$29,856,267,794          | +5.96%                             | 53.24%             |
| Cities            | \$8,380,435,861           | \$9,165,214,426           | +9.37%                             | 16.34%             |
| Counties          | \$8,696,387,395           | \$9,027,417,995           | +3.81%                             | 16.10%             |
| Special Districts | \$6,954,137,406           | \$8,031,407,848           | +15.49%                            | 14.32%             |
| Total             | \$52,207,426,524          | \$56,080,308,063          | +7.41%                             | 100%               |

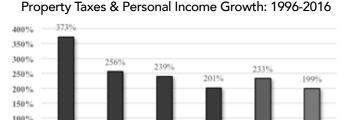
Source: Texas Comptroller of Public Accounts

From 1996 to 2016, local government tax levies grew by more than 230%. Among the different taxing units, special district taxes increased the most at 373%, followed by counties (+256%), cities (+239%), and school districts (+201%). In comparison, personal income increased just 199% which, in some cases, is dramatically lower than the rate of tax increases. This imbalance is an indication that taxes are growing faster than Texans' ability to afford them.

The consequences of high and fast-growing property taxes are numerous. Studies suggest that oppressive taxes can discourage economic growth and activity, distort investment decisions (especially among capital intensive industries), and depress job creation. It is critical that Texas lawmakers take steps to mitigate these negative effects with substantive policy reforms.

One proposal worthy of serious consideration is a property tax trigger which, if designed properly, will better control how fast the burden grows and will allow for greater public participation.

Under this proposal, all political subdivisions of the state would be required to seek voter approval for adopting tax rates that allow property tax revenues to grow in excess of 2.5% compared to the previous year. Additionally, a two-thirds supermajority vote should be required to ratify any increase above 2.5%. Structured in this way, the proposal would place the onus on local officials to convince a broad cross-section of voters on the need to excessively increase already-high property tax bills.



Total Tax

Levy

Personal

Income

School

Districts

Source: Texas Comptroller of Public Accounts and the U.S. Census Bureau

Cities

Counties

Structural reforms, like the one above, are key to creating a more predictable and sustainable tax environment that is necessary for ongoing economic growth and job creation. Without these kinds of long-term taxpayer protections in place, Texans will continue to struggle under the weight of an oppressive property tax system.

#### The Facts

50% 0%

Special

Districts

- In fiscal 2016, more than 5,000 local tax jurisdictions hit homeowners and businesses with tax bills totaling \$56.1 billion.
- On a per capita basis, Texas' property tax is large enough to collect more than \$2,000 from every man, woman, and child in the state or more than \$8,000 from a family of four.
- From 1996 to 2016, Texas' property tax grew by 233%. In comparison, personal income only increased by 199%.

#### **Recommendation**

Require voter approval for property tax rates that result in property tax revenue increases of more than 2.5%.

#### Resources

*The Freedom to Own Property: Reforming Texas' Local Property Tax* by Kathleen Hunker, James Quintero, and Vance Ginn, Texas Public Policy Foundation (Oct. 2015).

# Eliminating the School M&O Property Tax

#### The Issue

Texas has some of the highest property taxes in the nation. In 2014, the Tax Foundation reported that Texas had the sixth highest effective property tax rate. In 2016, more than 5,100 local tax jurisdictions levied \$56.1 billion in property taxes, or \$2,000 on average for every Texan—man, woman, and child. And property taxes continue to increase. The overall property tax levy increased by 233% between 1996 and 2006, while personal income only increased by 199%. Texans risk losing their house—and sometimes do—because of an out-of-control growth of local governments. An excessive growth of government also discourages investment, job creation, and economic growth in general.

Out of the total property tax levy (from all local governments), school districts' maintenance and operations (M&O) property tax revenues represented almost half of the burden to taxpayers in 2016. The M&O tax levy amounted to nearly \$25 billion in 2018. Although the state has explored options to reduce the overall property tax burden, one obstacle has remained: The Texas Constitution prohibits the state from levying a property tax.

Nonetheless, multiple legislatures explored different options. One of them was raising the homestead exemption for school district property by \$10,000, first in 1997 and again in 2015. These exemptions may have benefited those with a homestead but not those without. The overall property tax burden also continued to increase.

In 2006, the Legislature tried to reduce property taxes and increase state funding for education by increasing the Texas franchise tax, the motor vehicle sales tax, and taxes on tobacco products. The goal was to use the additional revenue, combined with changes in the school funding formulas and property tax caps to both bring the school finance system into compliance with the Texas Constitution (the Texas Supreme Court had ruled the system unconstitutional in 2005) and provide relief to property taxpayers. This solution failed to bring effective, broad-based, and long-term relief to Texans.

A different approach could bring relief to property taxpayers and limit government growth. This approach encourages state and local governments to exercise fiscal restraint through tax and expenditure limits to progressively eliminate the M&O tax while reducing the growth of government. The state surplus created could be used to replace the M&O tax.

Using the past rate of growth (10.08%) of general revenue-related (GRR) state revenue, Texans could eliminate district-level education M&O taxes and cut property taxes almost in half in as little as 11 years. This can be accomplished by restraining state spending growth to 4% biennially and using 90% of the surplus state revenue this produces to ratchet down local property tax rates. Under this plan, every dollar not spent by the state or school districts would produce a 90-cent property tax cut for Texans.

Within the 4% limit on GRR appropriations growth, the Legislature could appropriate money for any purposes legally available, including education funding. If circumstances required for the plan to be adjusted—e.g., due to lower-than-expected economic growth, or a natural disaster that would require additional

#### 2019-20 LEGISLATOR'S GUIDE TO THE ISSUES

spending—the Legislature could exceed the appropriations limits and/or reduce the property tax replacement surplus by a majority vote of both houses. If the property tax replacement payment was reduced during certain years, the replacement plan would be extended but would continue until full elimination of the M&O property tax.

At the local level, each year school districts would set their M&O tax rate to reduce property tax revenue by the same amount they received from the state's replacement funding. On average, property taxpayers in districts across the state would see the same percent reduction in their taxes, though that might vary from one district to another. At the end, every taxpayer's M&O property tax burden would be equal to zero.

If school districts wanted to exceed the replacement rate, they could do it with the approval of a majority of voters in an election with at least a 20% turnout. However, additional funds raised through a voter-approved tax increase would be fully recaptured by the state. So all increases in education funding each year under the plan would come from the state.

#### The Facts

- Texas has one of the highest property tax burdens in the nation. The Tax Foundation ranked the state's effective property tax rate sixth highest in 2014.
- Texas school districts' M&O property tax accounts for almost half of the overall property tax burden, representing nearly \$25 billion in 2018.
- Only local governments in Texas can levy a property tax. The Texas Constitution prohibits the state from levying the tax.
- Past attempts by the Legislature to provide relief to property taxpayers by increasing the homestead exemption or by increasing other taxes have failed.
- The overall property tax levy increased by 233% between 1996 and 2006. Personal income increased by only 199%.

#### Recommendations

- Restrain state spending growth by imposing a limit of 4% on GRR appropriations growth.
- Restrain local government spending growth by imposing a limit of 2.5% of property tax revenue growth.
- Use the surplus generated by the new state spending restraint to progressively replace and eliminate the M&O property tax, while school districts progressively decrease their M&O property tax rate by the replacement rate.

#### Resources

Abolishing the "Robin Hood" School Property Tax by Kara Belew, Emily Sass, and Bill Peacock, Texas Public Policy Foundation (June 2018).

# Margins Tax

#### <u>The Issue</u>

o matter how you evaluate Texas' business franchise tax, commonly called the "margins tax," it fails the least-burdensome-tax test and fails to allow Texans the opportunity to flourish. This broad-based, gross-receipts-style margins tax is far more complex and unique among all taxes nationwide—with only Nevada having a similar gross-receipts-style tax. Eliminating this onerous tax would best serve Texans.

Businesses do not pay taxes; people do, in the form of higher prices, lower wages, and fewer jobs available. Given taxes exist to fund only the preservation of liberty, the least burdensome taxes should fund conservative budgets that grow, if at all, by no more than population growth plus inflation.

The margins tax is inherently complex with multiple calculations to determine the lowest tax liability, two tax rates depending on business type, and the \$1 million gross revenue exemption. Complying with it is also markedly different from complying with the federal corporate income tax; as a consequence many firms must keep separate financial books. Because of these substantial costs, firms can spend more on compliance than their actual tax liability.

The 84th Texas Legislature <u>cut</u> the margins tax by \$2.6 billion by reducing the rates by 25% and raising the ceiling to file with the E-Z computation to \$20 million at a lower tax rate. This cut not only reduced the size of government, but employers also have more money to invest and hire workers.

Studies modeling the dynamic economic effects of phasing out or repealing the margins tax find substantial economic benefits, including thousands of net new private sector jobs and billions of dollars in net new personal income statewide.

The Foundation's <u>research</u> includes a dynamic economic model that accounts for burdens on the private sector of paying annual margins taxes and complying with the tax. The estimated results of full elimination of the margins tax within the first five years compared with the status quo include:

- More prosperity: Texas could gain \$16 billion in new inflation-adjusted total personal income.
- More jobs: Net new private sector nonfarm employment in Texas could increase by 129,200 jobs.

While eliminating the margins tax will enhance Texans' prosperity, the stakes are much higher than just one state. This transformational policy would make Texas a leader for America—and even the world—in tax policy. For example, this would allow Texas to join just South Dakota and Wyoming without a general business tax or individual income tax.

Getting rid of the margins tax should be done no matter the budget situation. While cutting the tax may result in a short-run drop in tax revenue, the associated dynamic increase in economic activity will likely generate additional tax revenue through other taxes that could replace some, if not all, of the drop. In addition, spending restraint will ease the path to elimination.

If immediately eliminating the margins tax is not possible, phasing out the tax over a couple of budget cycles would be a valuable alternative. Of course, phasing it out reduces the potential full economic gains because of the compliance costs that remain. If the phase-out option is chosen, lowering the tax rates for all firms is preferable to raising the revenue exemption threshold that forces the burden on fewer firms.

#### The Facts

- Texas' margins tax is complex, costly, and difficult to comply with, giving rise
  to a less competitive business tax climate, for which the <u>Tax Foundation</u> ranks
  Texas 13th overall and second worst in the corporate tax ranking.
- Texas does not have a revenue problem. Between the 2004-05 to 2018-19 budgets, the state's estimated total tax collections increase is 97%, much faster than the 63% increase in population growth and inflation.
- The margins tax fails to be a least burdensome tax and to allow Texans the opportunity to prosper.

#### Recommendations

- Eliminate the business margins tax. Potential budget surpluses, more tax revenue from new economic growth, and spending restraint should fund this without imposing a new tax.
- Pass a bill requiring a supermajority (two-thirds) vote of each chamber to raise taxes or implement a new tax.

#### Resources

*Texans Prosper from Eliminating Business Franchise Tax* by Vance Ginn, Texas Public Policy Foundation (April 2017).

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

Economic Effects of Eliminating Texas' Business Margin Tax by Vance Ginn and Talmadge Heflin, Texas Public Policy Foundation (March 2015).

*The Texas Margin Tax: A Failed Experiment* by Scott Drenkard, Tax Foundation (Jan. 2015).

# Supermajority Requirement to Raise Taxes

#### The Issue

**B**ecause taxes burden Texans, legislators should not raise taxes unless there is a broad consensus. The challenge for conservatives is to develop a tax system that collects sufficient revenue to pay for the preservation of liberty while doing the least economic harm to Texans.

The state's current tax system is projected to collect \$\frac{\$107.1 \text{ billion}}{107.1 \text{ billion}}\$ in 2018-19, 97% more than the \$\frac{\$57.8 \text{ billion}}{107.1 \text{ billion}}\$ it collected in 2004-05. By comparison, the compounded growth rate of population and inflation over this period is expected to be only 63%. This suggests that the tax system collects more tax revenue than taxpayers should afford, reducing economic growth and job creation.

The state tax that generates the most revenue is the sales tax; it is expected to account for 58% of total tax collections in 2018-19. Compared with other major taxes, research finds the sales tax is the least intrusive, allows more choices, and is simple to understand and administer. Hence, a sales tax is the most efficient while causing the least economic harm.

Fortunately, Texas does not have a personal income tax. <u>Research</u> shows that the past 10-year economic performance of the nine states without an income tax surpasses that of the nine states with the highest personal income tax rates and the 50-state average.

To limit rising tax burdens on Texans, lawmakers should pass legislation requiring a two-thirds supermajority of the Legislature to raise taxes instead of the current simple majority threshold. Texas lags behind 14 states on a voting threshold for raising taxes, according to the National Conference of State Legislatures.

For multiple sessions, <u>Senate Joint Resolution 27</u> was filed but never passed. It would have achieved the goal of requiring a supermajority vote "for passage of a bill that imposes a new state tax or increases the rate of an existing state tax above the rate in effect on the date the bill was filed."

Considering taxes affect taxpayers and with so much at stake—jobs, the economy, and Texans' financial well-being—legislators should enact a higher threshold to raise taxes or pass a new tax.

## The Facts

- A sales tax is preferable because it is simple, transparent, and levied only on the end-user.
- The 10-year economic performance of the nine states without a personal income tax surpasses the economic performance of the nine states with the highest personal income tax rates.
- Because taxes burden Texans, they should be raised with only a broad consensus.

## Recommendations

- State and local governments should rely on the sales tax as their main source of revenue.
- Pass legislation requiring a supermajority (two-thirds) vote in each chamber to raise taxes or create a new tax.

#### Resources

*The Freedom to Own Property: Reforming Texas' Local Property Tax* by Kathleen Hunker, James Quintero, and Vance Ginn, Texas Public Policy Foundation (Oct. 2015).

<u>How Big Government Hurts the Economy</u> by Chuck DeVore, Nicholas C. Drinkwater, Arthur B. Laffer, and Stephen Moore, Texas Public Policy Foundation (Nov. 2013).

<u>Testimony Regarding Senate Joint Resolution 27</u> by Talmadge Heflin, Texas Public Policy Foundation (April 22, 2013).

# Personal Income Tax

## The Issue

Although no one likes to pay taxes, they are an inevitable part of funding government. A policymaker's challenge is to develop an efficient tax system providing necessary revenue while doing the least economic harm. A policymaker should note that not all methods of collecting taxes are created equal.

While each tax affects behavior differently, a personal income tax is among the most pernicious because of the negative effects it has on earnings, productivity, and wage gains. Because of these adverse effects, people are generally unable to save and consume as much as they would have otherwise.

What's more, a personal income tax requires a particularly large bureaucratic apparatus for tax collection purposes, much more so than for the collection of a sales tax. With more bureaucracy comes additional costs for taxpayers, resulting in higher taxes and fees.

No personal income tax is ideal for state lawmakers, as there are other ways to collect taxes without incurring such harmful economic effects or enlarging bureaucracy. And to its credit, Texas is one of only nine states without a personal income tax. While some argue that a broad-based personal income tax is needed to improve the state's overall outlook, this raises the question: How has Texas' economy performed without an income tax?

Texas' state and local tax burden ranks fifth lowest nationally, according to the Tax Foundation's latest <u>report</u>, placing it among the best states for taxpayers. Because of the state's comparatively friendly tax environment, Texas' private sector economy has surged forward. For example, Texas' employers created the largest share of U.S. jobs with 25% of all civilian jobs created nationwide from December 2007 to December 2017. Given the best path to prosperity is a job, Texas is certainly doing something right.

Research also finds major differences among the nine states without a personal income tax compared to the nine with the highest marginal personal income tax rates and the 50-state average. The **Chart** on the following page shows that in every category examined, the states without a personal income tax performed better than those with the highest income tax rates and, except for gross state product, the U.S. averages, often by a wide margin.

Based on economic principles and empirical data, Texas' economic prospects for its residents are best served by the current low tax, pro-growth approach rather than a new personal income tax.

## The Facts

- Texas is one of nine states without a personal income tax.
- Income taxes substantially damage a state's economy because they disincentivize savings, investment, productivity, job creation, and economic expansion.
- The nine states without a personal income tax outperformed the nine states with the highest marginal income tax rates and 50-state average in most economic areas from 2004 to 2014.

### Nine States with the Lowest and Highest Marginal Personal Income Tax (PIT) Rates (10-Year Economic Performance)

|   | As of 1/1/2017                   | 10-Year Growth |            |                    |                        |                               |  |
|---|----------------------------------|----------------|------------|--------------------|------------------------|-------------------------------|--|
|   |                                  |                | 2004-2014  |                    |                        |                               |  |
| State   | Top Marginal<br>Earned PIT Rate® | Population     | Employment | Personal<br>Income | Gross State<br>Product | State & Local Tax<br>Revenuel |  |
| Alaska  | 0.00%                            | 9.9%           | 3.1%       | 48.8%              | 13.5%                  | 135.1%                        |  |
| Florida   | 0.00%                            | 13.5%          | 7.5%       | 34.2%              | 24.2%                  | 22.9%                         |  |
| Nevada  | 0.00%                            | 16.5%          | 9.1%       | 27.4%              | 14.9%                  | 38.0%                         |  |
| South Dakota  | 0.00%                            | 10.5%          | 4.5%       | 50.9%              | 48.0%                  | 55.9%                         |  |
| Texas   | 0.00%                            | 19.3%          | 17.6%      | 62.3%              | 48.6%                  | 68.7%                         |  |
| Washington  | 0.00%                            | 14.4%          | 9.2%       | 51.6%              | 48.3%                  | 50.2%                         |  |
| Wyoming   | 0.00%                            | 12.0%          | 5.2%       | 43.1%              | 15.9%                  | 54.7%                         |  |
| New Hampshire§  | 0.00%                            | 2.0%           | 2.9%       | 36.0%              | 29.9%                  | 41.7%                         |  |
| Tennessee§  | 0.00%                            | 9.2%           | 3.7%       | 43.8%              | 37.6%                  | 34.6%                         |  |
| Average of 9 Zero<br>Earned Income Tax<br>Rate States*    | 0.00%                            | 11.9%          | 7.0%       | 44.2%              | 31.2%                  | 55.7%                         |  |
| 50-State Average*   | 5.60%                            | 7.9%           | 4.2%       | 41.0%              | 32.6%                  | 51.3%                         |  |
| Average of 9 Highest<br>Earned Income Tax<br>Rate States* | 10.31%                           | 5.6%           | 3.6%       | 38.6%              | 32.9%                  | 53.1%                         |  |
| Hawaii  | 8.25%                            | 9.1%           | 6.9%       | 42.7%              | 35.2%                  | 68.4%                         |  |
| Maryland  | 8.95%                            | 6.9%           | 6.5%       | 35.1%              | 36.3%                  | 50.6%                         |  |
| Vermont   | 8.95%                            | 0.3%           | -3.0%      | 36.6%              | 27.9%                  | 51.9%                         |  |
| Minnesota   | 9.85%                            | 6.9%           | 4.0%       | 41.4%              | 34.0%                  | 58.5%                         |  |
| New Jersey  | 9.97%                            | 3.3%           | 1.5%       | 32.3%              | 25.0%                  | 45.7%                         |  |
| Maine   | 10.15%                           | 0.6%           | -0.8%      | 30.0%              | 22.7%                  | 25.7%                         |  |
| Oregon  | 10.64%                           | 11.5%          | 9.5%       | 44.7%              | 38.7%                  | 55.4%                         |  |
| New York  | 12.70%                           | 3.4%           | 0.5%       | 40.8%              | 38.0%                  | 63.8%                         |  |
| California  | 13.30%                           | 9.0%           | 7.6%       | 44.1%              | 38.5%                  | 57.7%                         |  |

<sup>\*</sup>averages are equal-weighted

Source: Laffer Associates, U.S. Census Bureau, Bureau of Labor Statistics, Bureau of Economic Analysis

continued

<sup>†</sup> Top Marginal PIT Rate is the top marginal rate on personal earned income imposed as of 1/1/2017 using the tax rate of each state's largest city as a proxy for the local tax. The deductibility of federal taxes from state tax liability is included where applicable.

<sup>‡</sup> State & Local Tax Revenue is the 10-year growth in state and local tax revenue from the Census Bureau's State & Local Government Finances survey. Because of data release lag, these data are 2004 to 2014.

<sup>§</sup> New Hampshire and Tennessee tax interest and dividend income—so-called "unearned" income—but not ordinary wage income. Tennessee's unearned income tax, the Hall Tax, is being phased out.

# Personal Income Tax (cont.)

# **Recommendations**

- Never create a personal income tax in Texas.
- Encourage economic growth by keeping taxes low and adopting pro-growth reforms.

#### Resources

*Do Institutions Matter for Prosperity in Texas and Beyond?* by Vance Ginn, Texas Public Policy Foundation (Forthcoming).

*Rich States, Poor States* by Arthur B. Laffer, Stephen Moore, and Jonathan Williams, American Legislative Exchange Council (April 2017).

*How Big Government Hurts the Economy* by Chuck DeVore, Nicholas C. Drinkwater, Arthur B. Laffer, and Stephen Moore, Texas Public Policy Foundation (Nov. 2013).

# **Local Government**

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# **Local Control**

#### The Issue

or years, local governments have been able to forestall state efforts to protect liberty with misleading arguments about local control. Local control is used to justify the position that local government policies should never be limited or checked by the state government—despite the fact that local governments have been created by the state for the purpose of securing liberty.

Further, opponents of state-led reform argue that conservatives are being hypocritical when they preempt local control. Conservatives do not like federal overreach in state affairs, critics charge, so why are conservatives advocating for state meddling in the affairs of political subdivisions?

This argument misunderstands federalism. The federal government was created by the states, with certain enumerated powers delegated to it, for the purpose of better securing liberty for the people of the states. This is why the Tenth Amendment to the U.S. Constitution clearly articulates that those powers not granted to the federal government are reserved for the states and the people within those states. Where the federal government overreaches its delegated powers, the states and the people have an obligation to resist and protect their rights.

Just as the states delegated powers to the federal government to better secure liberty, so the state of Texas has delegated certain powers to local governments to better secure liberty for Texans. It is within this framework of securing liberty that local control must be understood. Local control is a policy tool allowing a greater degree of autonomy to some local governments—such as home rule cities—so that in areas of law where the state is silent, the local government may act under its own authority and initiative.

However, this grant of greater autonomy does not mean the state has abdicated final authority over local governments. As creatures of the state, all local governments are checked and limited by the state. In fact, political thinkers like James Madison have long recognized that smaller governments have a peculiar vulnerability to charismatic leaders and factions, which requires greater vigilance on the part of the larger government. As Madison explained in Federalist No. 10:

The influence of factious leaders may kindle a flame within their particular States, but will be unable to spread a general conflagration through the other States. A religious sect may degenerate into a political faction in a part of the Confederacy; but the variety of sects dispersed over the entire face of it must secure the national councils against any danger from that source. A rage for paper money, for an abolition of debts, for an equal division of property, or for any other improper or wicked project, will be less apt to pervade the whole body of the Union than a particular member of it; in the same proportion as such a malady is more likely to taint a particular county or district, than an entire State.

Following Madison's logic, local governments are particularly susceptible to factionalism and majoritarian abuses of power. So when local governments

abuse their authority and infringe on the people's liberties, the state government has an obligation to step in and safeguard those liberties.

Accordingly, local control must be understood as a policy tool that only makes sense as part of an overriding commitment to liberty. The fact that local governments are closer to the people does not give them permission to invade Texans' constitutional and fundamental rights. Policymakers must insist that like all governmental power, local control must be restrained within constitutional bounds.

#### The Facts

- The states delegated authority to the federal government in order to better secure liberty for the people of the states. The Tenth Amendment of the U.S. Constitution makes clear that those powers not delegated are reserved for the states and for the people.
- Similarly, the states delegated authority to local governments to better secure liberty. Part of that delegation is local control—a grant of greater autonomy to some local governments, like home-rule cities.
- Just like the state and the people have a right and duty to resist overreach by the federal government, the state and the people have a right and duty to resist overreach by the local government.
- Local governments are particularly susceptible to factions and majority-led abuses of individual liberty.

## **Recommendation**

Allow liberty, not local control, to be the overriding principle that informs and directs Texas' public policymakers.

#### Resources

<u>Laredo Merchants Association v. City of Laredo, Texas Amicus Brief</u> by Robert Henneke, Texas Public Policy Foundation (June 2017).

"State Regulation of Cities Does Not Illegitimately Infringe on 'Local Control'" by Thomas Lindsay, Forbes (July 24, 2017).

# Forced Annexation

#### The Issue

unicipal annexation power dates back to the 1912 Home-Rule Amendment to the Texas Constitution. By adopting a home-rule charter, cities with a population of 5,000 or more are given the inherent powers of self-government. Therefore, home-rule cities are defined by what they *cannot* do; such municipalities have the authority to exercise any power that is given them by the people and not prohibited by the Constitution or laws of the state.

Since no limit on annexation was expressly stated in the 1912 amendment, cities initially wielded virtually unlimited authority to annex property—including the right to forcibly annex without obtaining consent. However, the Legislature periodically enacted reforms after watching cities abuse their annexation power.

In the 1960s, a land battle between Houston and Pasadena prompted the Legislature to pass the Municipal Annexation Act of 1963. The act limits cities' expansion to a confined buffer zone around the municipality known as the extraterritorial jurisdiction ("ETJ").

Similarly, in 1989, the Legislature created a requirement that cities prepare a municipal annexation plan to extend services to newly annexed areas within four and a half years after annexation. Following Houston's controversial annexation of Kingwood, the Texas Legislature strengthened the requirements for municipal annexation plans, public hearing timelines, and notice requirements.

These earlier annexation reforms made a significant difference in limiting some of the more dangerous parts of annexation authority generally, but did not address the fundamental flaws inherent in the system—the forced, involuntary nature of the process.

This is why the Texas Annexation Right to Vote Act, which became effective on December 1, 2017, was so significant. Under the new law, a city that wants to annex an area at least partially located in a county with a population of 500,000—a "tier 2 county"—must obtain consent from that area via a petition or an election. However, cities in smaller counties—a "tier 1 county" with a population of less than 500,000—can still forcibly annex without obtaining consent.

Tier 1 counties that want to voluntarily come under the new law's protections against forced annexation must undergo a two-step process. First, at least 10% of registered voters in the county must sign a petition to their county commissioners court requesting an election to classify the county as a tier 2 county, in which forced annexation is prohibited. Next, a majority must approve classifying as a tier 2 county at the election.

Last session's monumental reform should be expanded in the next session to give all Texans the right to vote on being annexed. Doing so would bring a permanent end to a tyrannical practice.

## The Facts

 America was founded on the idea that citizens cannot be deprived of their liberty without representation and due process. The injustice of "taxation

without representation" is not rectified by giving a citizen the right to vote after the government has already taken his or her money.

- Citizens who prefer a smaller government and fewer central services live outside the city limits for a reason. Forcing citizens to become part of a city denies them the ability to vote with their feet.
- Cities view annexation as a way to expand their tax base and capture additional revenue, whether or not such annexation increases efficiencies.
   Wealthier suburbs are thus favored for annexation, although poorer areas outside of the city limits can oftentimes benefit more from municipal annexation since these communities frequently lack sufficient services.
- Forced annexation is unjust, no matter the size of the county in which the
  annexation is taking place. Like all governments, cities derive their authority
  from the people who formed them to secure life and liberty. No city should
  force annexation onto people residing outside its limits without first getting
  their consent.

#### Recommendation

Eliminate the distinction between large and small counties in the Texas Annexation Right to Vote Act, and prohibit forced annexation everywhere in Texas.

#### Resources

*Toward Annexation with Representation* by Bryan Mathew, Texas Public Policy Foundation (Feb. 2018).

*Ending Forced Annexation in Texas* by Jess Fields and James Quintero, Texas Public Policy Foundation (July 2015).

*The Philosophical Case Against Forced Annexation* by James Quintero and Jess Fields, Texas Public Policy Foundation (July 2015).

# Extraterritorial Jurisdiction (ETJ) Reform

#### The Issue

Cities have been abusing their authority by imposing regulations within the extraterritorial jurisdiction without a legislative grant of authority. Further, the scope of municipal authority within the ETJ should be re-examined in light of the recently passed Texas Annexation Right to Vote Act, which moves toward a model of annexation with representation in order to better safeguard property rights and the principle of the consent of the governed.

The history of municipal ETJ is closely tied to the history of municipal annexation. Cities like Houston and Pasadena were aggressively and forcibly annexing neighboring areas in the 1940s and 1950s and could annex right up to the corporate borders of a neighboring city.

In response, the state of Texas reformed the annexation process with the Municipal Annexation Act of 1963. The reformed process still permitted unilateral municipal annexation but confined annexation to within certain designated, unincorporated areas contiguous to the city's corporate boundaries.

The geographical extent of the city's ETJ ranges from one-half mile to five miles, depending on the number of inhabitants of the city. By state law, a city's ETJ can only expand through annexation, landowner request, or an increase in the city's number of inhabitants.

Moreover, Texas statutory provisions give cities certain limited, specific regulatory powers within the ETJ, including plat and subdivision regulatory authority; sign location and removal; creation powers over industrial districts, planned unit development districts, and municipal drainage utility systems; and the imposition of impact fees for water and wastewater facilities and stormwater, drainage, and flood control facilities. These legislative grants of power are not located in any one source of authority, but scattered throughout the Texas statutory code.

Texas cities have gone beyond these limited, authorized powers and thereby abused their authority. For example, cities have been enforcing their building codes in the ETJ, despite the lack of constitutional or statutory authorization.

In *Town of Lakewood Village vs. Bizios*, the Town of Lakewood Village argued that state law either expressly or impliedly granted it the authority to enforce its building codes in the ETJ. After examining the relevant statutes, the Texas Supreme Court disagreed and held that the Legislature did not grant this authority.

In response, home-rule cities have argued that their power to enforce building codes in the ETJ does not come from a legislative grant of authority but from the Texas Constitution through the Home Rule Amendment of 1912, which gives them the full power of self-government. In *City of McKinney v. Custer Storage*, the Texas Fifth Court of Appeals rejected this argument, holding that a city does not have inherent authority to enforce building codes in the ETJ—instead, regulatory power in the ETJ must come from a legislative grant of authority.

While the courts are beginning to restrain cities' abuses of authority within the ETJ, these examples should prompt a reconsideration of the scope of municipal authority in the ETJ altogether. The ETJ was created in the context of unilateral,

forced municipal annexation without consent. With the passage of the Texas Annexation Right to Vote Act, that assumption no longer holds for much of the state.

The same objections that moved the state to curtail forced municipal annexation apply with equal force against city regulation of the ETJ: Texans in the ETJ must comply with regulations of their private property by a city government they cannot hold politically accountable. This is both a threat to private property rights and the principle of consent of the governed. Accordingly, lawmakers should identify every legislative grant of regulatory power to cities in the ETJ and re-examine whether such authority is appropriate, or whether it should be eliminated.

Further, Texans in the ETJ need to know that they are responsible for complying with regulations to a city government they do not elect. Therefore, property owners in an area that would be included in the newly extended ETJ as a result of a proposed annexation should be given written notice of the city's scheduled annexation hearings, along with a list of the ordinances that would apply in the ETJ.

#### The Facts

- The Municipal Annexation Act of 1963 created the concept of municipal ETJ, and a city's authority within its ETJ is restricted to those powers specifically granted by the state.
- Cities have been abusing their authority by imposing regulations that were not granted by the state, such as enforcing building codes in the ETJ.
- The passage of the Texas Annexation Right to Vote Act moved the state from a model of "forced annexation" toward a model of "annexation with representation." In light of that change, the rationale and scope of city powers within the ETJ should be re-evaluated.

#### **Recommendations**

- Identify every legislative grant of authority to cities in the ETJ, and determine whether such authority is still needed, or whether it should be eliminated.
- Require cities to give written notice to property owners that are newly included in the ETJ when the ETJ expands through annexation or an increase in the number of the city's inhabitants. This notice should include a list of municipal ordinances that would apply in the ETJ.

#### Resources

Town of Lakewood Village v. Bizios, 493 S.W.3d. 527, 530 (Tex. 2016).

City of McKinney v. Custer Storage, No. 05-17-00546-CV (Tex.App.-Dallas 2018).

*Toward Annexation with Representation* by Bryan Mathew, Texas Public Policy Foundation (Feb. 2018).

*Ending Forced Annexation in Texas* by Jess Fields and James Quintero, Texas Public Policy Foundation (July 2015).

# **Local Spending**

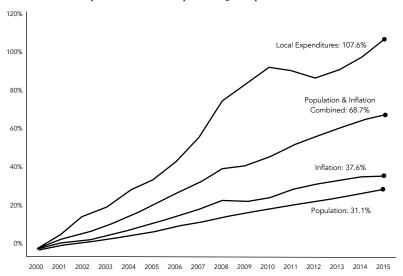
## The Issue

ocal government spending is growing faster than the ideal. In 2000, Texas' local governments spent a total of \$66 billion, according to the U.S. Census Bureau's *State and Local Government Finance*. By 2015—the latest available data—aggregate local spending had risen to \$137 billion, equating to a 108% increase over the period.

While some level of expenditure growth is to be expected—especially in a fast-growing state like Texas—the current trajectory is well above conservative guidelines.

From 2000 to 2015, Texas' population grew from 20.9 million to 27.5 million, representing an increase of 31%. Concurrently, the rate of inflation increase, as measured by the Consumer Price Index (U.S. All items, 1982-84), was just 38%. Combined, population and inflation grew at a modest pace over the period, at around 69%. The evidence clearly suggests that actual and ideal growth rates are going in much different directions.

#### Growth Comparison: Local Spending, Population, and Inflation



Source: U.S. Census Bureau, Bureau of Labor Statistics

Local spending is growing faster than it should, and, as a consequence, it is fostering an environment of higher taxes and bigger debt. After all, persistently high levels of government spending have to be provided for somehow.

The fiscal problems prompted by local overspending are obvious. Texas is home to some of the nation's highest property taxes and some of the largest local debt. In fact, studies suggest that Texans pay the sixth highest property tax in the nation, and its local debt per capita ranks as the second largest among the top 10 most populous states.

Restraining the growth of local spending is critical if Texas wants to remain the nation's economic engine. To that end, here are two ways to begin getting a handle on the problem.

First, lawmakers should expand Texas' constitutional Tax and Expenditure Limit (TEL) to include spending by all types of local governments, i.e., cities, counties, school districts, and special districts. Right now, Texas' TEL only applies to certain types of state government spending; however, with modest changes, it could be broadened to apply those same limitations locally too. There's no reason that local governments shouldn't be subject to the same good government restrictions that govern by the state.

Second, lawmakers should require all mid- and large-sized local governments to undergo a private sector-led efficiency study similar to President Ronald Reagan's Grace Commission. Unleashing the creativity and ingenuity of executives and entrepreneurs on Texas' local governments has the potential to be a real game-changer—one that can help free up much-needed resources to eliminate waste, slow down the growth of taxes and debt, and improve public services. Moreover, it will put fresh eyes on old problems to imagine new solutions.

Dr. Arthur Laffer, one of President Ronald Reagan's chief economic advisors, said it best: "Government spending is taxation." If the Texas Model of low taxes and limited government is to be maintained well into the future, then it is critical that policymakers take proactive steps to tackle this big and growing problem.

#### The Facts

- Local government spending totaled \$66 billion in the year 2000. By 2015, aggregate local spending had grown to \$137 billion, an increase of 108%. Over the same period, population and inflation grew only 69%.
- The accelerated rate of local spending growth helps, in part, to explain the high and fast-growing nature of property taxes in Texas.

# Recommendations

- Texas' constitutional spending limit should be expanded to include expenditures made by all political subdivisions of the state.
- Certain local governments should be made to undergo a private sector-led efficiency study.

#### Resources

<u>Legislator's Guide to the 85th Legislature: Special Session 2017, Local Spending Limit</u>, Texas Public Policy Foundation (July 2017).

"Harvey Presents a Chance to Re-examine Role of Government" by James Quintero, *Austin American-Statesman* (Oct. 30, 2017).

# Local Debt

#### The Issue

Texas' local governments are awash in red ink. In fiscal year 2017, the principal amount owed by cities, counties, school districts, and special districts totaled \$216.6 billion. That's enough government debt to send a bill to every man, woman, and child in Texas for \$7,650 or saddle a family of four with \$30,600. Of course, this ocean of red ink is even greater when interest is taken into account. Texas' total local debt burden—or the amount required to fully repay all of the principal and interest owed—stood at more than \$338 billion in fiscal year 2017. On a per capita basis, that's enough of an obligation to charge every Texan \$12,000 or cost a family of four \$48,000.

Two types of governmental entities are most responsible for Texas' debt load—school districts and cities. According to the Bond Review Board, school district debt totaled \$126.6 billion or \$23,624 owed per student, while city governments owed a combined \$106.8 billion or \$9,766 per household. Together, school district and city debt accounts for almost 70% of the overall total.

Local Debt Service Outstanding in Texas as of August 31, 2017
(Preliminary subject to change)\*

|                                       | Principal         | Interest**        | Total Debt Service |
|---------------------------------------|-------------------|-------------------|--------------------|
| Public School Districts               | \$79,762,562,383  | \$46,843,798,969  | \$126,606,361,352  |
| Cities, Towns, Villages               | \$71,028,163,478  | \$35,737,606,928  | \$106,765,770,406  |
| Water Districts & Authorities         | \$26,865,352,886  | \$12,482,396,074  | \$39,347,748,960   |
| Other Special Districts & Authorities | \$16,974,656,620  | \$15,350,565,438  | \$32,325,222,059   |
| Counties                              | \$13,751,842,460  | \$6,285,477,218   | \$20,037,319,678   |
| Community & Junior Colleges           | \$4,870,465,597   | \$2,391,584,328   | \$7,262,049,924    |
| Health/Hospital Districts             | \$3,355,067,698   | \$2,431,545,589   | \$5,786,613,287    |
| Total                                 | \$216,608,111,122 | \$121,522,974,544 | \$338,131,085,666  |

<sup>\*</sup>Excludes commercial paper. Excludes conduit debt (some of which was included in prior years).

Source: Bond Review Board

It's not just the size of local debt that is troubling, but also the rate at which it is accumulating. Since 2000, local government debt has grown by 168%. By comparison, traditional economic measures like population and inflation have risen a combined 78%. The delta indicates that there's a measurable difference between the actual rate of growth and the ideal.

The size and growth of local government debt presents policymakers with a major challenge. Left unchecked, the status quo promises to saddle future generations with enormous obligations, unleash higher taxes today, slow economic growth and business investment, and trigger credit rating downgrades.

While there's no silver bullet solution, a number of ways can help Texas localities get back on firmer footing, including:

• Informing Voters at the Ballot Box. Require each new bond proposition to

<sup>\*\*</sup>Excludes Build America Bond subsidy

include an estimate of the additional tax burden on the average homeowner resulting from its passage. This will give voters a better understanding of the cost of each new proposition.

- Maximizing Voter Participation. Change the law so that all elections with a fiscal impact are held on the November uniform election date. This will ensure maximum voter participation on issues affecting the family budget.
- **Separating Big Ticket Items.** Require that major capital improvement projects, above a certain cost or percentage threshold, be submitted to voters as separate propositions. This will eliminate the "all or nothing" approach seen today and allow for greater community customization.
- Ending "Rolling Polling." Eliminate the practice of moving polling locations during the early voting period. Early voting locations should remain constant throughout an election cycle to avoid even the perception of impropriety.
- Encouraging Fairer Elections. Establish a minimum voter turnout threshold for the approval of new bond propositions or tax rate increases, preventing the process from being dominated by a relatively small percentage of voters.
- Restricting the Use of Unspent Bond Proceeds. Prohibit local governing bodies from using unspent bond proceeds on purposes and projects that were not specified at the time of voter approval. This will safeguard voters' wishes and eliminate temptations.

These reforms as well as others promise to make important process changes that will bring about greater government transparency and accountability. Those elements are absolutely necessary if Texas policymakers are to ever turn the ship and avoid the danger ahead.

## The Facts

- In FY2017, local debt outstanding (principal only) was estimated at \$216.6 billion, or approximately \$7,650 owed per person.
- In FY2017, local debt service outstanding (including principal and interest) was estimated at \$338.1 billion, or approximately \$12,000 owed per person.
- Among the top 10 most populous states, Texas' local debt per capita ranks as the second highest total, behind only New York.

# **Recommendation**

Reform the current local debt structure to inform voters at the ballot box, maximize voter participation, separate big ticket items, end rolling polling, encourage fairer elections, and restrict the use of unspent bond proceeds.

#### Resources

*Red Ink Rising: Local Government Debt* by James Quintero, Texas Public Policy Foundation (March 2017).

*Red Ink Rising in the Lone Star State: FY 2016* by James Quintero, Texas Public Policy Foundation (March 2017).

# **Special Purpose Districts**

#### The Issue

Special purpose districts (SPDs) and authorities are the most abundant types of government in Texas, but their small size and relative obscurity oftentimes mean that they go unnoticed. In fact, their nickname is "invisible governments."

Broadly speaking, SPDs are independent governmental units created for a particular purpose, like removing graffiti; maintaining harbors, boat ramps, and fishing piers; or boosting tourism. Each entity's structure, functions, and governance can vary substantially; however, they are commonly vested with the authority to:

- Impose a property or sales tax;
- Assess fees and other charges;
- Issue bonds and borrow money;
- Contract with other entities;
- Sue and be sued;
- · Acquire, purchase, sell, or lease real or personal property; and/or
- Exercise eminent domain.

Today, there are approximately 3,400 special districts in Texas providing all manner of government goods and services. Of these, independent school districts are the most commonplace. However, there are many different types besides ISDs.

Because of the sheer quantity and inconspicuous nature of special district governments, a number of public policy problems have begun to emerge, including:

- Local government layering. Once created, these entities tend to exist, outside
  of the public consciousness. As such, occasions can arise whereby multiple
  jurisdictions overlap one on top of another which can result in inefficiencies,
  redundancies, and waste.
- Pushing up property taxes. A majority of special districts have the authority
  to levy a property tax. In 2016, special district property tax levies totaled \$8
  billion out of a total levy of \$56 billion. One year prior that levy was just under
  \$7 billion.
- Questions of accountability. There is no comprehensive review mechanism in place to determine if these entities are still providing value to the community. Further, too few transparency requirements exist, giving the public little opportunity to see how their tax money is being spent.

Next session, it will be important for legislators to address these growing problems and more with good government reforms.

## The Facts

- Special districts and authorities are the most numerous and common form of government in Texas. In 2016, there were approximately 3,400 of these entities in existence.
- While ISDs are the most commonly occurring variety, these entities come in all
  different types. Some are focused on providing core services while others are
  more trivial.

• Together, these entities levied property taxes totaling \$8 billion in 2016.

#### Recommendations

- Require special districts to adhere to basic financial transparency standards, such as the public provision of budgets, financial statements, and a check register.
- Create a comprehensive review process for SPDs to undergo periodic assessment.
- For certain districts, include a "sunset" provision that automatically expires the district unless a public vote affirms its continuance.
- Subject all SPDs that levy a property tax to a revenue-trigger requirement.

#### Resources

*Invisible Government: Special Purpose Districts in Texas*, Texas Senate Research Center (Oct. 2014).

2012 Census of Governments, U.S. Census Bureau (Sept. 2013).

# **Local Pension Reform**

### The Issue

Over the years, more than a dozen municipal retirement systems have convinced the Legislature to codify certain parts of their pension plans in state law, such as contribution rates, benefit levels and the composition of their board of trustees. By establishing these provisions in state law, these select few systems have made it difficult to make good government changes locally.

Absent legislative action, many critical features of these state-governed systems cannot be changed or modified by community stakeholders. Instead, a new law must be passed before reforms are realized, which is no easy feat.

Since the Texas Legislature only convenes a regular session for 140 days every other year, community stakeholders only have a short time to achieve reform. This narrow window can be an especially challenging hurdle to overcome for stakeholders who are new to the legislative process or lack the right connections.

Generally speaking, the fossilization of these plans' features has not produced superior results. In fact, according to the Pension Review Board's March 2018 Actuarial Valuations report, the fiscal standing of a majority of these state-governed systems is in poor shape.

Overview of Local Retirement Systems Under State Governance

|  | Unfunded<br>Liability | Unfunded<br>Liability Per<br>Active Member | Discount<br>Rate | Amortization<br>Period | Funded<br>Ratio |
|--|-----------------------|--|------------------|------------------------|-----------------|
| City of Austin Employees' Retirement System      | \$1,168,107,291       | \$128,887                                  | 7.5%             | 31                     | 67.5%           |
| Austin Fire Fighters Relief & Retirement         | \$115,259,156         | \$104,972                                  | 7.7%             | 16.2                   | 88.3%           |
| Austin Police Retirement System                  | \$374,484,500         | \$212,654                                  | 7.7%             | 27.3                   | 66.2%           |
| Dallas Police & Fire Pension System-Combined     | \$2,209,380,724       | \$408,011                                  | 7.25%            | 44                     | 49.4%           |
| Dallas Police & Fire Pension System-Supplemental | \$15,720,295          | \$349,340                                  | 7.25%            | 10                     | 52.9%           |
| El Paso Firemen's Pension Fund                   | \$138,989,515         | \$160,311                                  | 7.75%            | 26                     | 79.2%           |
| El Paso Police Pension Fund                      | \$179,938,283         | \$179,043                                  | 7.75%            | 33                     | 81.1%           |
| Fort Worth Employees' Retirement Fund            | \$1,570,660,433       | \$250,105                                  | 7.75%            | Infinite               | 58.5%           |
| Fort Worth Employees' Retirement Fund Staff Plan | \$1,199,669           | -  | 7.75%            | 10.3                   | 73.7%           |
| Galveston Employees' Retirement Plan for Police  | \$29,145,290          | \$205,249                                  | 8.0%             | 48.7                   | 42.1%           |
| Houston Firefighters' Relief & Retirement Fund   | \$943,914,000         | \$229,719                                  | 7.0%             | 30                     | 80.5%           |
| Houston Municipal Employees Pension Systems      | \$2,123,492,000       | \$179,546                                  | 7.0%             | 30                     | 56.4%           |
| Houston Police Officers' Pension System          | \$1,349,679,000       | \$256,544                                  | 7.0%             | 30                     | 78.3%           |
| San Antonio Fire & Police Pension Fund           | \$408,920,749         | \$107,188                                  | 7.25%            | 13.1                   | 87.9%           |
|  |                       |  |                  |                        |                 |
| TOTAL/AVG.                                       | \$10,628,890,905      | \$209,693                                  |                  | 26.9                   | 68.7%           |

Source: Texas Bond Review Board

Combined, unfunded liabilities for Texas' 14 state-governed systems—which have 50,000 active members—totaled more than \$10.6 billion. The amount of pension debt owed per active member amounted to an average of \$209,693.

Among the systems, 5 of the 14 plans had unfunded liabilities standing in excess of \$1 billion. Twelve of the 14 plans had unfunded liabilities totaling at least \$100

million. Of all the systems, the Dallas Police & Fire Pension System—Combined had the single largest unfunded liability, at \$2.2 billion.

What's more, 10 of the 14 systems had funded ratios below 80%, which can be taken as a sign of duress. Importantly, none of these plans had funded ratios of 100%, which would indicate that they are fully funded and prepared to meet their obligations.

Finally, 10 of the 14 systems had amortization periods in excess of the PRB's recommended timeline of 25 years. Even the PRB's "maximum" recommended guideline of 40 years was exceeded by three systems: the Fort Worth Employees' Retirement Fund (Infinite), the Galveston Employees' Retirement Plan for Police (48.7 years), and the Dallas Police & Fire Pension System—Combined (44 years).

The actuarial evidence makes clear that the hardening of these plans in state law has been to the detriment of health and sustainability. It's time for the Legislature to move away from this model of governance and toward an approach that restores local control of local retirement systems. More specifically, policymakers should restore management and authority over these systems back to the community of their origin, so that stakeholders can implement necessary changes and ensure these systems' long-term viability and recovery.

#### The Facts

- More than one dozen local retirement systems in Texas have engrained certain aspects of their plans in state law, including benefit levels, contribution rates, and the composition of their boards of trustees.
- In the absence of local control, the soundness and sustainability of these pension plans have come into question.
- Unfunded liabilities among these 14 state-governed plans totaled \$10.6 billion or more than \$209,000 owed per active member as of March 2018.

# **Recommendation**

The Legislature should restore local control of local retirement systems under state governance to allow for greater community oversight.

#### Resources

<u>Restoring Local Control of State-Governed Pension Plans</u> by James Quintero, Texas Public Policy Foundation (March 2017).

"A Solution to Our Public Pension Problem" by Vance Ginn and James Quintero, *Forbes* (May 2, 2016).

<u>Senate Bill 152</u> and <u>House Bill 1502</u> of the Regular Session of the 85th Texas Legislature.

# Property Rights and the Local Government Permitting Process

#### The Issue

Current local government permitting is a lengthy, burdensome, and complex process that infringes upon private property rights and violates the foundation and ideals that Texas was built upon. Overall, government regulations can comprise as much as 25% of a unit's final sales price—partly because local governments often change permitting and development rules midway through construction projects.

Imposing additional regulations in the middle of the construction process not only reduces the profit margin for builders, but diminishes the number of units developed and raises the cost of housing and operating a business. For every occurrence in which work is stopped for regulations requiring changes in the project, costs go up, and time that could have been spent building additional units is lost. For buyers, this translates to higher prices and decreased selection—an undesirable outcome for producers and consumers alike.

The number of onerous regulations, repeated checks, and unnecessary reviews that businesses have to pass for permits also generally causes a huge delay within the permit approval process. In Austin, for instance, regulatory delay adds on average 3.5 months to the process, compared to just three weeks of regulatory delay in Denver, Colorado, or less than a week in Raleigh, North Carolina, suggesting that Austin is dragging its feet in the approval of site plans.

In Harris County, the approval process for business permits can cause opening delays for up to six months while trying to comply with unnecessary provisions. In one instance, an individual rented a space to make and bottle fresh juices but was forced to have equipment and amenities completely unrelated to the business, such as grease taps and vent hoods. This caused almost a two-month delay to opening.

The effects of these regulations are not localized; they have far-reaching consequences on the lives of all individuals across the state. The tedious permitting process adds considerable time and costs to many sectors of the economy; it hinders construction projects and imposes undue burdens upon entrepreneurs and companies. This results in delays, higher construction costs, higher housing costs, higher prices paid by consumers, fewer jobs, and less economic growth.

One reason cities can add these costs with impunity is because they are not subject to the Texas Real Private Property Rights Preservation Act (RPPRPA). Passed into law by the Legislature in 1995, RPPRPA allows property owners to receive compensation for loss of property value due to new regulations on land use. Since the act exempts municipalities, none of the cities' zoning and permitting regulations are subject to RPPRPA, rendering the act essentially ineffective.

## The Facts

- Meeting unnecessary criteria for the permitting process causes large delays of up to six months for businesses in certain municipalities.
- A report done in 2015 found that in Austin regulatory delay adds an average of 3.5 months to the already 4-month long permit approval process.

- Due to regulatory delays in the Austin permit review process, which stifles the production of new housing, "between 2004 and 2013 average rents in the Austin area increased by 50% while median incomes increased by just 9%."
- According to the National Association of Homebuilders (NAHB), a nationwide survey of hundreds of single-family home builders found that "government regulations represented 25% of unit's final sales price."
- The Texas Real Private Property Rights Preservation Act, in Section 2007.002, allows property owners to seek compensation for any government action that reduces the market value of private property by 25% or more.

#### Recommendations

- Reduce the regulatory burden that local municipalities have on businesses and building by lowering the time for approval and certain code requirements for permits.
- Prohibit municipal and county governments from imposing new regulations or requirements after property owners have acquired the necessary permits and permission to begin development or construction.
- The Texas Real Private Property Rights Preservation Act should be amended to apply to municipal actions relating to the permitting process.

#### <u>Resources</u>

"Here's what business owners have to say about city, county permitting processes" by Danica Smithwick, *Community Impact Newspaper* (May 19, 2017).

<u>Affordable Housing Starts with Private Property Rights</u> by Kathleen Hunker, Texas Public Policy Foundation (Nov. 2015).

Quantifying the Impacts of Regulatory Delay on Housing Affordability and Quality in Austin, Texas by Megan Elizabeth Shannon, University of Texas at Austin (May 2015).

Zucker Final Report by Paul Zucker, City of Austin (April 2015).

"Austin renters face soaring costs in 'extraordinary market" by Marty Toohey, Austin American Statesman (May 3, 2014).

<u>Private Real Property Rights Preservation Act Guidelines</u>, Texas Attorney General. <u>Private Property Interrupted</u> by Kathleen Hunker, Texas Public Policy Foundation (July 2014).

"Time to Defend Our Property Rights" by Bryan Mathew, Texas Public Policy Foundation (April 28, 2017).

<u>Building a More Affordable Texas</u> by Kathleen Hunker, Texas Public Policy Foundation (Jan. 2016).

"Some businesses say Bee Cave's permitting process is too slow" by Rob Maxwell, Community Impact Newspaper (Feb. 14, 2014).

# The California-zation of Texas: Tree-Cutting Ordinances

#### The Issue

According to the Texas Chapter of the International Society of Arboriculture, about 50 Texas cities—including major population centers like Austin, Dallas, Houston, and San Antonio—have adopted burdensome regulations that restrict or prohibit a property owner's right to prune or remove trees on their land.

The city of Austin requires private landowners to request and receive the city's permission to remove any tree with a trunk diameter of 19 inches or more. Further, Austin forbids the removal of "heritage trees"—trees of particular species with diameters of 24 inches or more—unless the landowner can prove to the city that the tree is diseased, a fire safety risk, or that the tree prevents reasonable development of the land.

The city of West Lake Hills prohibits the removal of any tree except under certain specified conditions. Even when those conditions apply, a city inspector must give approval before trees can be removed to establish a fire safety buffer zone, to make way for new construction, to remove non-native invasive species trees or plants, or even to remove a dead or diseased tree.

Proponents of tree-cutting ordinances argue that the presence of trees can improve property values for the neighborhood as a whole: Trees mitigate flooding impacts, they improve air quality, and they reduce stormwater runoff. Additionally, it is argued that trees provide aesthetic or sentimental value, or that they are key to a community's self-conception. Supposedly, these communal benefits justify prohibiting the removal of privately owned trees.

But this approach to private property flips the Texas legal tradition on its head. Whatever societal benefits they may provide, trees on private property are not a collective resource to be communally managed. They are real property owned by the landowner.

The idea that private property rights include ownership of the natural resources contained within—including timber—dates back to the philosophical articulation of private property ownership itself. As John Locke wrote: "As much land as a man tills, plants, improves, cultivates, and can use the product of, so much is his property."

It is unjust for government to coerce a private owner to use their private property to provide a social benefit without compensation. The state of Texas has long understood this as an issue of justice—Article I, Section 17 of the Texas Constitution states: "No person's property shall be taken, damaged or destroyed for or applied to public use without adequate compensation being made."

If public benefits are being provided by trees on private property, and the public wants to continue to receive those benefits against the wishes of the landowner, then the public should pay for these benefits. Otherwise, property owners should be free to develop their land as they see fit—including trimming and removing all trees and timber.

## The Facts

- Approximately 50 Texas cities have adopted burdensome regulations that restrict or prohibit a property owner's right to prune or remove trees on their land, according to the Texas Chapter of the International Society of Arboriculture.
- It is generally recognized that private property rights include ownership of the natural resources contained with the land. As John Locke states in the *Second Treatise of Civil Government*: "As much land as a man tills, plants, improves, cultivates, and can use the product of, so much is his property."
- Article I, Section 17 of the Texas Constitution states "No person's property shall be taken, damaged or destroyed for or applied to public use without adequate compensation being made."

#### Recommendations

- The Texas Legislature should prohibit local governments from restricting the trimming or removal of trees or timber located on a landowner's property.
- The Legislature should clarify that if a government forces unwanted trees to remain on private land, the government must provide adequate compensation.

#### Resources

<u>Local Overregulation: Tree-Cutting Ordinances</u> by James Quintero, Texas Public Policy Foundation (May 2017).

Section 22.03.303, West Lake Hills Code of Ordinances.

# **Affordability**

### The Issue

The Texas Model of low taxes, light regulation, and respect for private property has empowered Texans to secure the blessings of liberty by keeping the cost of living low and the benefits from private enterprise high. However, Texas cities' burdensome land use regulations weaken property rights and consequently hinder voluntary exchange, price signals, and the ability to profit from one's efforts. One symptom of this regulatory excess is Texas' growing housing affordability problem.

In a May 2018 report, the Texas A&M University Real Estate Center demonstrates that home price growth is outpacing disposable income growth in Texas, negatively impacting housing affordability. The report states that the variation in housing affordability across metro areas is largely due to differing city land use restrictions, which increase land values.

The National Association of Home Builders found that about 25% of the final cost of a new home for sale is attributable to federal, state, and local regulations. Nationally, for every \$1,000 increase in price, about 152,903 households are priced out of the market for the median-priced new home.

In sum, local land use regulations constrain supply and thereby increase housing costs, and for every marginal increase in cost, thousands of Texas households are priced out of the market for a new home. In order to preserve Texas' affordability, lawmakers must pay more attention to Texas' local land use regulations.

Two land-use restrictions in particular deserve a hard look: minimum lot size requirements and mandatory parking minimums. Minimum lot size regulations restrict housing density by mandating the smallest possible area on which something may be built. Parking minimums mandate that a specified set of parking spaces be provided per building based on the government's forecast of the parking demand that would be generated by the buildings' use.

Minimum lot size requirements contribute more than any other land use regulation to restricting the supply and increasing the cost of housing. Similarly, parking minimums artificially restrict density and push up home prices. In each area, there is no reason why market forces would not be better able to determine the adequate size of a lot upon which to build, or the amount of parking that should accompany a building, rather than dubious government forecasts.

But to truly sustain housing affordability into the future, the state must affirm its historic commitment to robust private property rights.

In 1995, Texas passed into law the Texas Private Real Property Rights Preservation Act. A portion of the law addresses regulatory takings: When a government action restricts a property owner's right to use his land, and thereby reduces the property's value by at least 25%, the property owner is entitled to compensation. Unfortunately, the law largely exempts cities from its regulatory takings provisions. Since cities are the major actors when it comes to land use restrictions, this exemption sharply mitigates the law's property rights protections.

Therefore, state lawmakers should protect private property by extending the reach of the Texas Private Real Property Rights Preservation Act to city government actions, as well as state and county government actions. Further, the 25% devaluation threshold should be eliminated.

#### The Facts

- In a May 2018 report, the Texas A&M University Real Estate Center demonstrates that the extent of Texas' housing affordability problem varies across metro areas largely due to differing city land use restrictions.
- A 2016 study by the National Association of Home Builders estimates that government regulations account for about 25% of the final price of a new single-family home, on average.
- Minimum lot size regulations restrict housing density by mandating the smallest possible area that something may be built on. Minimum lot size regulations conducted by the Mercatus Center shows that minimum lot size requirements contribute more than any other land use regulation to restricting the supply and increasing the cost of housing.
- Parking minimums mandate that a specified set of parking spaces be provided
  per building based on the government's forecast of the parking demand that
  would be generated by the buildings' use. Like minimum lot size regulations,
  these policies raise the price of housing.
- The Texas Private Real Property Rights Preservation Act provides that when a government action restricts a property owner's right to use his land, and thereby reduces the property's value by at least 25%, the property owner is entitled to compensation. Currently, however, the law primarily applies to state and county governments, not city governments, which limits its effectiveness.

## Recommendations

- Prohibit local governments from mandating minimum lot size requirements.
- Prohibit local governments from mandating parking minimum requirements.
- Strengthen the Texas Real Private Property Rights Preservation Act by extending its property rights protections to city government action and eliminate the property devaluation threshold before the law's protections apply.

#### Resources

<u>Out of Reach? Texas Affordable Housing</u> by Luis B. Torres and Wayne Day, Texas A&M University Real Estate Center (May 2018).

<u>Government Regulation in the Price of a New Home</u> by Paul Emrath, National Association of Home Builders (May 2016).

"Households Priced-Out by Higher House Prices and Interest Rates," National Association of Home Builders (2016).

continued

# Affordability (cont.)

*Bringing Down the Housing Restrictions* by Kathleen Hunker, Texas Public Policy Foundation (May 2016).

*How Land-Use Regulation Undermines Affordable Housing* by Sanford Ikeda and Emily Washington, Mercatus Center (Nov. 2015).

*Private Property and Public Use: Restoring Constitutional Distinctions* by Bill Peacock, Texas Public Policy Foundation (Oct. 2006).

"Piketty vs. Rognlie: Land Use Restrictions Inflate Housing Values, Drive Wealth Concentration" by Chuck DeVore, Forbes (July 22, 2015).

*The Freedom to Own Property: Reforming Texas' Local Property Tax* by Kathleen Hunker, James Quintero, and Vance Ginn, Texas Public Policy Foundation (Oct. 2015).

<u>Testimony: Ten Facts About Texas' Property Tax</u> by James Quintero, Texas Public Policy Foundation (April 2015).

# **Grace Commission**

### The Issue

In the late 1960s, then-Gov. Ronald Reagan signed an executive order establishing the Governor's Survey on Efficiency and Cost Control, a private citizen-composed commission tasked with examining and evaluating the entirety of California's state government. The monumental effort sought to bring a fresh perspective to old systems and determine what, if anything, could be improved.

Making up the commission's membership were 250 business and industry professionals who freely donated their time and expertise toward achieving a common goal. Over the course of 10 months, this group thoroughly examined California state agencies and developed close to 2,000 specific recommendations. Full implementation of these recommendations could have yielded hundreds of millions in state savings. The commission also anticipated that their recommendations could produce annual savings for federal and local authorities.

In the early 1980s, then-President Reagan signed an executive order establishing the "Grace Commission" to identify excessive federal expenditures and improve managerial accountability. Like the California commission before it, the Grace Commission was entirely constituted of private sector citizens who found numerous ways to better serve the public.

The Grace Commission found almost 2,500 separate and distinct ways to rightsize the federal government. According to the commission's findings, the full implementation of their recommendations, either through administrative or legislative action, could have saved an estimated \$424.4 billion over a three-year period plus achieved cash accelerations of \$66 billion. Importantly, all of its proposals were achievable "without raising taxes, without weakening America's needed defense build-up, and without in any way harming necessary social welfare programs."

Over time, a number of the Grace Commission's proposals became law, temporarily bending down the federal government's cost curve and improving the delivery of services in some areas. Even those recommendations that did not become law armed the grassroots with substantive ideas to improve the operations of government.

In Texas, there's an opportunity and a need to relaunch President Reagan's Grace Commission concept. A variety of factors—like heightened population growth, near-term budgetary excesses, and long-term structural imbalances—are putting pressure on state and local government finances. If left unchecked, these pressures threaten to erode the foundation of the Texas Model—low taxes and limited government.

To the extent that it makes sense, state agencies and large local governments should be required to undergo this kind of private sector-led analysis. A recommissioned group should aggressively seek after-cost containment strategies and ways to improve management techniques. Any redesigned committee should be composed entirely of private citizens, entrepreneurs, employers, and other volunteers appointed by key elected officials.

# Grace Commission (cont.)

The goals of this new efficiency commission should be similar to that of its predecessors, seeking to identify the following:

- Efficiency gains and cost reductions that can be realized through administrative discretion, legislative changes, or by the enactment of ordinance or charter amendment;
- Opportunities to streamline programs, departments, and positions;
- Best practices that allow federal, state, or local governments to better share
  resources, such as personnel and equipment, and that improve personnel accountability in areas such as overtime;
- The nature and structure of federal funds received, including matching requirements and maintenance of effort requirements.
- Possible redundancies and overlap;
- Processes that can be made more cost-effective through the introduction of competitive bidding practices; and
- Programs, departments, and functions that merit further study.

In this way, Texas' state and local governments can have outside experts examine their systems, operations, and procedures with a fresh set of eyes—and at no cost. Any potential savings could be shifted to other, higher uses like lowering taxes, paying down debt, improving infrastructure, and improving the solvency of public pension funds.

## The Facts

- The California commission was created as a way to restrain the growth of state government, which was outstripping population growth.
- Near its end, the Grace Commission consisted of 36 task forces that were chaired by more than 160 top executives from around the country, and it was staffed by more than 2,000-plus volunteers who had thoroughly examined "federal departments, agencies, and functions that cross-cut the entire government, in addition to 11 special studies on other important issues." This exhaustive review led the commission to offer "2,478 separate, distinct, and specific recommendations" which, if fully implemented, would have resulted in \$424.4 billion in net savings and revenue increases over a three-year period.

## <u>Recommendation</u>

Require state and local governments to create separate, independent private sector-led commissions to conduct a comprehensive review of all systems and procedures. Mandate full cooperation from all relevant personnel.

#### Resources

"Harvey presents a chance to re-examine role of government" by James Quintero, Austin American-Statesman (Oct. 29, 2017).

# K-12 Education

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# Parental Choice

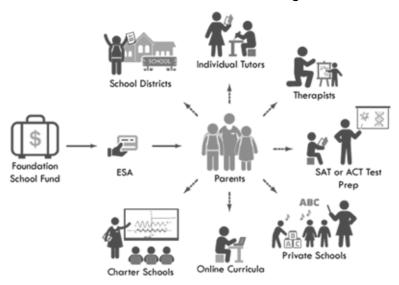
### The Issue

Compared to the majority of states, Texas is behind in educational opportunity. Twenty-nine state legislatures and Congress (for the District of Columbia) have established some form of private school choice. Texas has none. Every Texas child should be afforded the opportunity to select the educational options which best suit his or her individual needs.

Though many students in Texas are served well by the public school system, other students need alternative solutions. Over 1,300 (1 in 8) schools in Texas, attended by approximately 800,000 students, are currently categorized as Public Education Grants (PEG) schools, which are schools failing in some or all categories. Over 140,000 students are on waiting lists for high-quality charter schools, indicating unmet demand for better options. A federal investigation recently revealed that special needs students in Texas are being underserved, and the state is searching for ways to meet those students' needs.

In 2015, Nevada passed a law that created an Education Savings Account (ESA) program to allow almost every student in the state the freedom to select the best educational program for their own educational needs. In 2017, Arizona followed Nevada's example with an expansion of their own pioneering ESA program. An ESA can be used for a variety of educational expenses throughout a school year, including therapy, tutoring, test fees, textbooks, transportation expenses, or tuition. Families can roll over unused ESA dollars from one school year, and any remaining funds can be used for higher education expenses. Modeled after Health Savings Accounts, the ESA concept provides an offset to many of the third-party pay problems inherent in education today. The **figure** below illustrates how ESAs might work.

## Reformed Flow of Funds through ESAs



ESAs have been established by legislatures in Nevada, Arizona, Tennessee, Mississippi, Florida, and North Carolina. Arizona's and Nevada's programs are the leading models because of their focus on near-universal availability. In Arizona, which has had an ESA since 2011, parents have taken full advantage of the program's flexibility. About one-third of ESA funds are expended on multiple items; in other words, a sizable number of parents choose not to use the entire ESA on tuition. In addition, when Arizona parents were given the option to roll over unused dollars and spend them on future educational expenses—such as college tuition—they rolled over an average of 43% of their ESA allotment.

Special needs students in Arizona were the first to be given access to ESAs. In 2015, they comprised 58% of the 2,406 Arizona ESA holders. Parent satisfaction with the program is notably high: a survey of over half of participating families in the 2012-13 school year found that all respondents were satisfied with the program and none registered negative or neutral feedback. Similar programs created especially for special needs students in Florida have found similarly high levels of parental satisfaction and drastically lowered levels of student victimization.

Student performance improves as a result of educational choice. According to EdChoice, of 18 empirical studies on this topic, 14 found that student achievement improved and 2 found no measurable impact. Choice also has been proven to improve public school performance. Of 33 empirical studies surveyed by EdChoice, 31 found that surrounding public schools improve when students are allowed a choice.

#### The Facts

- A universal (meaning available to all Texas students) ESA program starting
  in 2017 could have led to an additional 11,809 students graduating from high
  school instead of dropping out by 2022. Those 11,809 additional high school
  graduates could have resulted in five billion dollars' worth of economic benefits
  to ESA participants and society as a whole. Those societal benefits include
  higher tax revenues, lower welfare costs, and less criminal activity.
- Public schools will improve significantly with the implementation of universal choice.
- Universal choice will drive up teacher pay as schools divert more funds to classrooms—where they have the greatest effect on students.

# Recommendations

- Promote educational excellence in Texas by adopting ESAs for all Texas students, and establish a variety of educational choice alternatives.
- Empower students with special needs with educational choice options.

#### Resources

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continued

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<u>A Texas-Sized Brand: Education Savings Accounts in the Lone Star State</u>, by Inez Feltscher Stepman and Lindsey M. Burke, ALEC (March 2017).

Whether to Approve Education Savings Accounts: Preventing Crime Does Pay by Corey DeAngelis and Dr. Patrick Wolf, University of Arkansas (Dec. 2016).

*The Moral Case for School Choice* by Michael Barba and Kent Grusendorf, Texas Public Policy Foundation (Sept. 2014).

<u>Children in Need: Special Needs Students in Texas Would Benefit From Education Savings Accounts</u> by Emily Sass and Stephanie Matthews, Texas Public Policy Foundation (May 2017).

# Funding Public Schools for the 21st Century

#### The Issue

he Texas Constitution establishes public education through Article VII, Section 1, which states:

A general diffusion of knowledge being essential to the preservation of the liberties and rights of the people, it shall be the duty of the Legislature of the State to establish and make suitable provision for the support and maintenance of an efficient system of public free schools.

Since 1989, the Texas Supreme Court has ruled seven times on school finance. In the process, the Court has laid out four tests that the system must fulfill in order to be constitutional. These are illustrated in Figure 1 and are explained in detail in Texas School Finance: Basics and Reform.

of Texas Public Education Article VII, Section 1 sets up 3 tests for public education in Texas Efficiency Qualitative Quantitative Does the system Are students produce results provided with little waste? equitable funds? Adequacy Suitability Is the system Does the system well-structured. accomplish a operated, & general diffusion of knowledge? funded?

Figure 1: Constitutional Tests

Critically, the Qualitative Efficiency test had not been addressed by the courts until the most recent ruling in 2016. In 2005, the Texas Supreme Court wrote that it wished to rule upon Qualitative Efficiency but did not do so because no petitioners at that time appealed to this test, which asks: does the system produce results with little waste? Like the courts, the Legislature must address this test, which requires an appropriate relationship between inputs and outputs.

In the 2016-17 school year, Texas taxpayers spent a total of \$68.3 billion on public education according to the Texas Education Agency's (TEA) 2016-17 Financial Actual Report. In the same school year, there were 5,341,009 students attending Texas public schools. As a result, Texans spent \$12,787 per student, whereas the average tuition for accredited private schools in Texas was only \$7,922. According

continued

# Funding Public Schools (cont.)

to the TEA's 2016-17 Texas Academic Performance Reports, the average elementary and secondary school class size is about 20 students. Therefore, Texans spend about \$255,000 for the average class. At the same time, the 2016-17 TAPR shows that the average annual salary for teachers was \$52,525. Resources are not currently allocated in the most efficient manner to help Texas students in the classroom.

Court decisions and legislative expediency have resulted in the ungainly system of wealth equalization referred to as "recapture" or "Robin Hood." Were the source of education funding to be shifted from property taxes to some other revenue source, Robin Hood could be eliminated with no reduction to the entitlements of property-wealthy or property-poor districts. See the "Property Taxes" entry for more details on one possible method.

As the District Court ruled in 2014, "hundreds of thousands" of Texas students are being underserved by the system. According to the judge in the case, "all performance measures considered at trial demonstrated that Texas public schools are not accomplishing a general diffusion of knowledge." And while correctly concluding that the education funding structure is woefully flawed, the suggestion that more money would resolve the systematic problems was off track.

Public education is funded by an unnecessarily complex and inefficient system that is not student-centered. Texas' funding formulas have been cobbled together based on political dynamics, not by what works for students. As a result, the system fails the Texas Constitution's Qualitative Efficiency test. In addition, the system fails the Quantitative Efficiency test on a student basis. We detail solutions to this problem in our *Basics and Reform* study (49-56).

The Texas Supreme Court concluded in *West Orange Cove II* that "Pouring more money into the system may forestall [constitutional] challenges, but only for a time." The Texas Legislature must offer a solution to the fundamental problem of our system, which is that the system is not student-centered. This can be accomplished by reforming the student allotment based upon the following principles:

- 1. Shift the focus from equity for districts to equity for students.
- 2. Assure that the student's allotment is portable.

Structural efficiency would be improved when the allotment is made portable. Funds should be portable based upon parental discretion. Such a system encourages continued dialogue between parents and school districts, and public schools begin to adjust their course offerings based on parent feedback. Early adopters of educational choice, such as Grand Prairie ISD, have found that parent satisfaction increases, and about 9 in 10 GPISD teachers want to expand the choice system.

In such a system, education finance would be transparent, efficient, and equitable. Educational consumers—parents and students—would have flexibility in the ways they allocate their education dollars within the public school system. Furthermore, educators should be freed of most unnecessary regulations that excessively burden them today. By restructuring school finance in this manner, a real market for educational services will be created within individual schools, within school districts, and throughout the state, thereby resulting in significant improved efficiencies and effective resource allocation.

The Texas Supreme Court, which has dealt with school finance reform for the last 30 years, has repeatedly encouraged the Legislature to make structural reforms to the system. These reforms would offer Texas children the lasting promise of excellent education and equal opportunities for success.

#### The Facts

- Total public education expenditures in the 2016-17 school year were \$68.3 billion. With 5,341,009 students in average daily attendance (ADA), per student spending is \$12,787.
- The average tuition of an accredited private school in Texas is \$7,922.
- 1,340 public schools in the state of Texas were identified as PEG schools (academically failing) by TEA for the 2018-19 school year.
- A "disastrous" 14-25% of public school students fail to graduate from high school.
- Only 18% of high school graduates from 2010-13 met the SAT or ACT collegereadiness standards.
- One-third of English Language Learners (ELL) in grades 3-12 failed to progress a grade level in English.

#### Recommendations

- Implement a student-centered funding structure for public education. Ensure that allotments are transparent, equitable, and portable.
- Deregulate public schools and allow educators to operate as professionals.

#### Resources

<u>Texans Need More Education for Their Money</u> by Vance Ginn and Stephanie Matthews, Texas Public Policy Foundation (Dec. 2017).

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<u>Evaluation of the DC Opportunity Scholarship Program: Final Report</u> by Patrick Wolf, Babette Gutmann, Michael Puma, and Brian Kisida, U.S. Department of Education (June 2010).

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*Eric Hanushek's Expert Report for School Finance Trial* by Kent Grusendorf, Michael Barba, and Dianna Muldrow, Texas Public Policy Foundation (Oct. 2014).

## **Encouraging Charter Innovation**

#### The Issue

igh-performing charter schools—those that improve student results—are in demand by parents and students across Texas. In fact, each year, 140,000 Texas students are on "waiting lists" hoping to be chosen in a lottery to get one of the limited spots at a nearby charter school.

Texas families choose charter schools for many reasons. One of the most fundamental reasons is that their student has been arbitrarily assigned to a failing traditional school simply based on their ZIP code. In fact, according to Texas' new A-F School District Academic Accountability System, thousands of Texas children are in D- and F-rated school districts, where learning is not taking place. In such cases, a nearby charter is often the only option to help ensure a child's success. With 58% of Texas third-graders reading below grade level, Texas leaders need to support the expansion of robust, high-performing charter schools to provide immediate alternatives to students trapped in D- and F-rated districts.

Texas families are also choosing charter schools because charters better meet their student's unique needs, by providing, for example, more individualized student attention, smaller school settings, character building, college classes, STEM options, flexible schedules, and an atmosphere that works better for the student's education attainment.

Research by many economists indicates that competition from charter schools improves traditional public education and that high-performing charter schools often have better student outcomes than their peers in traditional public schools. As a result, traditional school officials often feel threatened by charter schools and work to inhibit charter expansion at the expense of students. For example, in an effort to prevent charter expansion, traditional public school districts often argue that charter schools have less state regulation, giving charters an unfair advantage. However, HB 1842 (2015) allows nearly all public school districts to adopt the same regulations as charters by becoming a "District of Innovation."

In addition, traditional urban public schools argue that charters may receive more maintenance and operations money per student. However, according to TEA, on average charters receive \$600 less in total funding than traditional public schools. Further, this argument ignores the fact that traditional public schools have substantial advantages over charters; traditional schools have existed within the community for many years and often garner enormous community support, have existing facilities, and wield taxing authority.

Texans must insist on doing what is best for students and teachers rather than what is demanded by those stakeholders who primarily want to defend the status quo instead of focusing on improving student results at each of their campuses. We should remove all restrictions inhibiting student achievement and act in the best interest of the students, teachers, and taxpayers by ensuring high-performing charter schools can rapidly expand in Texas.

#### The Facts

- Thousands of Texas students are trapped in low-performing D- and F-rated traditional public schools, with no other alternative. Charter schools could provide the only option for these students to succeed.
- Over 140,000 students are on charter school waiting lists.
- High-performing Texas charter schools often outperform traditional public school districts in student results and achievement. Charters also place needed and significant pressure on traditional public schools to improve student results.
- Traditional public schools can adopt the same regulations as charter schools and have many other advantages; yet parents are actively choosing charter schools because of their student results.
- Restricting charter expansion protects the status quo at the expense of Texas students, taxpayers, and teachers.
- Artificial legal restrictions on the number of charter schools prevent many students from exercising their freedom of educational opportunity.
- The typical new charter school application runs hundreds of pages and can cost thousands of dollars which inhibits new charter schools from serving Texas students.

#### Recommendations

- Remove the statutory cap on charter schools contained in Texas Education Code 12.101.
- Streamline the charter application process to encourage innovation while ensuring quality.

#### Resources

*Time to Change Course: Reclaiming the Potential of Texas Charter Schools* by Adam Jones and Amanda List, ExcelinEd and Texas Public Policy Foundation (June 2018).

<u>Urban Charter School Study Report on 41 US Regions</u>, Center for Research on Education Outcomes (2015).

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What Keeps Texas Schools from Being as Efficient as They Could Be? by Paul Hill (July 2012).

<u>Allan E. Parker's Expert Report for School Finance Trial</u> by Kent Grusendorf and Michael Barba, Texas Public Policy Foundation (Jan. 2015).

Would School Choice Change the Teaching Profession? by Caroline Hoxby, National Bureau of Economic Research (Aug. 2000).

*How School Choice Affects the Achievement of Public School Students* by Caroline Hoxby (2002).

## A-F Accountability

#### The Issue

Texas' student reading and math results are lackluster and declining. According to the State of Texas Assessments of Academic Readiness (STAAR), 55% of Texas third-graders are reading below grade level and 52% are doing math below grade-level. Similarly, according to the April 2018 Nation's Report Card (NAEP), Texas reading scores are some of the lowest in the nation and declining: Texas ranks 46th in fourth-grade reading (down from 40th in 2015). In addition, the achievement gaps between white and minority children are persistent and the state's economically disadvantaged population is increasing.

Most Texas students are assigned to their schools based on their ZIP code, with no meaningful choice in the matter. In a situation where school districts have a monopoly on education, it is imperative that parents understand academic outcomes, so that failing schools are identified for a quick turnaround. In addition, without accountability systems, vast differences in student performance between schools teaching economically disadvantaged students and wealthier student populations can grow undeterred over time, and there is no consistent way to compare public schools across Texas.

HB 22 (2017) created Texas' new A-F Accountability System, which is a first-of-its-kind method for determining academic performance and improving and comparing student outcomes. Starting in August 2018, each district will get an A, B, C, D, or F rating. Starting in August 2019, each individual campus will also get a rating. The system will allow parents, students, taxpayers, policymakers, and educators to:

- Understand how schools and groups of students compare across Texas.
- Provide incentive for improvement in student performance to go from D or F to A or B ratings.
- Recognize schools with high levels of student performance so that best practices can replicate.
- Identify D- and F-rated schools so that turnaround efforts can be deployed to help students.
- Measure if economically disadvantaged and minority students are progressing.
- Determine whether statewide, district, and campus student performance are getting better or worse over time.

Texas' A-F Accountability System is thoughtfully designed and transparent. The new system:

- Uses easy-to-understand and meaningful A-F letter grades for districts and schools.
- Allows for a school district to design its own "local" campus accountability ratings.
- Relies in part on the STAAR test, which is developed with Texas teachers and
  is the only assessment that allows for statewide, uniform student performance
  measurement and growth comparisons.
- Provides that all school districts and schools can earn an A grade. There is no forced bell curve.

Will remain the same for at least five years so that school districts and campuses that improve will receive higher grades over time. (This assumes no significant legislative changes.)

Previous accountability systems sometimes gave schools with high levels of economically disadvantaged students poor ratings mainly based on raw STAAR passage rates. However, Texas' new system gives credit for student growth. Even if a campus has many students who do not attain grade level STAAR performance, the campus can still earn an A, if students are learning and progressing.

#### The Facts

- Despite taxpayers investing \$114 billion each biennium on public education, Texas' student results are poor and declining.
- The fundamental obligation of our schools is to teach children to read and do math. Parents, students, taxpayers, and educators have a right to know whether their schools are teaching students to read and do math at grade level.
- Texas' A-F Academic District and School Accountability System is fair, transparent, well-designed, and will improve student outcomes.
- Texas students often do not have a choice as to where to attend school. Poorperforming schools should be identified and turned around.

#### Recommendation

Transparently and fairly hold school districts and campuses responsible for improving students' results using Texas' new A-F Accountability System adopted in HB 22 (2017).

#### Resources

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"The Big Idea of School Accountability" by William McKenzie and Sandy Kress, George W. Bush Institute (Feb. 2015).

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"House Bill 22, Implementation of A-F Accountability," Testimony of Texas Commissioner of Education Mike Morath, House Public Education Committee (April 18, 2018).

"NAEP 2017 Mathematics and Reading Results," NAEP Texas (April 2018). Available at the Texas Education Agency.

"Nation's report card: 'Something very good is happening in Florida'" by Leslie Postal, *Orlando Sentinel* (April 10, 2018).

"Texas Public Education Outcomes," Presentation by Texas Commissioner of Education Mike Morath, Texas Commission on Public School Finance (Jan. 23, 2018).

#### Civic Education

#### The Issue

Informed and involved citizens are critical to the survival of any democratic society. Texas' own Constitution gives "the preservation of the liberties and rights of the people" as the very reason for providing for public education in the state.

One of the <u>objectives</u> stated in the Texas Education Code is that "Educators will prepare students to be thoughtful, active citizens who have an appreciation for the basic values of our state and national heritage and who can understand and productively function in a free enterprise society." To these ends, the state of Texas has written <u>civic education</u> into its curriculum standards, the Texas Essential Knowledge and Skills (TEKS).

Sadly, these good intentions appear to be faltering in execution. In 2016, only 26% of Americans could name the three branches of American government—down from 38% five years before. Nearly a third could not name even a single branch.

Worse, free speech and debate—the cornerstone of democracy—are under attack. <u>Polling reveals</u> that 61% of American college students find that their school prevents some students and faculty from openly declaring their views because others might deem them "offensive."

Most frightening of all: 20% of respondents in a <u>national survey</u> of college students said that using violence to silence a controversial speaker is acceptable. One-fifth of the nation's best and brightest students have emerged from high school not only ignorant of the importance of free speech but willing to support its violent suppression.

Texas does require an End-of-Course Assessment in U.S. History for high school graduation, but civics is not its focus. If the Texas education system is indeed to produce informed citizens, Texas should ensure that its students are instructed in the basic facts of American history and government. The United States requires specific knowledge of anyone applying to become a United States citizen. Though natural-born citizens do not need to defend their citizenship, it only stands to reason that our nation should attempt to impart the same basic knowledge to them.

Fortunately, there is a simple way to incorporate this basic civic education into Texas classrooms. The United States <u>citizenship test</u> is available to the public at no charge. Study kits and videos are also available.

Seventeen states already require their students to take a civics test based on the United States citizenship test. Eight states have made a passing score on this test a requirement for high school graduation.

Texas should also reinforce knowledge of our history and civics structure in college. The Legislature has already stated that every student in a state university must take at least two American history courses to fulfill general education requirements. However, there is no distinction regarding the types of courses that meet this requirement. The statute should clarify that these history courses must be survey courses, and both must be American history courses.

These reforms would ensure that civic education is given its proper role within Texas education. With basic civic knowledge covered and tested in high school,

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and subsequently reinforced in college, the state will set up its students—and its democracy—for continued success.

#### The Facts

- In 2016, only a quarter of Americans could name the three branches of American government. Nearly a third could not name even a single branch.
- Half of American college students believe it is acceptable to shout down a speaker they consider controversial, and one-fifth believe it is acceptable to use violence to silence a controversial speaker.
- The Legislature has set civic education as a priority for Texas schools, but testing of civic education is minimal.
- Seventeen states require their students to take a civics test based on the U.S. citizenship test. Eight require passage for high school graduation.

#### Recommendations

- Incorporate the concepts assessed on the USCIS citizenship test into the Texas state curriculum and ensure all Texas students are assessed on those concepts and demonstrate proficiency as a requirement for high school graduation.
- Clarify that history courses to fulfill college general education requirements must be survey courses, and both must be United States history courses.

#### Resources

"A Bill for the More General Diffusion of Knowledge," Thomas Jefferson (1778).

"Americans' Knowledge of the Branches of Government Is Declining," Annenberg Public Policy Center (2016).

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"Views Among College Students Regarding the First Amendment: Results From a New Survey," John Villasenor, Brookings Institution (Sept. 18, 2017).

"Study Materials for the Civics Test," U.S. Citizenship and Immigration Services (Accessed June 2018).

"Texas Essential Knowledge and Skills for Social Studies," Texas Education Agency (Accessed June 2018).

<u>Texas Education Code, Chapter 4</u>, "Public Education Mission, Objectives, and Goals," (Accessed June 2018).

<u>Civics (History and Government) Questions for the Naturalization Test,</u> U.S. Citizenship and Immigration Services (2017).

## Teacher Pay and Administrative Flexibility

#### The Issue

According to the Nation's Report Card (NAEP), Texas student reading scores are some of the lowest in the nation and declining; Texas ranks 46th in fourth-grade reading and 42nd in eighth-grade reading. Further, 2018 STAAR results indicate over 58% of Texas third-graders read below grade level.

It is well-established that individual classroom teachers matter much more to student achievement than any other aspect of schooling except for parental involvement. According to the Texas Education Agency (TEA) teacher effectiveness can be measured, and the best Texas teachers can be identified. Effective teachers increase student learning gains, close learning gaps, increase workforce and college attainment, and boost the state's economy. Conversely, ineffective teachers not only harm individual student performance, but increase taxpayer-funded student remediation costs and Texas' economic prospects.

Despite the dramatic impact effective teachers have on student achievement and the urgent need to recruit and retain them, the Texas school finance formula system does not encourage or reward school districts that adopt differentiated teacher pay for performance programs wherein the most effective teachers are identified and compensated for their success. This is in large part due to the use of teacher salary schedules in districts that are modeled on the state's salary schedule. Under these schedules, teacher compensation is based almost exclusively on years of experience and education. Little attention is given to actual achievement, i.e., the increase in student learning. Further, teacher unions have long objected to paying effective teachers more and to removing ineffective teachers from the classroom.

As a result, Texas is struggling in both urban and rural areas to recruit and retain effective teachers:

- The teacher turnover rate is 16.5%, creating large and ongoing taxpayerfunded effective teacher recruitment, training, school continuity, and related human capital expenses;
- Thirty-four percent of new Texas teachers leave within five years;
- In many rural districts, more than 20% of teachers, and more than 30% of new teachers, leave each year; and
- Nationally, 86% of teachers come from the bottom two-thirds of their graduating college class.

The primary reasons highly effective teachers leave the classroom are:

- They do not receive meaningful pay raises throughout their tenure. Teachers
  who are highly effective and teach in a high-poverty, rural, or difficult to staff
  subjects or campuses are usually paid the same as all other teachers. In fact,
  nearly all teachers in Texas—regardless of effectiveness or longevity—will earn
  between \$45,000 and \$61,000, with very little chance for a meaningful salary
  advancement.
- To advance in pay, prestige, and responsibility, effective Texas teachers must often leave the classroom to become a principal or administrator.
- Few professions offer so little opportunity for advancement in pay, prestige, or career advancement.

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It is important for Texas to adopt a teacher compensation program that works. In the past, Texas has financed expensive across-the-board salary increases. Experts agree these one-time increases are not effective at retaining high-performing teachers, waste taxpayer money, and interfere with local control.

Research suggests that effective compensation programs will:

- Provide significant ongoing increases in salary to highly effective teachers, with the top 5% of master teachers earning \$100,000 or more;
- Be transparent in program design and operation; and
- Be permanent and reliable parts of the formula system.

A differentiated teacher compensation program does not have to increase tax-payer costs. Texas spends more on teacher salaries than anything else in public education, and as a result, changes in existing compensation allocations and practices could have a significant impact. Many districts already give annual, ineffective across-the-board raises. These across-the-board raises could be converted into raises for effective teachers determined by those who know the teachers best—the principals who supervise the teachers. Further, existing school finance funding could be easily deployed toward differentiated compensation, especially if some existing state mandates on the use of funds were removed.

Across Texas, differentiated teacher compensation programs are already being enacted within existing district resources; programs exist in Dallas ISD, Lubbock ISD, Austin ISD, Longview ISD, Pharr-San Juan-Alamo ISD, and Era ISD. Dallas ISD's Accelerating Campus Excellence (ACE) teacher compensation program is seeing dramatic increases in student results, with double-digit, year-over-year STAAR reading gains at multiple high-poverty elementary schools.

Texas teachers often cannot advance professionally without leaving the classroom. In other high-performing countries, in-classroom teachers can advance; for example, Singapore provides that teachers can become lead teachers and master teachers. In Texas, some schools compensate teachers who earn certifications or micro-credentials in areas that will improve their practice or student results. Programs that reward lead, master, and specially certified teachers should be supported in the formula system.

#### The Facts

- Texas needs to vastly improve its student results and nothing matters more to student achievement than individual teacher effectiveness.
- Highly effective teachers can be successfully identified.
- Texas teacher turnover rates are increasing, especially in rural districts.
- Texas spends more money on teachers than any other aspect of public education.
- If Texas used existing resources to increase the recruitment and retention of its
  highly effective teachers, Texas student results would increase, while expensive,
  on-going remediation and human capital costs would decline.
- Similar to Singapore teachers, Texas teachers should be able to advance professionally while remaining in the classroom.

## Teacher Pay and Administrative Flexibility (cont.)

#### Recommendations

- Eliminate the state teacher salary schedule and encourage districts to do the same.
- Allow principals to determine teacher compensation within their schools.
- Existing school finance formula funds should be repurposed, and barriers to
  using funds removed, to ensure school districts adopt effective teacher differentiated pay programs and that teachers are given career advancement opportunities.
- Remove legal barriers to principals removing ineffective teachers.

#### Resources

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# **Higher Education**

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## Free Speech on Campus

#### The Issue

Over the past few years, a plethora of news accounts has exposed serious restrictions on free speech and debate on our campuses. University speech codes, restrictive "free-speech zones," and commencement speaker "dis-invitations" threaten to undermine our schools' defining mission: the free, nonpartisan quest for truth, that is, the Socratic vision from which liberal education originated.

There is no more pressing issue in higher education today. If free speech and debate die on our campuses, they will come in time to die in the public square, dooming self-government.

The model for higher education currently threatened is born of Socrates' proposition that "the unexamined life is not worth living for a human being." It is no accident that the words "liberal" and "liberty" share the same root: Liberal education, for Socrates, is an education *in* and *through* liberty. The highest purpose of liberal education is to foster the freedom of the mind, that is, freedom from unexamined assumptions—e.g., swings in intellectual fashion, partisan politics, and ideology. Liberty at its peak is thus identical with the pursuit of truth.

But truth-seeking, as Socrates' trial and execution show, is not without dangers. Thus, the institutions devoted to cultivating intellectual liberty—colleges and universities—depend for their safety on their being situated in a system of political liberty. In this respect, the cultivation of free minds *both* transcends *and* depends on the political freedom enshrined in our Constitution.

If students are deprived of the growth opportunities provided by encountering and debating ideas with which they disagree, they will lack the qualities essential to informed, effective citizenship, which requires knowledge of our fundamental moral and political principles. Democracy depends on a citizenry so endowed.

Academic freedom is a subset of the freedom of speech promised under a constitutional democracy. History shows that regimes that do not protect free speech in the political sphere also do not protect it in the academy. Freedom of speech in the political sphere is animated by the conviction that the people, if free to engage in debate over policy issues, will, through this process, be better able to choose wisely among competing policies and the candidates espousing them. Academic freedom is animated by the conviction that the examined life is the highest capacity of human beings. In both spheres, truth-seeking is the end to which freedom of speech and inquiry exist as the indispensable means.

#### The Facts

- The Supreme Court has ruled that "state colleges and universities are not enclaves immune from the sweep of the First Amendment. ... [T]he precedents of this Court leave no room for the view that ... First Amendment protections should apply with less force on college campuses than in the community at large" (Healy v. James).
- The nonpartisan think tank the Foundation for Individual Rights in Education (FIRE) has published its latest <u>report</u> on academic freedom, Spotlight on Speech Codes 2018: The State of Free Speech on Our Nation's Campuses. Its most salient findings are:

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- 1. "Just under one-third (32.3%) of surveyed institutions received FIRE's lowest, <u>red light rating</u> for maintaining speech codes that clearly and substantially restrict freedom of speech."
- 2. Most schools (58.6%) "receive a <u>yellow light rating</u>. Yellow light policies restrict narrower categories of speech than red light policies do, or are vaguely worded in a way that could too easily be used to suppress protected speech, and are unconstitutional at public universities."
- Duly alarmed over the rising intolerance sweeping across campuses nation-wide, the University of Chicago released its "Report on Free Expression" in 2015. The Chicago Statement, as it has come to be called, has been adopted by the administrations or faculty bodies of 42 universities as of June 17, 2018, among them, Columbia, Princeton, Johns Hopkins, Georgetown, Purdue, Michigan State, the University of Missouri System, and LSU.
- Versions of the Goldwater Institute's model proposal on campus free speech have been adopted by the North Carolina Legislature as well as the University of Wisconsin System Regents.
- In Texas, not one school has signed the Chicago Statement or embraced the Goldwater model proposal. Moreover, Texas houses five schools with FIRE's worst rating for free speech ("Red Light") and 11 schools with its second worst rating ("Yellow Light").
- A version of the Goldwater model bill passed in the Texas Senate in 2017, but was not heard in the House.

#### Recommendations

- Each college and university's board of trustees (or "regents") could adopt the Chicago Statement, in the manner done by Purdue and the University of Nebraska.
- The Texas Legislature could pass legislation requiring all Texas public universities to adopt the Chicago Statement and/or the Goldwater model.

#### Resources

"Chicago Statement: University and Faculty Body Support," Foundation for Individual Rights in Education (June 15, 2018).

<u>Campus Free Speech: A Legislative Proposal</u>, by Stanley Kurtz, James Manley, and Jonathan Butcher, Goldwater Institute (2018).

<u>Free to Learn? Think Again: Restoring the First Amendment at Texas Public Universities</u> by Thomas Lindsay, Texas Public Policy Foundation (Aug. 2016).

<u>The Need for Free Speech and Debate in Both Our Schools and the Public Square</u> by Thomas Lindsay, invited testimony before the Senate State Affairs Committee, Texas Public Policy Foundation (Jan. 31, 2018).

"Report of the Committee on Freedom of Expression" by Stone et al., University of Chicago (2015).

## Higher Education Affordability

#### The Issue

Between 1985 and 2009, average college tuition nationwide has jumped 440%—four times the increase in general inflation and twice that of health care costs. To pay for these historic price increases, students and their parents have amassed historic debt. Student loan debt now stands at \$1.4 trillion, for the first time ever surpassing total national credit card debt.

Increases in federal student aid have led to corresponding increases in tuition sticker prices, in what is known as the Bennett Hypothesis. For example, each additional Pell Grant dollar to an institution leads to a roughly 40 cent increase in sticker-price tuition. Federal regulations also raise the cost of higher education. Regulatory compliance accounts for 2 to 8% of a typical institution's non-research expenditures, costing the higher education sector an estimated \$27 billion annually.

It is no accident that the hyperinflation of tuition and student debt has coincided with a period of sustained administrative bloat. Between 1993 and 2007, the number of full-time administrators per 100 students at America's leading universities grew by 39%, while the number of employees engaged in teaching, research, or service grew by only 18%. A poll of Texas voters found that reducing administrative overhead was one of the three most popular strategies for addressing budget shortfalls at the state's postsecondary institutions.

Texas voters' support for reducing administrative costs reflects a broader perspective on the cost of college among Texans. Of the state's voters, 71% believe universities can improve teaching while reducing costs. As a result, Texas' higher education sector has spent the past several years developing new programs seeking to make higher education more affordable for both students and taxpayers.

Now entering its fifth year, the Texas Affordable Baccalaureate Program (TABP) continues to refine its new approach. The TABP offers qualified returning students baccalaureate degrees for between \$4,500 and \$6,000. In 2016 it received a \$400,000 grant from the AT&T Foundation to help scale the program from its current 2 schools to 10. The College Credit for Heroes Program (CCH), which uses competency-based education to award credit to veterans for skills they acquired during service, has expanded from 4 schools in 2011 to 48 in 2018.

To address affordability, Purdue University recently began a program titled "Degree in 3," which provides students the option to complete a bachelor's degree in three years. The three-year option can save in-state students as much as \$9,021 compared to a four-year degree. For out-of-state students, the savings can be as much as \$18,422.

Texas can build on the successes of programs like the TABP and CCH by emulating these programs' strengths and by experimenting with other creative approaches to making higher education more affordable. Schools across the country have reduced costs while maintaining institutional quality with innovations such as discounted Friday and weekend classes, three-semester calendars, debt counselors, and "online campuses" serving rural regions.

#### The Facts

- A national Pew survey found 57% of prospective students believe a college degree no longer provides value equal to its cost, and 75% deem college simply unaffordable.
- Pell Grants have a pass-through effect on tuition of 40 cents on the dollar. This
  pass-through effect is about 60 cents on the dollar for subsidized loans and 15
  cents on the dollar for unsubsidized loans.
- An assessment of 13 postsecondary institutions across the U.S. found the cost
  of federal compliance varied from 3% to 11% of total nonhospital operating
  expenditures.
- Compliance costs for research are particularly steep: Research-related compliance as a percentage of research expenditures ranges from 11% to 25%.
- Asked how schools should address shortfalls, Texas voters' favorite options were reducing administrative overhead, delaying new facilities, and requiring professors to teach more. Raising tuition or taxes were the least favorable options.

#### Recommendations

- Exempt affordable degree programs (such as the TABP) from formula funding restrictions based on past student performance—including the 30-hour, 45-hour, drop-6, and 3-peat rules—by updating and passing HB 1502 (2015-R).
- Institute three-year bachelor's degrees in liberal arts fields.
- Encourage reductions in administrative budgets—in the manner that the Texas A&M System cut its administrative budget 3.6% between 2011 and 2015.

#### Resources

<u>The Cost of Federal Regulatory Compliance in Higher Education: A Multi-Institutional Study</u> by the Boston Consulting Group, Vanderbilt University (Oct. 2015).

<u>Revolution Rising? Update on Texas' Affordable Baccalaureate Degrees</u> by Thomas Lindsay, Texas Public Policy Foundation (March 2015).

Winning the "Space Race": How Universities Can Maximize Existing Space to Reduce Tuitions by Thomas Lindsay, Texas Public Policy Foundation (Dec. 2014).

(Not) Cheaper by the Dozen: 12 Myths about Higher Education's Cost and Value by Thomas Lindsay, Texas Public Policy Foundation (Dec. 2013).

<u>Credit Supply and the Rise in College Tuition: Evidence from the Expansion in Federal Student Aid Programs</u> by David O. Lucca, Taylor Nadault, and Karen Shen, Federal Reserve Bank of New York (Feb. 2017).

"<u>Degree in 3: Accelerated. Economical. Uncompromised</u>" by Purdue University (Accessed March 2018).

"Our Bloated Universities" by Mary Claire Reim, SeeThruEdu (Feb. 2016).

## Restoring Standards in Higher Education

#### The Issue

Texas higher education faces a crisis in standards. Students receive higher grades now than ever before, even though studies show that too many students (36%) learn little during their four years invested in college. Yet, in spite of inflated grades and a diluted, intellectually aimless curriculum, nearly 40% of students at Texas' public four-year colleges fail to graduate within *six years of enrollment*. The fact that the higher education establishment now focuses on six-year rather than four-year graduation rates is another troubling sign.

While this is a Texas problem, it is far from Texas' alone. The academic world was rocked by the 2011 publication of the landmark study of collegiate learning, *Academically Adrift*. Adrift tracked a national cohort of college students for four years, measuring their fundamental academic skills—critical thinking, complex reasoning, and clear writing—in both their freshman and senior years, using the Collegiate Learning Assessment (CLA). The results are alarming: *Adrift* found that 36% of college students nationally show little to no increase in fundamental academic skills *after four years invested in college*.

Feeding on and fostering the student-learning crisis is the problem of college grade inflation. Research reveals that, in the early 1960s, 15% of all college grades awarded nationally were A's. But today, 45% of all grades are A's. *In fact, an A is the most common grade given in college today.* Moreover, nearly 80% of all grades today are A's or B's, meaning that a majority of college transcripts now provide little context into how well the students in question performed relative to their peers. College grades are in danger of becoming equivalent to Monopoly money.

As monetary inflation devalues the dollar, so grade inflation debases the currency of higher education—student transcripts. Before grade inflation, the college transcript served as a useful tool for employers looking to assess potential hires. A recent survey commissioned by the American Association of Colleges and Universities reveals that this is no longer the case, with two-thirds of the employers surveyed indicating that college transcripts are of either "limited use" or "no use" in determining whether a job applicant will succeed on the job.

The crisis in college standards threatens democratic citizenship. In addition, diminished rigor in higher education also tangibly affects the economy. A rudder-less curriculum and inflated transcripts increasingly pass the costs of evaluating and training new employees onto the business community. Low graduation rates, in particular, have a negative fiscal impact on the state—and, more importantly, on the students themselves, as well as their families. The two million Texans who have acquired some college credits but no degree are in even worse shape—having accumulated debt, but with little additional earning power from their time spent in school.

Most of the higher education debate will remain focused on affordability, but issues of academic rigor must not remain unaddressed. Even if Texas public higher education were to become significantly more affordable, bachelor's degrees will continue to cost more than their actual value—until colleges and universities improve student graduation rates and better demonstrate the added intellectual value that a degree from their institution is meant to signify.

#### The Facts

- 57% of students believe a college degree costs more than it is worth.
- 36% of college students nationally demonstrate little to no increase in fundamental academic skills after four years in college.
- Grade inflation is real and measurable: college grade point averages have increased at a rate of approximately 0.15 points per decade since the 1960s.
- 67% of employers consider college transcripts of either limited use or no use in determining whether a job applicant will succeed at the company.

#### Recommendations

- Encourage university regents to institute measurements of learning outcomes at the freshman and senior years, such as the updated Collegiate Learning Assessment (CLA+) or the Collegiate Assessment of Academic Proficiency.
- Reform existing funding formulas for four-year universities so that a percentage of formula funding is outcomes-based. Use this outcomes-based funding to incentivize student completion, positive learning outcomes, and employment outcomes that promote the Texas Higher Education Coordinating Board's TX60x30 goals.
- Pass legislation requiring contextualized grading, which provides, alongside
  the grade each student received for his/her class, the average grade given by
  the professor for the entire class.
- Improve transparency by making accessible data on student academic performance, graduation rates, average post-graduate debt burden, and average post-graduate earnings.

#### Resources

Academically Adrift: Limited Learning on College Campuses by Richard Arum and Josipa Roksa, University of Chicago Press (2011).

"Graduation Rates of Texas Colleges" by Jolyn Brand, Brand College Consulting (April 12, 2015).

<u>Combating the "Other" Inflation: Arresting the Cancer of College Grade Inflation</u> by Thomas Lindsay, Texas Public Policy Foundation (Aug. 2014).

(Not) Cheaper by the Dozen: 12 Myths about Higher Education's Cost and Value by Thomas Lindsay, Texas Public Policy Foundation (Dec. 2013).

<u>Toward Strengthening Texas Public Higher Education: Ten Areas of Suggested Reform</u> by Thomas Lindsay, Texas Public Policy Foundation (Dec. 2012).

<u>How Should Colleges Assess and Improve Student Learning? Employers' Views on the Accountability Challenge</u> by Peter D. Hart Research Associates (Jan. 2008).

#### **Tuition Revenue Bonds**

#### The Issue

n 1971, the Legislature began using bonds secured with the tuition revenue of public universities as part of the state's funding for capital expansion in public higher education. Two types of bond are used—revenue financing system bonds and tuition revenue bonds (TRBs). Both are secured with pledged future revenues of the university issuing the bonds.

The one difference between these two types of bonds explains the controversy surrounding TRBs. Unlike revenue financing system bonds, which are repaid by the university, TRBs are repaid in full—principal and interest—by the Texas Legislature.

No law or statute requires the Legislature to service TRB debt. Still, the Legislature does so with such regularity that the state's assumed responsibility for TRB debt service is often described as a custom or tradition. In 2015, with \$2.2 billion of previously issued TRB debt outstanding, the Legislature authorized HB 100, the single largest TRB bill in Texas history, set to cost \$3.109 billion in principal and \$2.24 billion in interest. By comparison, the Legislature appropriated approximately \$2.6 billion to retire TRB debt from 1971 to 2014.

TRBs were not widely used from 1971 to 2000. The \$1.08 billion in TRBs authorized in 2001 nearly doubled the amount of TRB authorizations to that point. In the aftermath of a special session in 2006, when \$1.86 billion in TRBs was authorized for 63 projects statewide, the Texas Higher Education Coordinating Board (THECB) was tasked with developing an objective process for evaluating TRB requests. Between 2007 and 2014, the coordinating board developed better tools for prioritizing capital project requests, such as the Space Use Efficiency (SUE) score. Only \$168 million in TRB debt was authorized during this time, most of which went toward financing emergency capital projects. This lull ended in 2015, when the Legislature more than tripled TRB debt.

Besides concerns with the growing cost of TRBs are concerns over how much scrutiny TRB requests actually face. Under standard practice, a majority of TRB requests are bundled into an omnibus TRB bill, passage of which authorizes many lower-priority projects that might not have received approval on their own. For example, if requests from schools with failing grades in all three SUE score categories (classroom, lab, and overall) had been removed from the 2015 session's omnibus TRB bill (HB 100), it would have cut \$606 million, or 19.5%, from the bill's final cost (\$1.04 billion including interest).

Despite opposition to the way TRBs are used, the most frequently touted alternatives are not without pitfalls. Replacing TRBs with general obligation bonds or direct funding from the economic stabilization fund would not address the need for an objective evaluation process of TRB requests. Public-private partnerships, often publicized as the future of capital expansion at public universities, are particularly inappropriate alternatives to TRBs. Public-private partnerships generally require revenue-generating projects—dormitories, parking garages, cafeterias—but TRBs are legally restricted to financing projects that cannot generate their own revenue.

#### 2019-20 LEGISLATOR'S GUIDE TO THE ISSUES

The problem of expensive construction projects will not be solved by simply changing how these projects are financed. The Legislature and universities need also to rethink the centrality of new construction. For instance, most university facilities are more expensive to replace than to renovate, with some facilities twice as expensive to replace than to renovate. Online learning presents another alternative, with schools such as the University of Florida (UF) and Brigham Young University-Idaho reporting such impressive savings from their online programs that they've been able to reduce tuition. Freshmen enrolled in UF's PaCE program—where the first year of classes are all online before moving on campus as sophomores—pay only 75% of what first-year residential students pay.

Even without a "silver bullet" solution for replacing TRBs, the Legislature has a number of policy options available to reduce higher-education costs. TRBs should be replaced with a more transparent funding mechanism that is less subject to political pressure, and that incentivizes prudent stewardship.

#### The Facts

- From 1971 to 2014, the Legislature authorized TRB debt of approximately \$4.8 billion (including interest), \$2.2 billion of which had been retired at taxpayer expense as of August 31, 2014.
- In 2015, the 84th Texas Legislature passed HB 100, which authorized an additional \$5.35 billion in TRB debt (including interest), to be paid over a 20-year period.
- According to the Legislative Budget Board, TRB debt service on the bonds authorized by HB 100 costs the state approximately \$270 million per year. This debt will not be completely serviced until 2035.
- If TRBs from institutions with across-the-board failing SUE scores had been removed from HB 100, outstanding TRB debt in Texas would have been reduced by about \$1.04 billion—nearly one-fifth of the projected final cost of HB 100.

#### Recommendations

- Attach institutional Space Use Efficiency scores—already developed by THECB—to TRB bills, the same way the Legislative Budget Board attaches a fiscal note to each piece of legislation. TRB bills should not authorize construction at schools with across-the-board failing SUE scores.
- Allow institutions to pledge up to 75% of HEAF revenue to service endowment fund revenue bonds (up from the current 50% limit), and allow these bonds to be paid over 20 years (up from the current 10-year limit). Incorporate these bonds in a broader strategy for reducing the state's reliance on TRBs.
- Study various policies for incentivizing schools to reduce costs by renovating existing infrastructure instead of raising debt for new construction.

continued

## Tuition Revenue Bonds (cont.)

 Study and prioritize policies that accelerate the already rapid development of online education in Texas, especially where online degree plans and other online resources reduce the demand for new construction on Texas campuses.

#### Resources

HB 100 Fiscal Note, Legislative Budget Board, 84th Texas Legislature (May 2015).

Winning the "Space Race": How Universities Can Maximize Existing Space to Reduce Tuitions by Thomas Lindsay, Texas Public Policy Foundation (Dec. 2014).

<u>Center for Higher Education: 84th Texas Legislature in Review</u> by Thomas Lindsay and Trevor McGuire, Texas Public Policy Foundation (Aug. 2015).

<u>Tuition Revenue Bonds: An Analysis of the History and Use of TRBs in Texas from 1971-2016</u> by Trevor McGuire, Texas Public Policy Foundation (June 2017).

<u>Capital Expenditures Report FY 2016 to FY 2020</u>, Texas Higher Education Coordinating Board (Oct. 2015).

# Energy

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#### Clean Power Plan

#### The Issue

In early February 2016, the U.S. Supreme Court granted a stay of the Environmental Protection Agency's (EPA) Clean Power Plan (CPP), freezing the rule's implementation until final review by the courts. In response to petitions from more than two dozen states and many industry groups, this was the Supreme Court's first stay of an administrative rule, reversing the D.C. Circuit's earlier denial.

The CPP, linchpin of the Obama administration's climate policy, is the most sweeping regulation in EPA's history. The rule carries a \$7.2 billion annual price tag. This is a conservative estimate, as total costs amount to over \$30 billion. The rule has evoked the ire of constitutional scholars who view it as a fundamental violation of the U.S. Constitution's provision on the separation of powers. The rule exceeds the legal authority that Congress delegated to the EPA through the Clean Air Act. In the CPP, the Obama-era EPA asserted the authority to federalize and overhaul the country's electric power system, long a prerogative of state authority.

According to the EPA's own calculations, the CPP's goal to cut  $\mathrm{CO}_2$  emissions from electric generation by 32% would result in a mere 0.018 degree Celsius reduction in the rate of warming predicted by the Intergovernmental Panel on Climate Change (IPCC)—an immeasurable change. The rule would impose on Texas one-fifth of the total national obligation to reduce  $\mathrm{CO}_2$ . The total volume of  $\mathrm{CO}_2$  emissions that the EPA's rule intends to reduce by 2030 is emitted by China in less than two weeks.

The CPP's  ${\rm CO}_2$  standards would have forced fuel switching from coal to natural gas on a vast scale and also assumed a 150% increase in renewable sources that cannot provide reliable energy. The EPA's rule conveniently ignores the fact that Texas, at 14,000 megawatts (MW) of installed electric capacity, is already America's largest renewable energy generator. The CPP would have forced the state to increase its installed renewable capacity by 200%, an additional amount of wind and solar generation that is more than any other nation produces at present. The carbon cuts necessary to meet the final goals of the rule in 2030 would limit even natural gas-fired generating plants and force a massive expansion of renewables.

#### The Facts

- The U.S. Congress has never explicitly delegated to EPA the authority to directly regulate human-induced emissions of CO<sub>2</sub>.
- The previous EPA projected that the CPP rule would force the early closure of over 16,500 MW of coal-fired generation by 2020—roughly 15% of Texas' total 110 gigawatts of electric power.
- Texas joined 28 other states in a suit challenging the CPP.
- The CPP will cost at least \$7.2 billion annually to curb 32% of CO<sub>2</sub> emissions in exchange for a 0.018 degree Celsius change in global warming.
- The Supreme Court stayed the CPP until full judicial review is completed.
- The U.S. Congress disapproved the CPP under the Congressional Review Act.

President Trump's Executive Order 13783 ("Promoting Energy Independence and Economic Growth") directed EPA to review the CPP. On the basis of this review, finding that the CPP was unlawful, EPA proposed the repeal of the CPP in late December 2017. EPA also issued an Advanced Notice of Proposed Rule (ANPR) to replace the CPP with a lawful rule in late December 2017.

• The rules to repeal and to replace may be adopted in late summer 2018.

#### Recommendations

- Texas should not expend any state resources in an effort to comply with EPA's CPP until full judicial review on the merits by the Supreme Court.
- Texas should learn from the grim lessons of European countries who aggressively rushed to renewable energy as a way to displace fossil-fueled electric generation.
- Any rule to replace the CPP must apply control measures to the source of emissions "inside the fence."

#### Resources

"Texas Savors Court's Clean Power Plan Ruling" by Mark Lisheron, Watchdog.org (Feb. 18, 2016).

Red Tape Rising 2016: Obama Regs Top \$100 Billion Annually, by James L. Gattuso and Diane Katz, Heritage Foundation (May 2016).

The Many Problems of the EPA's Clean Power Plan and Climate Regulations: A Primer, by Nicolas Loris, Heritage Foundation (July 2015).

*The Facts About the Clean Power Plan* by Kathleen Hartnett White, Texas Public Policy Foundation (Jan. 2016).

*EPA as Overlord of U.S. Electric Power* by Kathleen Hartnett White, Texas Public Policy Foundation (Oct. 2014).

EPA's Final 111(d) Rule (a.k.a. the "Clean Power Plan") – Impact on Energy Council States by Mike Nasi, Jackson Waler L.L.P.

<u>EPA's Proposed 111(d) Rule for Existing Power Plants: Legal and Cost Issues</u>, Testimony of Laurence H. Tribe to the U.S. House Committee on Energy and Commerce, Subcommittee on Energy and Power (March 2015).

## Renewable Energy

#### The Issue

Wind, water, biomass, and the sun are the oldest energy sources used by mankind. The inherent limitations of these sources motivated people to seek more efficient and reliable fuels to power society.

The 1930s and 1940s saw the peak use of windmills. Farmers stopped using them because rural electrification provided power far more reliable and often less expensive than wind. Yet today, we are turning back to this expensive and inefficient energy source because of government mandates and subsidies, which are driving up electricity costs for Texas consumers.

In 1999, Texas adopted a Renewable Portfolio Standard (RPS) mandating that the state's competitive electric providers buy a minimum 2,000 MW of qualifying energy by 2009. In 2005, the Texas Legislature increased the RPS to 10,000 MW by 2025. Texas met the RPS target for installed wind capacity in 2010, a full 15 years ahead of schedule. Subsidies from the RPS flow to generators through renewable energy credits (RECs).

In addition to the Texas' RPS, generous federal subsidies and favorable wind conditions in the vast open plains of west Texas have encouraged wind production. In fact, the federal tax credits for renewable energy may be the driving force behind the rapid growth of Texas' wind generation; when the federal credits briefly lapsed, new wind installation in Texas dried up, despite the fact that no change had been made in Texas' RPS.

Texas' wind farms are concentrated in the panhandle region. While this makes sense insofar as this is where there is the most wind to capture, this area is far from the focus of Texas' highest electrical demand, which is mostly within the "Texas Triangle" of Austin-San Antonio, Dallas-Fort Worth, and Houston. The long distance of wind generation from population centers has led to large subsidies through the construction of the Competitive Renewable Energy Zone (CREZ) transmission lines.

Chapters 312 and 313 of the Texas Tax Code provide incentives for economic development that benefit renewable developers. These incentives consist of property value limitations (resulting in a lessened property tax obligation) and tax abatements. Developers are supposed to create a minimum of 10 jobs in rural areas and 25 in urban areas to qualify, but more than 50% of the agreements are granted waivers to the jobs requirement, with 87% of those waivers going to wind development.

The total cost of subsidies for wind is tremendous. The federal Production Tax Credit alone is estimated to cost \$17.1 billion for the period 2008-17. The CREZ lines cost Texas taxpayers about \$6.8 billion, while all Chapter 313 incentives cost another \$7.1 billion, 22% of which went directly to wind. All of these costs are borne by consumers and taxpayers.

For wind and solar power, the difference between installed capacity and actual net generation is often substantial, because of the intermittent nature of those energy sources (the sun doesn't shine at night or when it is cloudy, and the wind does not blow hard enough or often enough to utilize a turbine's full capacity). The capacity factor, a measure calculated by dividing the generated capacity by the installed

capacity, of United States wind energy was around 36.7% in 2017 and even lower at 31.1% in Texas. Solar performed even worse at 27%. This is substantially below other sources, such as nuclear, that stay near or above 90% every year.

Wind also incurs costs as renewables are integrated into the electrical grid. Because they are intermittent, use of wind and solar power requires continual back-up generation to replace this electricity on the grid at a moment's notice. Typically, natural gas-fired generating units are used in an interruptible mode similar to idling a car. The cost of back-up generation is a hidden and wasteful cost of renewable energy. These costs are not paid for by the investors in wind generation—as in the case of generation from traditional sources—and thus traditional market incentives cannot operate.

#### The Facts

- Subsidies for CREZ lines ran about \$6.8 billion, the federal PTC about \$17.1 billion (2008-17), and the state's RECs about \$560 million.
- The Texas Renewable Portfolio Standard (RPS) mandates 10,000 MW of renewable capacity by 2025, of which 500 MW must be from non-wind sources.
  This goal was met in 2015.
- The backup generation and grid-related costs of wind energy could increase ERCOT's system production costs by \$1.82 billion per year.
- Wind and solar underperform other resources, evidenced by their low capacity rates, 36.7% and 27%, respectively.

#### Recommendations

- Make compliance with the Renewable Portfolio Standard voluntary.
- Support elimination of the federal Production Tax Credit.
- Require renewable energy generators to pay for the costs they impose on the electric grid.
- Eliminate Chapter 312 and Chapter 313 tax abatements for renewables that destabilize Texas' electrical grid.

#### Resources

<u>Texas Wind Power Story, Part 1: How Subsidies Drive Texas Wind Power Development</u> by Lisa Linowes, Texas Public Policy Foundation (June 2018).

<u>Texas Wind Power Story, Part 2: The Impacts of Texas Wind Power Siting</u> by Lisa Linowes, Texas Public Policy Foundation (July 2018).

Setting the Record Straight on Renewable Energy Subsidies by Bill Peacock, Texas Public Policy Foundation (Feb. 2013).

*The Cost of the Production Tax Credit and Renewable Energy Subsidies in Texas* by Bill Peacock and Josiah Neeley, Texas Public Policy Foundation (Nov. 2012).

*Texas Wind Energy: Past, Present, and Future* by Drew Thornley, Texas Public Policy Foundation (May 2010).

## Resource Adequacy

#### The Issue

Competition was introduced into the Texas electricity and telecommunications markets in the late 1990s. Unlike the telecommunications market that has seen increasing levels of deregulation, the electricity market has been subject to a steady assault of attempts to heap new regulations on the market. Many have succeeded. Nevertheless, the competitive Texas electricity market has proved all critics wrong by supplying a reliable, affordable supply of electricity since its inception in 2002.

One attack against the market was made through a series of forecasts in 2012 of diminishing resource adequacy. This set the stage for a push by generators and the Public Utility Commission of Texas (PUC) toward vastly increasing government intervention in the electricity market. However, a more accurate assessment of the data debunked the notion that Texas needs to adopt a capacity market with subsidies to generators as high as \$4 billion a year—on top of what Texass pay for electricity.

In May 2016, the Electric Reliability Council of Texas (ERCOT) forecast historically high levels of reserves: 18.2% for 2017 (as opposed to a 12.84% forecast in 2014), and 25.4% for 2018 (almost double the forecast made for that year in 2014). However, a series of coal plant retirements has substantially lowered forecasted reserve margins. The ERCOT December 2017 forecast projected a 9.3% reserve margin for 2018, with reserve margins of 11.7%, 11.8%, and 11.1% for 2019, 2020, and 2021, respectively.

Although these projections are all below ERCOT's target reserve margin of 13.75%, they still show that Texas should have enough electricity to meet demand for the next four years. Perhaps the biggest challenge the Texas electricity market will face during this period is keeping policymakers and the public on track with competition when supplies get tight and prices increase. All of this will be temporary, but some people start to panic when they see prices rising and want to turn to regulation.

As lawmakers deliberate this issue in 2019, the facts will show that Texas' competitive electricity market is working, and re-regulating the market by emulating East Coast capacity markets will bring harm, not good. The low electricity prices that Texas is still experiencing are the best evidence that Texas has an adequate supply of electricity; the law of supply and demand tells us the low prices are the result of excess supply over demand. If this summer that changes for a period, that is ok—that is how markets work. Higher temporary prices will encourage additional investment in generation, which will increase our reserves. Texas can ensure sufficient generation of electricity for years to come and improve reliability by letting competitors compete and reducing intervention in the market.

#### The Facts

- Texans use about 350 million megawatt hours (MWh) of electricity a year; reliability issues involve perhaps only 1.5 million MWh, less than 0.05% of annual use.
- Peak use is slowing, diverging from economic growth because of market innovation in demand-response.
- Texas' competitive market is already maintaining resource adequacy and improving reliability, both on the supply and demand sides.
- No evidence shows capacity markets boost capacity; from 2007-11, capacity payments in PJM (the mid-Atlantic grid) funded about a 4% increase in generation

while generation in Texas' energy-only market grew about 12%.

 Moving toward a capacity market in Texas would result in an "electricity tax" on consumers—of up to \$3 billion annually if Texas completely abandons its competitive market. Payments from consumers through the tax would mainly be used to increase the profitability of electricity generators and Wall Street investment firms, not to fund new generation.

#### Recommendations

- The PUC and ERCOT should not manipulate the operating reserve demand curve (ORDC) at the state or local levels to increase revenue for generators.
- The PUC should eliminate the high systemwide offer cap.
- The PUC and ERCOT should more closely evaluate the ability of current and potential market-driven demand response to handle peak load strains on the system.
- The Legislature should prohibit a capacity market in statute.
- The Legislature should reorient/eliminate the Independent Market Monitor and the regulation of market power abuse.
- The Legislature should reduce the PUC's excessive regulatory authority.
- The Legislature should make the Texas Renewable Portfolio Standard voluntary.
- Texas policymakers should eliminate state and local subsidies/abatements for renewable energy.

#### Resources

Report on the Capacity, Demand and Reserves in the ERCOT Region, 2017-2026 by the Electric Reliability Council of Texas (ERCOT) (May 2016).

<u>Debunking the Myth: Texas is Not Running out of Electricity--The Generators</u> by Bill Peacock, Texas Public Policy Foundation (Feb. 2014).

*Texas' Competitive Capacity Market* by Robert Michaels, Texas Public Policy Foundation (Jan. 2014).

*Electricity in Texas: Markets, not Manipulation* by Bill Peacock, Texas Public Policy Foundation (Jan. 2014).

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<u>Capacity Markets Represent a Bad Bargain for Texas Consumers</u> by Kathleen Hunker, Texas Public Policy Foundation (Oct. 2013).

*There and Back Again: The High Transition Costs of Electricity Regulation* by Kristin Cavin and Bill Peacock, Texas Public Policy Foundation (Oct. 2013).

<u>Competition is Working in the Texas Electricity Market</u> by Bill Peacock, Texas Public Policy Foundation (Sept. 2013).

<u>A Texas Capacity Market: The Push for Subsidies</u> by Kathleen Hunker, Texas Public Policy Foundation (Sept. 2013).

<u>Does Competitive Electricity Require Capacity Markets? The Texas Experience</u> by Andrew Kleit and Robert Michaels, Texas Public Policy Foundation (Feb. 2013).

## Capacity Market

#### The Issue

Texas has the most competitive electricity market in the country. Nevertheless, there has been an ongoing debate at the Public Utility Commission of Texas on whether Texas' current energy-only market should be changed to make it operate more like a centralized capacity market, such as those that operate in the East and Midwest. Making such a change would re-regulate the market unnecessarily and shift the costs (and risks) of new investments to consumers.

A capacity market operates by giving electricity generators yearly subsidies in exchange for a promise that they will use the guaranteed revenue to invest in new capacity. These payments are not for the electricity that generators produce, but for the amount of electricity that they could theoretically produce if their operations were running at peak efficiency and, most important, were that energy needed.

Mimicking a capacity market would be a very expensive way to meet Texas' energy needs. Studies repeatedly show that the capacity payments alone would cost Texas consumers somewhere between \$3 billion and \$5 billion per year—an assessment that does not include design, implementation, and litigation expenses.

There is no evidence that a centralized capacity market boosts a region's energy capacity, much less helps avoid future blackouts. Capacity payments in PJM—the regional transmission organization serving the mid-Atlantic—yielded less investment in new generation than Texas' energy-only market, not only in terms of sheer megawatts but also as a percentage of the region's installed capacity, despite costing PJM consumers over \$50 billion during that timeframe.

One reason for this lackluster result is that most of the funds never went to finance new generation but instead found their way into subsidizing the operational costs of existing resources. For example, more than 93% of the money paid by PJM customers went to existing generation; only 1.8% found its way to new or "reactivated" generation sources. Additionally, the bulk of capacity payments subsidized base load generation plants even though there was no shortage of investment in base load generation and even though those plants can recoup their fixed costs from energy sales alone.

Finally, capacity markets suffer from a severe design flaw that damages the grid's overall reliability and may make the market more prone to blackouts. Capacity markets interpret reliability as being dependent on the amount of capacity alone. They, therefore, offer all generators uniform payments regardless of the plant's efficiency and ignore those characteristics that ensure that grid operators can convert and transport installed capacity to consumers. This has the consequence of eliminating price signals and discouraging investors from building plants where and when they are needed most—a perverse incentive that hurts ERCOT's overall operational reliability.

Today, the debate in Texas is not whether we should adopt a full-blown capacity market, it is whether we should adopt operational procedures and protocols being used in capacity markets. Proposals under discussion at the PUC such as updating the Operational Reserve Demand Curve (ORDC), using locational reserves,

and adding real-time optimization are all examples of this. These proposals are being pushed by generators who want to increase electricity prices to increase their profits. Texas should stay with its energy-only market and remove current regulations to make the market more efficient rather than import ideas from expensive East Coast electricity markets.

#### The Facts

- Numerous studies predict that a capacity market will cost Texas consumers an additional \$3 billion to \$5 billion per year, not including the market's design, implementation, and litigation expenses. The most recent Brattle Report estimated that these hard costs would come to an annual \$3.2 billion.
- The Brattle Report claims that, even assuming the optimal scenario, where a Texas capacity market delivers on its promises and offsets some of its hard costs, capacity payments would have an annual net cost of at least \$400 million.
- PJM spent \$50 billion in capacity payments between 2007 and 2011 and added 7,000 megawatts of new generation, about 4% of its total install capacity. During that same period, Texas' energy-only market added 10,000 megawatts of new generation, about 12% of its installed capacity, with zero extra cost to consumers.
- In September 2013, PJM suffered a series of rolling blackouts due to unusually
  high temperatures in combination with mechanical issues and plants being
  taken offline for season maintenance. The blackouts occurred despite a fully
  mature capacity market and over \$54 billion spent in capacity payments.

#### <u>Recommendations</u>

- Preserve Texas' energy-only electricity market by reducing current regulations on the market.
- Reject proposals that seek to turn Texas' energy-only market into a capacity market-lite version of other less competitive markets.
- Do not adopt a mandatory reserve margin.

#### Resources

<u>Capacity Markets Represent a Bad Bargain for Texas Consumers</u> by Kathleen Hunker, Texas Public Policy Foundation (Oct. 2013).

<u>A Texas Capacity Market: The Push for Subsidies</u> by Kathleen Hunker, Texas Public Policy Foundation (Sept. 2013).

Reforming Texas Electricity Markets: If You Buy the Power, Why Pay for the Power Plant? by Andrew N. Kleit and Robert J. Michaels (Summer 2013).

## Regulation of the Texas Electricity Market

#### The Issue

The state of Texas' world class electricity market demonstrates the benefits of competition. The average offer price for new service is about 11.6 cents per kWh, while the average of the 20 lowest offers is around 9.3 cents per kWh. In addition, projections for reserves are as good as they've ever been. The reserve margin is about 11% and has proved adequate during 2018's hot summer despite the closure of three coal plants.

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

Another type of interference in the market comes from various forms of price regulation and manipulation. One such effort to control prices is the hard price cap on wholesale prices. The problem with the cap for example is that it reduces prices at times of peak demand, when electricity is the most expensive to produce. If generators can't sell electricity at a profit at times of peak demand, they won't build generation plants that will supply electricity when we need it most.

Other means of interference with wholesale prices include ancillary services and the operating reserve demand curve (ORDC).

Though the system of ancillary services operated by the Electric Reliability Council of Texas (ERCOT) was designed to ensure adequate supplies of energy, what has too often happened instead is that it has reduced the prices during peak times needed to bring new investment in generation. The lower prices led generators to push for the adoption of ORDC, which is designed to artificially increase prices.

Calls to "fix" Texas' electricity market with more government and meddling with our "energy only," i.e., free-market, approach to generating electricity always make electricity more expensive for consumers. The appropriate long-term approach to Texas' energy market is not to regulate the market more, but to regulate it less.

If we let it work, the world-class Texas electricity market will power Texas' future.

#### The Facts

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

#### Recommendations

- Eliminate wholesale price caps.
- Eliminate the ability of the PUC to disgorge revenue.
- Eliminate the PUC's emergency cease and desist authority.
- Define more clearly the concept of market power and market power abuse.
- Make compliance with the Renewable Portfolio Standard voluntary, and support elimination of the federal production tax credit.

#### Resources

"Texas' Electricity Market can Power Our Future" by Bill Peacock, Texas Public Policy Foundation (July 2012).

*HB 2133: Don't Ruin the Texas Electricity Market* by Bill Peacock, Texas Public Policy Foundation (May 2011).

<u>Competition in the Texas Electricity Market</u> by Bill Peacock, Texas Public Policy Foundation (March 2011).

<u>Texas' Renewable Energy Experiment</u> by Bill Peacock, Texas Public Policy Foundation (Dec. 2010).

## Disgorgement

#### <u>The Issue</u>

In 2011, HB 2133 granted the Public Utility Commission (PUC) of Texas the power to disgorge revenue from electric companies if the revenue in question is determined to have been derived from "market power abuse" or other violations of the Utilities Code.

However, no evidence exists that market power abuse or similar anticompetitive behaviors has taken place in the Texas electricity market; in fact, the competitive nature of Texas' energy market is one of the features that makes it work so well and ultimately has kept power affordable and reliable for Texans.

Texas' electrical market helps keep Texas going, both in terms of energy provision and in terms of economic benefits. The investment that deregulation brings not only keeps our energy secure, but also generates new jobs for Texans. In addition, the rates are affordable—far more so than when government regulation controlled the price at the turn of the century.

The threat of disgorgement, however, threatens to stifle the advantages of competition. Rather than allowing the market to self-correct, the changes brought by HB 2133 increase the type of regulation that keep electricity prices high in New York, California, and other regulation-heavy states. This regulatory risk has also reduced the incentives to invest in new generation in Texas and contributed to the concerns over reliability in Texas' competitive electricity market.

Texas' continuing economic success depends on limiting excessive regulation of its energy markets—both the exploration and production of oil and gas and the generation and sale of electricity. Disgorgement threatens the success of Texas' competitive electricity market and threatens the success of Texas as a result.

#### The Facts

- Texas' electric markets have helped to lower overall prices without government intervention and have led to increased investment in our electrical infrastructure.
- Disgorgement powers granted by HB 2133, passed in 2011, threaten the health of Texas' electrical markets.
- No evidence exists of the existence of any market power abuse or similar anticompetitive behavior in the Texas power market.
- Disgorgement is a solution in search of a problem.

#### Recommendation

Repeal the provisions added by HB 2133 that allow for the PUC to exercise disgorgement authority.

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#### Resources

<u>A Tale of Two Markets: Telecommunications and Electricity</u> by Bill Peacock, Texas Public Policy Foundation (March 2013).

<u>HB 2133: Don't Ruin the Texas Electricity Market</u> by Bill Peacock, Texas Public Policy Foundation (May 2011).

*HB 2133 and 2134: Solutions in Search of a Problem* by Bill Peacock, Texas Public Policy Foundation (March 2011).

## **Environment**

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## **Climate Policy**

#### The Issue

Whether labeled global warming or climate change, the theory that manmade greenhouse gas (GHG) emissions will cause catastrophic warming is the justification for onerous climate policies that aim to limit or eliminate the use of fossil fuels: coal, natural gas, and oil. These policies have historically been institutionalized in Environmental Protection Agency (EPA) regulations and in other actions across the federal government. The U.S. Congress, however, has repeatedly refused to delegate authority to federal agencies to control greenhouse gases—among which carbon dioxide (CO<sub>2</sub>) is by far the dominant source.

 $\mathrm{CO}_2$  is a ubiquitous by-product of all human activity—from breathing to burning fossil fuels—that powers our cars and generates our electricity.  $\mathrm{CO}_2$  is also known as the "gas of life," as it is vital for the most fundamental energy conversion on earth: photosynthesis. Although it may be possible that increased atmospheric concentration of  $\mathrm{CO}_2$  may generate some warming, it is not clear whether the warming would have a significant negative effect. To the contrary, hundreds of research studies demonstrate that increased  $\mathrm{CO}_2$  concentrations and some warming would create a net benefit for plant growth, upon which human life on earth depends. Paleoclimatology has long recognized past geological eras with vastly higher levels of  $\mathrm{CO}_2$ . Science still lacks an understanding of how natural variables interact and affect climate—including the sun from which almost all energy in our climate system originates.

Much of the concern about climate change is based on unverified predictions of how slight increases in global temperatures will impact the climate through a "feedback loop." The predictions from these "scientific climate models" have been proven wrong time and again. Even the U.N.'s Intergovernmental Panel on Climate Change (IPCC), in its *Fifth Assessment Report*, backpedaled from a number of alarmist conclusions it had drawn in previous reports, questioning the degree of assumed climate sensitivity to man-made emissions of CO<sub>2</sub> and recognizing that a link between rising carbon emissions and extreme weather events is not likely.

Claims that the science supporting predictions of catastrophic warming are absolutely settled beyond all question belie the theoretical weakness of current climate science. No genuine science is ever settled beyond any question. Increasing efforts to silence "climate skeptics" and their employers by criminal prosecution are a chilling reminder of how fiercely politicized climate science and policy have become.

Texas is disproportionately harmed by climate regulations both because the state has the largest energy sector in the country and it leads the shale revolution, which has unlocked the mother lode of oil and natural gas found in hard shale rock.

Government limits and control of  $\mathrm{CO}_2$  have not been authorized in law by Congress. In fact, efforts at "cap and trade" legislation to limit  $\mathrm{CO}_2$  were specifically rejected by Congress. Instead, under the Obama administration, the EPA attempted to regulate  $\mathrm{CO}_2$  and the electric grid though the Clean Power Plan. EPA's rules to reduce greenhouse gas emissions, however, are futile. None of the rules would

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reduce CO<sub>2</sub> by an amount that would avert the warming predicted by the IPCC. The CPP would have redesigned the nation's entire system of electric generation but reduced predicted warming by only 0.018 degree Celsius. Fortunately, the U.S. Supreme Court stayed EPA's Clean Power Plan, and, under President Trump, EPA has proposed repealing the Clean Power Plan.

Yet, without EPA interference, the U.S. has reduced  $\mathrm{CO}_2$  emissions more than other countries through efficiency and innovation. The Energy Information Administration (EIA) announced that energy-related emissions of  $\mathrm{CO}_2$  decreased 3.7% in 2012, the lowest emission level of  $\mathrm{CO}_2$  since 1994. Indeed,  $\mathrm{CO}_2$  emissions in the U.S. are falling faster than in countries under mandates such as the European Union's Emissions Trading System or in countries like Germany that have most aggressively pursued renewable energy.

In late March 2017, President Trump issued Executive Order 13653: Promoting Energy Independence and Economic Growth. This executive order directed relevant federal agencies to suspend, rescind, or repeal climate-related regulatory actions to include Obama's former Climate Action Plan, the Clean Power Plan, and the easily misused and so-called "Social Cost of Carbon." These deregulatory actions are now pending within the agencies or federal courts. On June 1, 2017, the president announced that the U.S. would withdraw from the Paris Climate Accord.

## The Facts

- The use of fossil fuels has contributed to the longevity and quality of life for hundreds of millions of people. People live longer, have access to more affordable food and clean running water, more disposable income, and have good-paying jobs for themselves and their families because of our ability to use our abundant, reliable, and affordable domestic natural gas, oil, and coal.
- Eliminating fossil fuels without a fully comparable substitute risks energy scarcity that would increase poverty and stymie economic growth.
- Modern civilizations are utterly dependent on massive consumption of fossil fuels. Economic growth and increasing fossil fuel consumption rose in lockstep throughout the 20th century.
- Abundant, affordable, concentrated, versatile, reliable, portable, and storable—fossil fuels are far superior to any alternative energies at this point in time.
- America has abundant, reliable, and affordable supplies of natural gas, oil, and coal. We should use these domestic resources to benefit ourselves and our allies.

## <u>Recommendations</u>

- Urge federal policymakers to conduct an independent, rigorous review of the U.S. Global Change Research Program's "Climate Science Special Report" (conducted by an inter-agency program), as well as the most current Assessment Report of the U.N.'s IPCC.
- Suspend state programs that require or incentivize GHG reduction.
- Seek legislative repeal by Congress of EPA's Endangerment Finding.

continued

# Climate Policy (cont.)

#### Resources

<u>Statement to the Committee on Environment and Public Works of the U.S. Senate</u> by Judith A. Curry (Jan. 16, 2014).

<u>Global Warming: How to Approach the Science: Testimony before the House Subcommittee on Science and Technology</u> by Richard S. Lindzen (Nov. 17, 2010).

Coalition for Responsible Regulation, et al. v. Environmental Protection Agency, No. 09-1322 (D.C. Cir. Filed 16 Feb. 2010).

<u>Global Warming: What Should Texas Do?</u> by Iain Murray, Texas Public Policy Foundation (April 2007).

<u>Review of the President's Climate Action Plan: Testimony before the Senate Committee on Environment and Public Works</u> by Kathleen Hartnett White (Jan. 16, 2014).

## The EPA

#### The Issue

rom 2009-17, the Environmental Protection Agency (EPA) carried out "a regulatory spree unprecedented in U.S. history"—in scope, stringency, and costs, and with highly questionable justification. The costs of EPA rules dwarf the costs of all other executive branch agencies by a huge margin, accounting for \$23 billion of \$26 billion total regulatory costs in 2010. While the national economy has been impaired, Texas' prominent industrial and energy sectors were disproportionately affected.

As a result of the national election in 2017, major reforms of EPA's regulatory rampage is well underway. The EPA has begun at least 50 "deregulatory" actions and has announced that it is refocusing on original "core functions" under the Clean Air Act to protect human health and welfare to include economic growth.

Shared policy objectives within the administration and congressional leadership should present an opportunity for Texas to restore the state authority delegated to the states in the Clean Air Act.

#### Ozone National Ambient Air Quality Standards (NAAQS)

The EPA's NAAQS threaten economic growth at a time when low energy prices create unprecedented opportunity.

In February 2018, the U.S. Court of Appeals for the D.C. Circuit struck down nine elements of the EPA's 2015 rule governing state implementation of NAAQS for ozone set in 2008. Essentially, the court found that EPA had unlawfully authorized areas still in nonattainment of the 1997 NAAQS standard to ignore deadlines.

The decision will likely impact the Trump administration's intention to promulgate an implementation rule for the 70 parts per billion (ppb) 2015 ozone standard.

In Texas, as of March 2018, the EPA designated 24 counties as nonattainment areas under this new standard.

As adopted, the EPA dismisses concerns about the cost of the new standard by claiming huge public health benefits. The reality is that these are not benefits from directly lowering ozone levels but instead are the "co-benefits" of reducing fine particulate matter—another pollutant already regulated under its own NAAQS. EPA's 70 ppb ozone NAAQS is now challenged in federal court.

#### **Cross-State Air Pollution Rule**

Also adopted by the EPA, the Cross-State Air Pollution Rule (CSAPR) is another rule that disproportionately impacts our state. Although Texas has already reduced sulfur dioxide (SO<sub>2</sub>) emissions by 33% since 2000, the state alone is tasked with a quarter of total mandated SO<sub>2</sub> reductions.

The Electric Reliability Council of Texas (ERCOT), the operator of the electric grid carrying 85% of the state's electric load, concluded that "had CSAPR been in effect [during the record hot temperatures in the summer of 2011] Texans would have experienced rolling outages and the risk of massive load curtailment."

continued

## The EPA (cont.)

Although vacated by the 9th U.S. Circuit Court of Appeals, most of CSAPR was upheld by the U.S. Supreme Court in 2014. In late 2016, EPA modeling showed that Texas no longer significantly contributed to downwind nonattainment. In 2016, EPA issued new CSAPR regulations that went into effect in May 2017.

Mercury Rule: The Utility MACT (Maximum Achievable Control Technology) In 2015, the Supreme Court remanded the EPA's rule to control mercury emissions from power plants, rejecting the agency's method of estimating costs and benefits. This single rule had imposed multi-billion dollar expenditures, forced closure of power plants, and led to the bankruptcy of major coal companies. Although the rule carried compliance costs that the EPA estimated at \$10.9 billion per year, only 0.004% of the claimed benefits derives from direct reduction of mercury. The remainder, as in the new ozone standard, derive from the EPA's spurious use of co-benefits from reduced particulate matter.

#### Visibility: Regional Haze Program

When the U.S. Congress created the Regional Haze Program in the Clean Air Act amendments of 1977, it was clear that Congress intended for the states to take charge of the program.

Recent EPA rules have stripped the states of this right. Since 2009, the EPA began rejecting state implementation plans for regional haze and instead imposing federal implementation plans (FIPs). FIPs are the most hostile action that the EPA can take against a state, and in practice are seen as denial of state authority.

In December 2015, the EPA imposed on Texas a \$2 billion federal plan to attain a maximum visibility improvement of a mere 0.5 deciviews. Peer-reviewed research has shown that it takes a reduction of five to ten deciviews for the average person to perceive any improvement in visibility. In a 2014 report, ERCOT concluded that the Regional Haze Program's  $\mathrm{CO}_2$  emission limits could lead to closure of 3,300 to 8,700 megawatts of coal generation in Texas.

Under the new administration, the Regional Haze Program could receive renewed attention and recognition of state decisions. In October 2017, EPA published a final rule allowing the Lone Star State to implement a flexible, market-based, intra-state emission-allowance trading program for electricity generators to meet requirements at a lower cost.

## The Facts

- All six of the criteria pollutants regulated under the Clean Air Act have fallen substantially in recent decades. Ambient levels of carbon monoxide fell 82% between 1980 and 2010. SO, fell 76% and NO, fell 52%.
- The previous administration imposed more than 10 times the number of FIPs of the three administrations before it combined. Under the new administration the EPA has on average replaced every one FIP with a State Implementation Plan (SIP) every month.
- In April 2018, President Trump signed a memorandum for EPA Administrator Pruitt, directing the agency to provide efficient and cost-effective implementation NAAQS air quality standards and Regional Haze Programs of the Clean Air Act.

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 Over 60 planned industrial projects in Texas have been waiting more than a year for GHG permits from the EPA.

#### Recommendations

- Texas should work with the leadership at EPA to reclaim state authority under the Clean Air Act by science or law.
- Congress should pass a law clarifying that states, not the EPA, are the foremost decision makers in implementing the Regional Haze Program.

#### Resources

The Cross-State Air Pollution Rule: What American Lung Association v. EME Homer City Generation Means for Texas by Josiah Neeley, Texas Public Policy Foundation (Dec. 2013).

"Cross-State Air Pollution Rule (CSAPR)," Texas Commission on Environmental Quality (Accessed April 17, 2018).

*EPA's Pretense of Science: Regulating Phantom Risks* by Kathleen Hartnett White, Texas Public Policy Foundation (May 2012).

<u>EPA's Approaching Regulatory Avalanche</u> by Kathleen Hartnett White, Texas Public Policy Foundation (Feb. 2012).

"Recent Developments in Regional Haze Policy: EPA and Environmental Groups Battle Over a New Program for Texas" by Norman W. Fichthorn, Nickel Report (March 13, 2018).

<u>Texas vs. Environmental Protection Agency</u> by Josiah Neeley, Texas Public Policy Foundation (April 2012).

<u>Testimony on "EPA's Regional Haze Program" before the Subcommittee on Environment Committee on Science, Space, & Technology</u> by William Yeatman, Competitive Enterprise Institute (March 23, 2016).

# **Endangered Species Act**

#### The Issue

The Endangered Species Act (ESA) has long been known as the "pit bull" of federal environmental laws because of the inflexibility of how it attempts to protect species listed under the act, regardless of cost or impact on human activities. The law makes it a felony to "take" any species listed as endangered or threatened. The extremely broad interpretation of "take" includes activity to "harass, harm, pursue, hunt, shoot, wound, kill, trap, capture, or collect, or to attempt to engage in any of these activities." The scope of a take finding extends to both intentional and non-intentional activity.

For decades, the U.S. Fish and Wildlife Service (FWS) focused its implementation of the ESA on federal lands and thus had little impact on Texas. This has changed over the last 10 years as the FWS has lengthened its listing of protected species on private land and water resources.

After seven years of litigation regarding the federal protection of the endangered whooping crane and its impact on the state's authority to allocate surface water, the federal court exonerated Texas and upheld state authority. In this litigation known as *Aransas Project v. Shaw*, an environmental group sued the Texas Commission on Environmental Quality (TCEQ) for the alleged take of a number of cranes. The Aransas Project claimed that TCEQ's past or future issuance of water rights to divert water from the Guadalupe and the San Antonio rivers caused the cranes' death. The federal district court's ruling against the TCEQ was overturned by the 5th Circuit U.S. Court of Appeals.

If the district court's decision had not been reversed, Texas' long-recognized authority to allocate surface water within its borders through the issuance of water rights would have taken a backseat to a conservation plan enforced by the federal government.

The number of areas in Texas affected by species listed as threatened or endangered continues to grow. Concern over the listed Houston toad impeded recovery after the Bastrop fires in 2011, perhaps doubling the cost and time involved. The discovery of a single endangered spider, the Braken Bat Cave meshweaver, immediately halted construction of the last 1,500 feet of a six-mile \$11 million pipeline to convey water to the west side of San Antonio. In 2012, the potential listing of the dunes sagebrush lizard threatened to shut down significant oil and gas operations in the Permian Basin of west Texas. In a rare decision, the FWS decided not to list the lizard because of the protectiveness of the existing voluntary conservation plans, a decision subsequently upheld by a federal court. In the summer of 2018, environmental activists have again petitioned to list the lizard.

Williamson County is now battling the FWS on constitutional grounds over the listing of the Bone Cave harvestman. This tiny eyeless arachnid is stalling development of crucial infrastructure in the county, and its taking could lead to \$50,000 in fines and one year in prison. Incidental take permits and other mitigation measures are exorbitant. Mitigation permits cost \$10,000 per acre to develop within 345 feet of a harvestman cave spider and 40 times more—\$400,000 per acre—within 35 feet. In November 2015, the Foundation's Center

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for the American Future (CAF) filed a suit to delist the harvestman—a species existing only within Texas. CAF's suit questions the constitutional legitimacy of federal protection of exclusively intrastate species. In March 2018, the trial court held a final hearing on the merits with the order anticipated in the fall of 2018.

Texas freshwater mussel species have been a hot ESA topic since 2009. In February 2018, the Texas hornshell became the state's first mussel to be listed as a federally endangered species. There are 14 others that remain threatened at the state level, five of which (the golden orb, smooth pimpleback, Texas fatmucket, Texas fawnsfoot, and Texas pimpleback) are now candidate species under consideration for federal ESA listing. Listing of the mussels would lead to federal oversight of their aquatic habitats, which most likely involve federal mandates to augment environmental flows in many streams and rivers in central Texas. Dedicating this water to habitat conservation could significantly limit water supply available for human use.

The 83rd Texas Legislature passed HB 3509 to give the Texas Parks and Wildlife Department (TPWD) authority to help implement federal ESA programs. Ultimately vetoed by the governor, HB 3509 would have substantially expanded what has long been TPWD's limited authority over private land use.

#### The Facts

- Less than 2% of listed species have been removed from the ESA's endangered list in 40 years.
- The ESA's listing of the Delta Smelt fish forces the state of California to flush three million acre-feet of water intended for human use into the ocean instead.
- Texas' first mussel species, the Texas hornshell, has been federally listed as endangered under the ESA. It might be a foreshadowing for further listing decisions of 14 other freshwater mussel species to come.

## Recommendations

- Texas should not use state programs used to protect species listed under the ESA that facilitate federal land use controls on private land.
- Texas should encourage proactive state, local, and private strategies to conserve wildlife by means of rigorous science and voluntary programs.
- Support the efforts of Texas congressional members to reform the ESA.
- Maintain current program to assist local government, land owners, and businesses in challenging ESA listings and habitat conservation plans.
- Do not use top-down, state-centralized programs for Texas' response to ESA listings.

continued

# **Endangered Species Act (cont.)**

#### Resources

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<u>Analysis of the Science: The Whooping Crane Decision</u> by Lee Wilson, Texas Public Policy Foundation (May 2013).

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"<u>Texas Nature Trackers: Texas Mussel Watch</u>," Texas Parks & Wildlife (Accessed April 2018).

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# Water

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# Water Supply

## The Issue

Growth in the economy and population, as well as cyclical droughts throughout much of Texas, increases the urgency of providing adequate supply of water in Texas. As required by the landmark water legislation SB 1, passed in 1997, Texas has completed detailed State Water Plans (SWP), measuring available water supply, future demand, and identifying strategies to increase supply. The most recent 2017 SWP issued by the Texas Water Development Board (TWDB) estimates that our state will need an additional 8.9 million acre-feet of water per year by 2070 to meet the demands of a population projected to increase from 29.5 million in 2020 to 51 million.

According to the 2017 SWP draft, only 14% of the nearly 3,100 strategies recommended by the 2012 SWP have reported some form of progress. Delays increase the challenge of meeting demands even in the near term. The 85th Legislature saw the passage of SB 1151, which will require the SWP to provide information on implementation of high priority projects and lead regional water planning groups to exclude infeasible water management strategies.

By law, Texas plans for enough water to meet demand during a drought of record, which refers to hydrologic conditions averaged over the decade of the 1950s. But that model may need revising, as droughts of the last few years, particularly the drought of 2011, had worse hydrological conditions than the drought of record.

Project implementation has been delayed, in large measure, by state regulatory issues and funding. Following passage of SB 1, legislation was passed that complicates new water supply projects. SB 2 in 2001 and HB 1763 in 2005 enlarged the authority of Groundwater Conservation Districts, which is now often exercised to limit or block private development of groundwater. In 2007, SB 3 established a multi-layered process leading to the Texas Commission of Environmental Quality's (TCEQ) adoption of Environmental Flow Standards. Water supply projects, based on development of groundwater and new surface water rights permits, are delayed by these new groundwater and environmental flow statutes.

The 84th Legislature saw the passage of HB 200, which established a process for judicial appeal of desired future conditions made by Groundwater Conservation Districts. This is a needed step toward undoing previously legislated water policy, which obstructed beneficial use of privately owned groundwater in Texas.

Other regulatory issues complicate water supply projects. The junior rights provision strips water rights of their seniority when surface water is transferred for use in a water basin different from the basin in which the water rights originated. This discourages interbasin transfers, a key strategy to meet future water demand. HB 1153, introduced during the 84th Legislature, called for a repeal of the junior rights provision, a much needed reform.

SB 1 stipulated that "voluntary redistribution" of existing water supply would create much of the water needed for growing demand. Such redistribution assumes a well-functioning water market, which facilitates change of use (e.g., from irrigation to municipal use) and water transfers. Markets depend upon defined property rights and predictable regulatory decisions.

### The Facts

- The 2017 SWP estimates Texas will need an additional 8.9 million acre-feet of water a year until 2070 to meet demand under drought conditions.
- Implementation of the water supply strategies in the 16 Regional Water Plans has an estimated capital cost of \$62.6 billion.
- Voluntary redistribution of existing water supply through water marketing is constrained by state and local district regulations.
- Water management strategies could generate nearly 3.4 million acre-feet of additional supply per year by 2020, according to the SWP.
- Surface water strategies in the SWP are estimated to produce 3.8 million acrefeet of additional supply per year, approximately 45% of the total recommended strategy supplies in 2070.
- The 2017 SWP recommends construction of 26 new reservoirs, which would add 1.1 million acre-feet of new supply annually by 2070.

#### Recommendations

- Remove legal barriers to private investment in water supply projects.
- Amend Texas law to simplify TCEQ approval of water rights amendments.
- Simplify requirements for bed and banks authorization for indirect reuse of water and repeal the junior rights restrictions on interbasin water transfers.
- Amend SB 3 to clarify that the policy objectives for Environmental Flow Standards are critical flows during a drought of record.
- Clarify whether the TWDB's statutory authority in Regional Groundwater
  Management Areas to establish desired future conditions is consistent with the
  landowner's right to groundwater in place, as recognized by the Texas Supreme
  Court in Edwards Aquifer Authority v. McDaniel, and the Texas Legislature in
  SB 332.

#### Resources

*Texas Water Policy Options* by Josiah Neeley, Texas Public Policy Foundation (March 2013).

2012 State Water Plan, Texas Water Development Board (Jan. 2012).

*Liquid Assets: The State of Texas' Water Resources*, Texas Comptroller of Public Accounts (Feb. 2009).

<u>Solving the Texas Water Puzzle: Market Based Allocation of Water</u> by Ronald A. Kaiser, Texas Public Policy Foundation (March 2005).

Draft 2017 State Water Plan, Texas Water Development Board (March 2016).

<u>The Case for a Texas Water Market</u> by Kathleen Hartnett White, Carlos Rubinstein, Herman Settemeyer, and Megan Ingram, Texas Public Policy Foundation (May 2017).

# Surface Water Rights

## The Issue

Unlike groundwater, which is owned by the landowner as a real property right, surface water is legally owned by the state in Texas. Texas owns the corpus of the surface water but allocates this water through the issuance of rights for beneficial use of the water. Most Texas surface water rights are held in perpetuity and can only be cancelled for non-use over an extended period of time (TWC 11.0235(a)). Such usufructuary rights are recognized as private rights and entitle the appropriator of a given amount of water from a particular diversion point for a particular beneficial use enumerated in law. Such rights can be bought and sold with minimal state review if the purpose of use is not changed in the transaction.

Like most western states, Texas has adopted the prior appropriation system to allocate quantities of surface water for specific beneficial uses. Texas' prior appropriation system operates under the principle of "first in time, first in right," meaning that older or "senior" rights are given precedence over newer or "junior" rights in times of water shortage. An exception to the prior appropriation system is the landowner's qualified riparian rights for domestic and livestock use.

Surface water is the most significant source for the water supply strategies identified in the State Water Plan (SWP). It is the source of approximately 3.8 million acre-feet of water needed by water user groups, accounting for 45% of the total recommended strategy supplies in 2070 in the 2017 SWP draft. However, state and federal regulatory impediments, and legal questions about water right amendments, interbasin transfers, indirect reuse authorizations, environmental flows, and federal endangered species protection now delay and could preclude key surface water projects.

In 2007, SB 3 created a multi-layered process to protect environmental flows leading to the Texas Commission on Environmental Quality's (TCEQ) adoption of Environmental Flow Standards for instream flows (rivers) and freshwater inflows (bays and estuaries). The law stipulated a bottom-up process with five layers: (1) Bay/Basin Stakeholder Groups; (2) Bay/Basin Science Teams for each river basin; (3) an Environmental Flow Advisory Group appointed by the governor; (4) a statewide Science Advisory Group; and finally (5) TCEQ adoption of Environmental Flow standards in rule.

Some models used to estimate needed environmental flows would require greater volumes than anticipated in previous SWPs and existing law. For example, a key strategy for the Dallas-Fort Worth region involves a transfer of 600,000 acre-feet of water from Toledo Bend Reservoir on the Sabine River. The science team in the Sabine Bay/Basin group recommends environmental flow requirements, which would decrease water available for this transfer, undermining this source of new supply for DFW. Science team reports have prompted federal authorities to interfere with Texas water decisions. The 2017 update is the first SWP to include environmental flow standards in water availability models used for evaluating water management strategy supplies.

Environmental and human needs can both be met but should be legally integrated within the same process. In a state with widely varying rainfall and thus flows in our rivers, streams, and estuaries, environmental flows should be estimated to

protect critical flows under drought conditions.

Restrictions on interbasin transfers also pose obstacles to the completion of water supply projects. Interbasin transfers are a key strategy for certain regions of the state, particularly in the area surrounding Dallas-Fort Worth. SB 1, however, added a new section to the Texas Water Code providing that "any proposed transfer of all or a portion of a water right [in an interbasin transfer] is junior in priority to water rights granted before the time application for transfer is accepted for filing." The junior rights provision thus creates a situation where the act of transferring a water right from a seller to a buyer erases much of the value of that right. This can be a major disincentive to interbasin transfers. HB 1153 in the 84th Legislature called for the much-needed repeal of the junior rights provision but was not passed out of committee.

## The Facts

- Texas surface water resources: 191,000 river miles running through 23 river basins, 9 major and 20 minor aquifers, 7 major and 5 minor bays and estuaries, and over 3,300 miles of shoreline.
- Most of the state's existing surface water supply is stored in reservoirs.
- Surface water strategies in the 2017 SWP need to provide 4 million acre-feet per year in additional water supplies to meet Texas' demand for water in 2070.

#### Recommendations

- Legally integrate the Regional Water Planning process with the now separate Bay/ Basin Environmental Flow process. Assert the priority of human need for water.
- Establish policy objectives for environmental flow regimes to protect critical flows during drought and minimum standards for scientific rigor.
- Clarify the "Four Corners Provision" (TWC 11.122(b)) that a water right amendment for only a change or addition of use is not subject to administrative hearing.
- Simplify the requirements for indirect re-use of water in TWC 11.042 and 11.046.
- Articulate policy reinforcing the value of water marketing for efficient and timely implementation of water supply strategies in the SWP.
- Repeal the junior rights provision relating to interbasin transfers.

#### Resources

2012 State Water Plan, Texas Water Development Board (Jan. 2012).

*Rights to Use Surface Water in Texas*, Texas Commission on Environmental Quality, GI-228.

<u>Solving the Texas Water Puzzle: Market Based Allocation of Water</u> by Ronald A. Kaiser, Texas Public Policy Foundation (March 2005).

Draft 2017 State Water Plan, Texas Water Development Board (March 2016).

# **Groundwater Rights**

### The Issue

Groundwater has long provided a major part of the Texas water supply. Undeveloped groundwater can help meet growing demand for water in Texas. Texas has two distinct legal systems governing water: groundwater and surface water. Surface water is owned by the state, which grants water rights to use specific volumes of water for beneficial uses. The Texas Water Code recognizes surface water rights issued in perpetuity as private rights that can be bought and sold.

In contrast, under Texas common law and statute, landowners hold a vested private property right in the groundwater beneath their land. Both the Texas Legislature and courts have recently reaffirmed this principle. Passed in the 82nd Legislature, SB 332 stated that "a landowner owns the groundwater below the surface of the landowner's land as real property." HB 4112, which passed in the 84th Legislature, strengthened groundwater ownership rights by codifying common law. Still, further work is needed to clarify whether the Texas Water Development Board's (TWDB) statutory authority to approve Desired Future Conditions (DFCs) set by Regional Groundwater Management Areas (GMAs) is consistent with the landowner's right to groundwater in place.

In *Edwards Aquifer Authority v. Day*, the Supreme Court held that the rule of capture is not inconsistent with ownership of groundwater in place. Citing the opinion in *Day*, the Court of Appeals in *Edwards Aquifer Authority v. Bragg* rejected the Authority's argument that its enabling legislation in 1993 gave the Braggs ownership over water and its permits, which they did not own before. Therefore, the Authority's denial of water permits to the Braggs for beneficial use in their pecan orchards rose to the level of a taking.

The landowner's property right in groundwater is often confused with the rule of capture. The rule of capture is corollary to the landowner's ownership right; it does not define the groundwater rights but explains the means by which a landowner may exercise the property right.

Like fee title ownership of land, "absolute" ownership of groundwater is subject to reasonable regulation. Since 1949, local Groundwater Conservation Districts (GCDs) have been the main regulator of groundwater in Texas. In 1995, the powers of GCDs were expanded to include pumping limits on wells and tract size, and in 2001, SB 2 enlarged GCD authority including preservation of historic uses and creation of Groundwater Management Areas (GMAs) based on regionally shared aquifers. In 2005, HB 1763 significantly enlarged the scope of groundwater regulation through provisions about DFCs of an aquifer and Managed Available Groundwater (MAGs) determined and overseen by the TWDB. The regulatory authority created expands the state's role in groundwater regulation and is being used to limit or deny groundwater permits at GCDs.

Although GCDs are recognized in law as the state's "preferred method of ground-water regulation" (TWC 36:0015), the system does not always function optimally. GCDs sometimes lack the resources and scientific expertise to make informed permitting and regulatory decisions. District boundaries are often based more on politics than hydrology, resulting in actions in one GCD that affect landowners outside the district boundaries. GCDs are exempt from many of the conflict of

interest rules applicable to other government officials and regulators. In some cases, GCDs have imposed moratoria on groundwater development.

With the *Day* decision, Texas courts have begun to recognize that excessive regulation of groundwater can amount to a taking of property for which compensation is owed under the Texas and U.S. Constitutions. Several features of the law governing GCDs make it difficult to mount a successful challenge to burdensome regulation. GCDs are not subject to the record keeping requirements of the state's Administrative Procedures Act, which can complicate judicial review. And if a landowner's challenge to GCD regulation fails in court, he must pay the GCD's attorneys' fees in addition to his own.

The 84th Legislature passed HB 200 that allows judicial appeal of DFCs made by GMAs. This legislation helps undo previously legislated water policy that obstructs effective, efficient, and appropriate use of water in Texas. Despite the obstacles presented by current groundwater law, challenges to GCD authority are increasing. One legislative session later, in 2017, SB 1009 passed to limit the list of items a GCD may require in a permit application in addition to what is already required by statute.

#### The Facts

- By 2070, water demand in Texas is projected to increase by 17%, while groundwater supplies are expected to decrease by 24% between 2020 and 2070.
- Texas has abundant groundwater resources: 9 major aquifers and 21 minor aquifers. Total groundwater supplies were approximately 8 million acre-feet in 2010.
- Total groundwater in Texas aquifers is estimated at 17.1 billion acre-feet.
- Texas has 100 local groundwater districts covering all or part of 177 counties.

## Recommendations

- Remove legal impediments to the private development of new groundwater supplies and to proper functioning of water markets in Texas.
- Review the operations of Groundwater Conservation Districts and Groundwater Management Areas to see what progress has been made in securing proper groundwater regulation, and seek adjustments as needed.
- Reform the rules governing GCD record keeping and conflict of interest to promote greater uniformity of regulation.

#### Resources

2012 State Water Plan, Texas Water Development Board (Jan. 2012).

Edwards Aquifer Authority v. Day, 369 S.W.3d 814 (Tex. 2012).

Houston and Texas Centennial Railway Co. v. East, 98 Tex. 146, 81 S.W. 279 (1904).

*Solving the Texas Water Puzzle: Market Based Allocation of Water* by Ronald A. Kaiser, Texas Public Policy Foundation (March 2005).

Draft 2017 State Water Plan, Texas Water Development Board (March 2016).

*Edwards Aquifer Authority v. Bragg*, 421 S.W.3d 118, 124,137-38 (Tex. App. — San Antonio, 2013, pet. denied).

# Families & Children

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# Parent's Rights, Children's Best Interests

#### The Issue

**S** ince its 1923 *Meyer v. Nebraska* ruling, the U.S. Supreme Court has consistently confirmed the fundamental rights of parents and families. In *Meyer*, the Court recognized "the right of the individual ... to marry, establish a home and bring up children" is protected by the U.S. Constitution. Two years later, in *Pierce v. Society of Sisters*, the Court reinforced "the liberty of parents and guardians to direct the upbringing and education of children."

Likewise, the Supreme Court of Texas has held that "the natural right which exists between parents and their children is one of constitutional dimensions" (*Wiley v. Spratlan*). However, in *In re C.H.*, it found that "while parental rights are of constitutional magnitude, they are not absolute."

The natural rights of parents presume the obligation to protect children and not harm them. State intervention is appropriate as a last resort when parents pose a risk to their children's health or safety. Nevertheless, the proper balance of power between citizens and the state requires a narrow definition of harm. Coercive state intervention in the family should be limited to cases where (1) serious physical or emotional harm to the child is imminent and (2) the intervention is likely to be less detrimental than the status quo.

Rather than requiring imminent harm, family courts utilize the "best interests of the child" when called upon to make decisions affecting children. Section 153.002, Texas Family Code, provides that "the best interest of the child shall always be the primary consideration of the court in determining the issues of conservatorship and possession of and access to the child."

The use of the best interest standard in custody cases is problematic but not as pernicious as when the standard is employed against parents by others. In *Reno v. Flores*, Justice Scalia clarified that, unlike in cases between parents, "'the best interests of the child' is not the legal standard that governs parents' or guardians' exercise of their custody" in cases brought by third parties.

The best interest standard not only leads to arbitrary decision-making but also raises significant concerns about social engineering. The standard introduces "bias that treats the natural parents' poverty and lifestyle as prejudicial to the best interests of the child" (*Smith v. Organization of Foster Families*). In *Parham v. J.R.*, the U.S. Supreme Court established a legal presumption that "the natural bonds of affection lead parents to act in the best interests of their children."

Until 2000, the U.S. Supreme Court reliably applied strict scrutiny to questions involving the upbringing of children. Strict scrutiny demands the state prove that the objective it seeks is compelling (i.e., undeniably necessary) and that the means employed to achieve that objective are the least restrictive available.

In *Troxel v. Granville*, a plurality of the Court failed to apply the strict scrutiny to a Washington visitation law; instead subjecting parents to a case-by-case balancing test. Some have viewed the ruling as softening the Court's parental rights doctrine, resulting in conflicting interpretation, including by Texas appellate courts.

Interpreting the effect of *Troxel* in 2004, then-Attorney General Greg Abbott declared "state statutes that infringe upon a parent's right to control the care and

custody of his or her children are subject to strict scrutiny. A court may not, in visitation cases, substitute its own judgment in such a way as to infringe upon this fundamental liberty interest."

Ten states—Arizona, Colorado, Kansas, Idaho, Michigan, Nevada, Oklahoma, Utah, Virginia, and Wyoming—have responded to *Troxel* by enacting statutes that define and protect parental rights by declaring that parents possess a fundamental liberty interest in the upbringing of their children, to be protected at all costs against state intervention.

#### The Facts

- Since 1923, the U.S. Supreme Court has declared the fundamental rights of parents and has applied strict scrutiny to state intrusions into the family.
- In 2000, the Court in *Troxel v. Granville* applied a balancing test rather than strict scrutiny to third-party claims against parents for visitation.
- Since *Troxel*, 10 states have enacted legislation that defines and protects parental rights.
- In 2004, a Texas attorney general opinion confirmed that parents possess a fundamental liberty interest subject to strict scrutiny analysis.

#### Recommendations

- Enact parental rights legislation which recognizes that parents have a fundamental liberty interest in the upbringing of their children, giving rise to a right to raise children as parents see fit.
- Adopt a legal presumption that parents act in the best interests of their children.
- Limit government intervention in the parent-child relationship to cases in which physical or emotional harm is imminent and state intervention is less detrimental than the status quo.

#### Resources

*Family Privacy and Parental Rights as the Best Interests of Children* by Brandon Logan, Texas Public Policy Foundation (Feb. 2018).

In Re C.H., 89 S.W.3d 17 (Tex. 2002).

Meyer v. State of Nebraska, 262 U.S. 390 (1923).

Parham v. J.R., 442 U.S. 584 (1979).

Pierce v. Society of Sisters, 268 U.S. 510 (1925).

Reno v. Flores, 507 U.S. 292 (1993).

Smith v. Organization of Foster Families For Equality & Reform, 431 U.S. 816 (1977).

Texas Attorney General Opinion GA-0260 (Tex. A.G. 2004).

Troxel v. Granville, 530 U.S. 57 (2000).

Wiley v. Spratlan, 543 S.W.2d 349 (1976).

## Removal of Children from Parents

#### The Issue

The government may not seize a child from his or her parents absent a court order, parental consent, or imminent danger of physical or sexual abuse. Fourth Amendment protections against unreasonable seizures apply to the seizure of children from their homes.

Child Protective Services (CPS) may obtain an emergency order placing a child in state custody without notifying parents and without a hearing when probable cause exists that there is an immediate danger to the physical health or safety of a child *or* a child has been a victim of neglect or sexual abuse.

If there is no time to obtain an *ex parte* order, a CPS investigator, law enforcement officer, or juvenile probation officer may take possession of a child without a court order based on personal or corroborated facts that there is an immediate danger to the physical health or safety of a child or the child has been the victim of sexual abuse or trafficking. At an *ex parte* hearing on the next business day, the court retains the child in state custody if there is a continuing danger, sexual abuse or trafficking, immediate danger resulting from use of a controlled substance, or exposure to the manufacture of methamphetamine.

Although CPS previously removed a majority of children without a court order, current policy following *Gates* requires CPS to file for a court order prior to removal unless life or limb is in immediate jeopardy or sexual abuse is about to occur.

At an adversary hearing within 21 days of removal, the court must return the child unless it finds probable cause that (1) there was a danger to the physical health or safety of the child and for the child to remain in the home was contrary to the child's welfare, (2) the urgent need for protection required immediate removal, and (3) reasonable efforts were made to enable the child to return home. If the court finds probable cause, the child enters foster care.

Research demonstrates that separating a child from a parent for even a relatively short time can have a devastating emotional and physical impact on the child. Removal and foster care placement leads to long-term negative outcomes for children. Removal of children from their homes and separation from family affect children's ability to form relationships in the future.

A study in Cook County, Illinois, compared children placed in foster care with other children who were investigated for neglect or abuse but not removed. It found significant differences in long-term outcomes between the groups, including juvenile delinquency, teen motherhood, employment, and earnings. Children removed from home and placed in foster care fared worse than their counterparts who experienced neglect or abuse but were not removed. The results point to better outcomes when children at marginal risk remain at home.

Because removal and foster care present risks that adoption cannot cure, policymakers should focus efforts on keeping children at home and reunifying families as quickly as possible.

## The Facts

• In FY2017, CPS removed 19,782 children from their homes—a removal rate of

2.64 per 1,000 children. The rate of removals has increased 19.5% since 2008.

- In FY2017, CPS confirmed 39,570 cases of abuse or neglect—a maltreatment rate of 5.3 per 1,000 children. The rate of abuse or neglect has decreased 17.2% since 2008.
- After removal, children spend an average of 19.8 months in state custody. On average, foster children experience more than three different placements. Only 30% of children return home to parents.

#### Recommendations

- Limit removals to cases of immediate danger to physical health or safety, in which state intervention is less detrimental than the status quo. Removal for victim status (i.e., "a victim of neglect") rather than imminent risk violates Fourth Amendment protections as set forth in the Gates decision.
- Increase the standard of proof required for courts to remove and place children in state custody from probable cause to preponderance of the evidence. Although probable cause may be an appropriate standard for laypersons during an emergency until a hearing can be held, due process demands courts apply a higher evidentiary standard for courts to separate families indefinitely.
- Decisions to remove and place children in state custody should be subject to
  oversight by elected prosecutors and judges. Currently, significant decisions
  affecting families are made by unelected and unaccountable CPS attorneys and
  child protection court judges in over 20% of cases.
- Reunify families subject to appropriate court monitoring when a continuing danger to the physical health or safety of the child no longer exists in the home. Texas is among the worst performing states in timely reunification. Families should be reunified as soon as children's physical health or safety is no longer in danger, with continued court monitoring and support to ensure success.

#### Resources

"<u>Urgent Legal Advisory for Investigations</u>," Department of Family and Protective Service (Aug. 2008).

*The Texas Practice Guide for Child Protective Services Attorneys*, Department of Family and Protective Services (Sept. 2016).

<u>Effects of CPS Involvement on Child Wellbeing</u>, Testimony before the House Juvenile Justice and Family Issues Committee by Brandon Logan, Texas Public Policy Foundation (May 3, 2017).

*Family Privacy and Parental Rights as the Best Interests of Children* by Brandon Logan, Texas Public Policy Foundation (Feb. 2018).

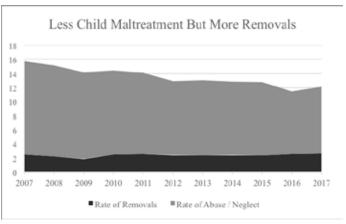
Gates v. Texas Department of Protective and Regulatory Services, 537 F.3d 404 (2008).

"Child Protection and Child Outcomes: Measuring the Effects of Foster Care" by Joseph J. Doyle, Jr., *American Economic Review* (March 2007).

## Alternatives to Removal

#### The Issue

n FY2017, Texas Child Protective Services (CPS) removed 19,782 children from their homes. From November 2016 to November 2017, removals increased 18.1%. More children are entering foster care than exiting (3% more in FY2016, 5% more in FY2017), contributing to a crisis in foster care capacity and increasing the state's reliance on congregate care.



Source: CPS Databooks FY2007-2017.

In FY2017, CPS obtained the placement of an additional 17,037 children outside their homes through a voluntary process called Parent Child Safety Placement (PCSP)—down from a high of 29,040 PCSPs in 2015. The Texas Supreme Court concluded this process is not always voluntary. Parents are sometimes threatened or coerced into agreeing to separation from their children. Removals and new PCSPs resulted in the separation under state supervision of 36,909 children from their parents in FY2017.

Paradoxically, the total rate of maltreatment in Texas is lower than in past years, continuing a downward trend over the last decade. Yet more children are victims of the system through forced separation from parents, which is never a benign event for children. Research demonstrates that separating a child from a parent for even a relatively short time traumatizes the child.

The most frequent cause of CPS involvement is not abuse but parental unemployment, housing instability, and substance abuse—conditions worsened, rather than solved, by removing children. Oftentimes, at-risk families need minimal, targeted assistance to ensure child safety. Civic, faith, and cultural communities are in the best position to support families through periods of difficulty while keeping children in or near their homes.

The family of a child who is at imminent risk of entering foster care but who can remain safely at home with services and monitoring should be referred to Family Based Safety Services (FBSS). The FBSS stage of service is intended to keep children safely with their parents, or to return children home after a short,

#### 2019-20 LEGISLATOR'S GUIDE TO THE ISSUES

voluntary separation, by increasing the resources of parents and decreasing threats to children's safety. Families with risk factors but no exigency should be referred to existing community programs.

The state should provide FBSS through local nonprofits in a public-private framework. Families are less resistant to supports provided by community members unaffiliated with government child protective agencies. Community providers are able to take advantage of existing services, including faith-based services, that best meet the needs of families and can remain available to parents after the case closes.

#### The Facts

- In FY2017, CPS separated 36,909 children from their parents—19,782 court-ordered removals and 17,037 agreed safety placements.
- In FY2017, FBSS served 98,730 children and 35,725 families, with 5,068 children removed from open FBSS cases.
- Current recidivism for FBSS services (11.4%) is comparable to recidivism for families separated through removal.
- Family preservation services provided by community nonprofits are more effective in increasing service utilization, reducing recidivism, and maintaining children in their homes.

#### Recommendations

- Limit family separation (through either removal or PCSP) to cases of immediate danger to physical health or safety.
- Expand voluntary use of FBSS in cases of marginal risk.
- Transfer primary responsibility for FBSS from DFPS to local nonprofits as part
  of the community-based care model.
- Reallocate spending from general prevention programs of unknown value to targeted foster care prevention, which diverts identifiable children from foster care through individualized family services.

#### Resources

Community Support for Children and Families, Testimony before the House Human Services Committee by Brandon Logan, Texas Public Policy Foundation (March 13, 2017).

<u>Effects of CPS Involvement on Child Wellbeing</u>, <u>Testimony before the House Juvenile Justice and Family Issues Committee</u> by Brandon Logan, Texas Public Policy Foundation (May 3, 2017).

<u>Family Privacy and Parental Rights as the Best Interests of Children</u> by Brandon Logan, Texas Public Policy Foundation (Feb. 2018).

<u>Parental Child Safety Placements</u>, Supreme Court of Texas Children's Commission Round Table Report (Dec. 2015).

# Community-Based Foster Care

#### The Issue

or decades, Texas Child Protective Services (CPS) has systematically placed children in its care at substantial risk of harm and even death, leaving children more damaged when they exit foster care than when they entered. Texas foster children experience an unreasonably high risk of physical abuse, sexual abuse, suicide, and poor supervision in the state's care.

The 85th Texas Legislature transformed the current, failing state system by localizing foster care service coordination. This new service delivery system, called "Community-Based Care" (CBC), shifts primary responsibility for placement and case management from CPS to single source providers—either nonprofits or local government entities. Those providers, called Single Source Continuum Contractors (SSCC), are responsible for providing all foster care services within the limited geographic area they serve.

The transition to a CBC model occurs in three stages: placement, case management, and performance review.

**Table 1: CBC Performance Measures** 

| Goal Performance Measures                                |   | Stage I Population            |  |
|--|---|-------------------------------|--|
| Safety   | Children/youth are safe in placement  | Children/Youth in Foster Care |  |
| Placement Stability                                      | Children/youth have stability in foster care  | Children Youth in Foster Care |  |
| Least Restrictive<br>Setting                             | Children/youth are placed in the least restrictive placement setting                | Children/Youth in Foster Care |  |
| Maintaining<br>Connections                               | Children/youth in foster care are placed in close proximity to family and community | Children Youth in Foster Care |  |
|  | Children/youth in foster care are placed with their siblings                        | Children Youth in Foster Care |  |
| Preparation for<br>Adulthood                             | Youth age 16 and older have a driver's license                                      | Children/Youth in Foster Care |  |
|  | Youth age 16 and older without a driver's license have a Texas identification card  | Children/Youth in Foster Care |  |
|  | Youth turning 18 complete Preparation for Adult Living (PAL) training               | Children/Youth in Foster Care |  |
| Participation in<br>Decisions                            | Children/youth age 5 and older participate in service planning                      | Children/Youth in Foster Care |  |
|  | Children/youth attend court hearings  | Children/Youth in Foster Care |  |
| Child/youth well-being is maintained or improved in care |   | Children/Youth in Foster Care |  |

Source: Procurement and Contract Services, Request for Application, Texas Health and Human Services, December 2017.

During Stage 1, the SSCC is responsible for children in paid foster care but not children placed with relatives. The SSCC oversees placement, adoption, and other services necessary to meet the needs of children in foster care and those aging out.

In Stage 2, the SSCC expands its child-related services to children placed in kinship care (with relatives or fictive kin). The SSCC takes a more active role in providing case planning and decision-making and becomes primarily responsible for

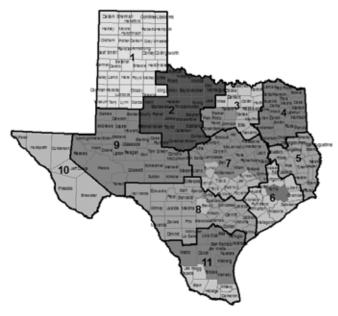


Figure 1: DFPS Regional Map

Source: Community-based care, Texas Department of Family and Protective Services.

deciding and planning for permanent outcomes for local children and their families and for making recommendations to the court with jurisdiction over the legal case.

The SSCC contract is outcome-focused and performance-based. In Stage 3, DFPS evaluates the SSCC on measureable outcomes (**Table 1**). Performance-based contracting in foster care has already proven successful in increasing efficiency, service quality, and innovation in Region 3b (Fort Worth area).

## The Facts

- Children in CPS's legacy system are 19 times more likely to die than children in the general population.
- One in 20 children killed by abuse and neglect since 2010 died in CPS custody.
- Foster children in the CPS legacy system experience Post-Traumatic Stress Disorder (PTSD) at twice the rate of Iraqi War veterans.
- The 85th Legislature funded the expansion of the CBC model to five regions (**Figure 1**) during the 2018-19 biennium including:
  - Region 3b (Fort Worth area)
  - Region 2
  - Region 8a (Bexar County)

continued

# Community-Based Foster Care (cont.)

#### Recommendations

- Implement community-based foster care statewide by funding expansion into remaining DFPS regions.
- Expand the CBC model to include the full spectrum of child welfare services by transferring the primary responsibility for prevention and early intervention (PEI) services and family preservation services (FBSS) from DFPS to community-led agencies (SSCCs).
- Integrate child welfare and child protection by breaking down siloed services
  that target vulnerable youth and at-risk families and by providing flexible funding to community-led agencies (SSCCs).

#### Resources

*The Community-Based Solution for Texas Foster Children* by Brandon Logan, Texas Public Policy Foundation (March 2017).

<u>Community-Based Foster Care</u>, <u>Testimony before the House Human Services</u> <u>Committee</u> by Brandon Logan, Texas Public Policy Foundation (April 17, 2017).

# **Health Care**

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## Medicaid Reform

## The Issue

Texas Medicaid is fiscally unsound and medically inadequate. By federal law, the first state dollars expended must be for Medicaid spending, and all other state priorities must accept the leftovers. With Medicaid taking an ever-larger bite out of the Texas budget, policymakers are left with fewer opportunities to meet the needs of Texans, restrain spending, and provide tax relief.

Medicaid is dollar inefficient. Federally mandated administration of the program along with requirements for compliance consume dollars needed to provide medical services to the aged, disabled, elderly, children, and pregnant Texans. Medicaid-covered patients have a difficult time getting into a doctor's office and must wait for months before seeing a doctor. During a <u>public hearing</u> in the 85th Texas Legislature, numerous Medicaid recipients testified before the House Appropriations Committee about the multiple medical failures of Texas Medicaid, such as a lack of services on weekends or services for special needs patients, particularly children.

The reason for these failures is Washington's subversion of the original 1965. Medicaid law. Medicaid programs were supposed to be administered by each state individually, not by the federal government. Washington has gradually and incrementally taken over total administration using a one-size-fits-all approach that fails to address a wide diversity of unique state problems, especially in a state as populous and spread out as Texas.

While the recently renegotiated 2011 Section 1115 waiver for managed care in Medicaid may help, the root cause of dysfunction—the administration of *Texas* Medicaid by *Washington*—remains.

Financing of Texas Medicaid is based on the Federal Medical Assistance Percentage Program that provides federal dollars in proportion to how much a state spends. This provides a very powerful and perverse incentive to enroll more people and to spend more money in order to receive greater support from Washington.

Fraud, abuse, and error are common in all Medicaid programs. Every dollar paid out unnecessarily reduces the funds available to pay for those who truly need care. Inappropriate payments have been reported in Arkansas (3.9%), Illinois (34%), Minnesota (17%), Nebraska (25%), New York (8%), and Ohio (10%). If Texas were freed from Washington's control and allowed to use a strict verification process rather than the mandated federal process, Lone Star Medicaid could save at least \$1.19 billion per year.

## The Facts

- Section 1801 of the original 1965 Medicaid law is titled "Prohibition against any federal interference." For five decades, Washington has ignored or distorted this prohibition.
- Medicaid spending from the Texas budget has increased from 17% in 1991 to 24% in 2018.

#### 2019-20 LEGISLATOR'S GUIDE TO THE ISSUES

- As much as \$12 billion of the \$30 billion to be expended by Texas Medicaid in 2018 will be wasted on federal administration and regulatory compliance.
- Less than half of Texas physicians (47%) accept new Medicaid patients. Only 11% of primary care needs of Texans are being met, and during a public hearing on <u>July 25, 2017</u>, during the 85th Legislature, Medicaid enrollees described how Texas Medicaid is failing to meet their needs.

#### Recommendation

Texas should request a new Section 1115 waiver from CMS for:

- a waiver of all Medicaid insurance regulations so that Texas can administer its own Medicaid program, and
- a fixed-sum block grant to reduce the current perverse incentive.

#### Resources

"Sendero Health Plans to Withdraw from Medicaid, CHIP Markets" by Taylor Goldenstein, *Austin American-Statesman* (March 23, 2018).

"2017 Survey of Physician Appointment Wait Times," Merritt Hawkins (Sept. 2017).

<u>Medicaid: Yesterday, Today and Tomorrow—A Short History of Medicaid Policy and Its Impact on Texas</u> by Mary Katherine Stout, Texas Public Policy Foundation (March 2006).

"<u>Hearing on HB 25 and HB 2</u>," Texas House Committee on Appropriations (July 25, 2017).

<u>Survey of Texas Physician 2016: Research Findings</u>, Texas Medical Association. <u>The Saga of 1115—A Waiver Can Fix Texas Medicaid</u>, <u>But Only Temporarily</u> by Deane Waldman, Texas Public Policy Foundation (March 2017).

## APRNs and the PAA

## The Issue

Millions of rural Texans as well as many inner-city residents have difficulty getting health care—medical, dental, as well as mental and behavioral—when they need it. There is a shortage of providers, both an insufficient number of doctors as well as maldistribution.

Midlevel providers could ameliorate the problem, but a regulatory barrier called a Prescriptive Authority Agreement (PAA) restricts their ability to care for patients.

In Texas, Advanced Practice Registered Nurses (APRNs) cannot treat patients without a PAA, an expensive contract with a physician who delegates his authority to write prescriptions. In major metropolitan hospitals, the institution pays the cost of the PAA for their APRNs, which averages \$20,000 per contract with some priced over \$100,000. These prices make it impossible for APRNs to practice independently, particularly in underserved areas, without a hospital paying the cost of the PAA.

Some argue that a PAA protects patients from errors made by the APRN because the contract includes reviews of APRN records by the contracting physician. Three facts rebut this concern: (1) APRNs are well-trained to perform the necessary diagnostic and therapeutic roles needed; (2) in states where APRNs are able to function independently, a host of research studies confirm the lack of errors, safety, and high quality of APRN solo practice; (3) the reviews performed by the contracting physician are typically done four times per year. The patient would suffer any putative adverse outcome long before such a review.

## The Facts

- Texas has 254 counties—232 have been designated as partially or completely Medically Underserved Areas.
- In 35 Texas counties, there is no licensed physician at all.
- In Dallas, there are 228 doctors per 100,000 inhabitants. In Hidalgo County, there are 42 per 100,000.
- Wait times to see a physician can be as long as 122 days.
- Only 47% of Texas physicians accept new Medicaid patients. The national average is 70%.
- An APRN in Texas makes on average \$84,000 per year. The cost of a PAA, averaging \$20,000 per year, represents 24% of an APRN's average gross income.

## <u>Recommendation</u>

Expand the scope of practice for APRNs by eliminating PAAs—this allows APRNs to practice independently to the full extent of their training and knowledge, and thus, they can provide care to Texans who otherwise might have no access to medical services.

#### 2019-20 LEGISLATOR'S GUIDE TO THE ISSUES

#### Resources

"Advanced Practice Nurse Strategies to Improve Outcomes and Reduce Cost In Elders With Heart Failure" by Kathleen McCauley, M. Brian Bixby, and Mary Naylor. *Disease Management* 9(5): 302-312 (Nov. 2006).

Evidence Brief: The Quality of Care Provided by Advanced Practice Nurses by McCleery E et al., U.S. Department of Veterans Affairs (Sept. 2014).

"The Role of Nurse Practitioners in Reinventing Primary Care" by Mary D. Naylor and Ellen Kurtzman *Health Affairs* 29(5) (May 2010).

"Quality of care provided by mid-level health workers: systematic review and meta-analysis" by Lassi ZS et al., *Bull World Health Organ* 91(11):824-833 (Nov. 2013).

"How do nurse practitioner regulatory policies, access to care, and health outcomes vary across four states?" by Andrea Sonenberg, and Hillary Knepper, *Nursing Outlook* 65(2): 143-153 (March-April 2017).

Survey of Physician Appointment Wait Times and Medicare and Medicaid Acceptance Rates, Merritt Hawkins (2017).

Background: Prescriptive Authority Agreement, Texas Medical Association (2013).

## **Telehealth**

## The Issue

Telemedicine refers to medical care provided remotely through the use of technology. Health care providers are increasingly using telephones, audiovisual platforms, smartphone applications, and other technologies to assess, monitor, diagnose, and even treat their patients remotely. Innovation in the field of telemedicine advances so rapidly year after year that attempts to regulate the industry often fail to remain relevant, even in the short term.

In the 85th Legislature, Texas fundamentally changed the way it defined and regulated telemedicine. SB 1107 broadened the definition of telemedicine to include more accessible telecommunication technologies, such as phone calls and faxes. It also lifted the Texas Medical Board's (TMB) blanket requirement on practitioners to complete an in-person consultation prior to providing telemedicine services, including those resulting in a prescription. Lifting this burden on patients and providers significantly increased access to care for populations that struggle to visit a doctor in person, including rural, disabled, and elderly Texans.

The 2017 legislation also clarified that telemedicine services are subject to the same standard of care as in-person services, which cleared up ambiguity that previously made providers hesitant to utilize telemedicine.

Finally, the bill imposed insurance mandates aimed at protecting telemedicine services from unequal treatment. It prohibited insurers from refusing to cover a service solely because it was delivered via telemedicine. Insurers cannot charge deductibles, co-pays, and coinsurance for telemedicine services that exceed their equivalent in-person charges.

Questions still remain about how telemedicine should be reimbursed in Texas. Many states have enacted parity laws, which mandate that insurance companies reimburse telemedicine services on the same basis or at the same rate as comparable in-person services. Advocates of reimbursement parity laws argue that they help spread the use of telemedicine throughout the state. However, telemedicine continues to thrive and remain cost-effective in states that do not have parity laws, such as North Carolina, Alabama, and Florida.

One of the major benefits of telemedicine is cost-effectiveness. If insurance companies are forced to pay providers the same amount for telemedicine and inperson services, despite telemedicine being a much cheaper method of delivery, it will artificially increase providers' profits and conceal the true cost of care from patients. As a result, providers will have a perverse incentive to overuse telemedicine and health care prices will remain artificially high.

Telemedicine is a convenient, affordable way to access health care services and recent advances in audiovisual communication technology are expanding the potential of telemedicine to reach more people and address a growing number of health care needs. On average, a telemedicine encounter can cost \$79 or lower, compared to \$146 for an in-person doctor's visit. Telemedicine also saves patients' transportation costs by bringing the care to them in their homes or in areas with no physicians.

In some cases, telemedicine is the only way for people to get care, such as in the aftermath of Hurricane Harvey. A 2017 RAND Corporation study found that 88 percent of telemedicine visits for acute respiratory illnesses constituted "new utilization," meaning the patients receiving telemedicine services were not active in the health care market prior to having telemedicine as an option. For these patients, the alternative to telemedicine was no care at all, and telemedicine was the tool they needed to obtain care.

Texas should continue to adopt policies that support market-based approaches to telemedicine, and avoid policies that undermine this highly innovative field, such as parity laws and mandates on private enterprise.

#### The Facts

- In 2017, Texas achieved a freer, more open telemedicine market by fundamentally changing how it defined and regulated the industry.
- An average telemedicine encounter costs \$79, compared to \$146 for an equivalent in-office doctor visit.
- Eighty-eight percent of telemedicine visits for acute respiratory illnesses represented new demand (2011-2013).
- Telemedicine makes accessing health care more convenient and affordable for all Texans, especially rural, disabled, and elderly populations.

### <u>Recommendations</u>

- Texas should continue to support policies in telemedicine that allow unfettered competition and expand consumer choice.
- State lawmakers should be cautious about mandating payment parity for telemedicine, because government regulations create barriers to both innovation and cost-savings.
- The Texas Legislature should take active steps to guard against the anticompetitive conduct of its licensing boards that also leave the state vulnerable to federal lawsuits.

#### Resources

*The Case Against Telemedicine Parity Laws* by Katherine Restrepo, John Locke Foundation (Jan. 2018).

"<u>E-Medicine Will Help Long After Hurricane Harvey</u>" by Deane Waldman, *Houston Chronicle* (Nov. 12, 2017).

<u>Direct-to-Consumer Telehealth May Increase Access to Care But Does Not Decrease</u> <u>Spending</u> by Ashwood et al., RAND Corporation (March 2017).

<u>Texas Session: New Telemedicine Rules for Texas</u> by Nora Belcher, Texas E-Health Alliance (March 2018).

# **Dental Therapy**

#### The Issue

The cost of dental care is skyrocketing in the U.S., while the availability of care remains stagnant. A 2018 report shows that the ratio of people to dentists in Texas is 1,790:1, compared to a national ratio of 1,480:1. Thirty-five Texas counties do not have a single dentist, and there are 322 designated dental health professional shortage areas (HPSAs) across the state. Furthermore, the U.S. Department of Health and Human Services (HHS) projects that Texas' dentist shortage will increase by 38% between 2012 and 2025.

State dental licensure laws play a major role in creating and sustaining Texas' shortage of dental care. The state's Dental Practice Act (Chapter 251 through 267 of the Texas Occupations Code) and the rules and regulations established by the Texas State Board of Dental Examiners (TSBDE) largely determine the number and type of available providers. Furthermore, providers are limited to practicing as these laws explicitly permit. Any activity outside of the law's explicit permissions is illegal, even if the law does not explicitly prohibit an activity. As a result, dentists are not free to experiment with new, innovative delivery systems, practice arrangements, or technologies.

While special interest groups would have policymakers believe that raising Medicaid reimbursement rates will solve the oral health issue, states like Minnesota, Maine, and Vermont are demonstrating a superior strategy: broadening their dental licensure regulations to make room for new mid-level providers, also known as dental therapists.

Dental therapists are mid-level dental providers, similar to advanced practice nurses in primary care. They are typically trained to perform preventive and restorative care under the supervision of a licensed dentist. In licensing states, dental therapists primarily practice under general supervision, meaning a dentist is not required on the premises where care is provided. This allows dental therapists to travel outside the dental office and provide care to rural and underserved populations, such as patients with disabilities.

In the 84th Legislature, Texas considered legislation that would have allowed dentists to hire dental therapists (HB 1940/SB 787). It had widespread bi-partisan support, represented by a coalition including the Texas Hospital Association, the American Association of Retired Persons, the Coalition of Texans with Disabilities, Americans for Tax Reform, Americans for Prosperity, the Texas Public Policy Foundation, and the Center for Public Policy Priorities. But efforts by market participants rejecting additional competition contributed to the legislation's defeat.

Care shortages are not simply determined by the number of providers versus demand. Restrictions on the type of available providers or the use of efficient practice arrangements also contribute to care shortages. If Texas policymakers want to expand access to dental care, they should reform dental licensure regulations in ways that empower providers to innovate their delivery systems to meet patients' dynamic needs. Licensing dental therapists is a demonstrably effective reform that could have a major impact in Texas.

#### The Facts

- Among low-income adults in Texas, the top three reasons cited for not visiting the dentist regularly were cost (85%), trouble finding a dentist (20%), and inconvenient time or location (19%).
- HHS has designated 322 dental HPSAs in Texas in the first quarter of 2018.
- Dental therapists in Alaska and Minnesota have significantly improved oral health outcomes and access to dental care, especially for rural and underserved communities.

### Recommendations

- Allow mid-level dental providers to practice in Texas.
- Legislation allowing mid-level dental providers should maintain dentists' authority to provide oversight of how mid-level dental providers operate in their practices.
- Reform dental licensure regulations to lower barriers to entry, increase competition, and grant dental providers more flexibility to innovate their delivery systems.

#### Resources

<u>Dental Workforce Reform in Texas</u> by John Davidson, Texas Public Policy Foundation (March 2016).

2018 County Health Rankings Report, by Givens et al., Robert Wood Johnson Foundation and University of Wisconsin Population Health Institute (2018).

<u>2018 Texas Data</u>, Robert Wood Johnson Foundation and University of Wisconsin Population Health Institute (2018).

"The future of dentistry: Dental economics" by Eric Solomon, *Dental Economics* 105(3) (March 19, 2015).

*First Quarter of Fiscal Year 2018 Designated HPSA Quarterly Summary*, Bureau of Health Workforce (Jan. 2018).

National and State-Level Projections of Dentists and Dental Hygienists in the U.S., 2012-2025, National Center for Health Workforce Analysis (Feb. 2015).

Oral Health and Well-Being in Texas, American Dental Association (2015).

Dental Utilization for Communities Served by Dental Therapists in Alaska's Yukon Kuskokwim Delta: Findings from an Observational Quantitative Study, Chi et al., University of Washington (Aug. 2017).

*Early Impacts of Dental Therapists in Minnesota*, Minnesota Department of Health and Minnesota Board of Dentistry (Feb. 2014).

# **Criminal Justice**

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# Constitutional Policing

# The Issue

Liberty is a guiding principle for the Texas Public Policy Foundation. Protecting the pursuit of liberty and other constitutional freedoms is a critical mission for our nation's peace officers. But many outside the ranks assert confidence of the police in this role has fallen. Militarization, lack of transparency, and overcriminalization often surface as contributing to distrust.

Police are told they are at war—on crime, drugs, and terrorism. This has fueled an increase in militarization. Chiefs and sheriffs have introduced armored personnel carriers, high-powered rifles, and combat-style uniforms to their ranks. Citizens could easily mistake their protectors for an invading army. Little transparency exists in the process for obtaining equipment, or for its use. Paramilitary-style SWAT teams have increased as a result. Training and tactics for these units is untethered unless by individual department policy. Statewide tracking of actual deployment of SWAT or the use of their military-style gear is nonexistent. Protective gear such as helmets and vests is not at question. Personnel carriers, grenade launchers, and the like are where concern lies.

Situations occur requiring special weaponry and procedures, but a fine line exists that must be monitored where teams are otherwise deployed. Police sometimes need special weapons and tactics (SWAT) in some situations, but there is a fine line between necessity and common practice. Citizen liberties—those protected by our Bill of Rights—can easily suffer collateral damage from roughshod "battle" tactics. Many police officers fashion themselves as warriors. A "warrior mindset" represents a human survival drive and a will to win. This is important when lives are on the line. But the title must be worn with care because it also embodies an infringement to liberty our Founding Fathers fought against in revolutionary times. In fact, the oft-overshadowed Third Amendment represents more than a prohibition to quartering soldiers. To colonists it symbolized the aversion to soldiers with weapons of war policing their communities.

Excessive and unnecessary laws are coupled with militarization. Both lead to questionable police tactics and certainly alter public trust. Committing a traffic violation—any violation—can be grounds for citations and related fines. A police officer can also make an arrest for even the most minor of infractions if they so choose. State statute and case law affirm this latitude. A simple warning is allowed, but this is at the officer's discretion. Many assert traffic stops are a gateway to detecting other violations or for seizing property and money. An unbridled officer can stop car after car looking for drugs and cash, but only at a cost to those simply commuting from place to place.

Traffic enforcement is meant to educate the public, reduce accidents, and save lives. Constant enforcement for simple infractions, however, fosters distrust and creates an atmosphere of animosity, especially in minority communities. Legitimacy of authority and acting justly can powerfully affect a citizen's choice to follow the law. Yet officers lacking the capacity or desire to exercise good discretion can cause this to come crashing down.

Indisputably, a law enforcement focus—a mission—is necessary in our society. But "mission over liberty" should never pilot the course.

# The Facts

- SWAT team formation, training, equipment procurement, and deployment criteria are not regulated or monitored by the state.
- Local law enforcement, including school district police departments, currently
  possess or can readily obtain military equipment such as armored personnel
  carriers and high-powered weapon systems. Requirements for transparency in
  its planned use, actual use, or costs for upkeep are few.
- Chapter 14 of the Texas Code of Criminal Procedure authorizes peace officers
  to arrest without a warrant for offenses within their presence or view. Offenders can be stopped and jailed for minor violations, including traffic infractions
  at the discretion of a police officer even if the category of the offense does not
  carry a custodial sanction.
- The Fourth Amendment clearly outlines a warrant preference for seizure of persons. An affidavit and prior judicial review is required for an arrest warrant but not for warrant field arrests where the officer makes a probable cause decision.
- Broad arrest authority for peace officers was affirmed in the United States Supreme Court's ruling in *Atwater v. City of Lago Vista*.
- Most Texas police officers have little training in search and seizure law or in the
  exercise of discretion beyond that which is required in the basic police academy.

# Recommendations

- Require greater transparency in the use of equipment procured from military sources, including the related costs for upkeep.
- Regulate SWAT team formation, training, and deployment criteria to comport with public liberties and constitutional protections.
- Require tracking of SWAT deployments by police agencies, including outcomes from the related situations.
- Require the Texas Commission on Law Enforcement to establish more comprehensive training for basic police academy programs and for incumbent officers focused on the better understanding of the principles of liberty, the use of discretion, and the protections afforded citizens under the Fourth Amendment.

#### Resources

Rise of the Warrior Cop: The Militarization of America's Police Forces by Radley Balko, New York: Public Affairs, 2013.

*Militarizing the American Criminal Justice System* by Peter Kraska, Boston: Northeastern University Press, 2001.

*Final Report of the President's Task Force on 21st Century Policing*, Office of Community Oriented Policing Services (May 2015).

# Procedural Liberty and Asset Forfeiture

## The Issue

Our western criminal justice system is at its core one of laws, not of men. The supremacy of law is deliberate. Man's passions are fickle, prone to capricious reaction, and oftentimes unmeasured during times of stress and uncertainty. Steadfastness in the rule of law allows society to weather such perilous times rather than careen from one crisis to another.

The rule of law—and by proxy the legitimacy of the criminal justice system—is rooted firmly in unflinching adherence to the formal procedure as a manifestation of our founding principles. The presumption of innocence, entitlement to a jury of one's peers, the state bearing the high burden of proof, and the sanctity of property rights are representative of our revolutionary inheritance, direct responses to the atrocities endured at the orders of George III and Santa Anna. These procedural elements ensure that the end result of the criminal process is just.

Today, this legitimacy is threatened. Whether by laziness, fear, or emphasis on clearance over correctness, procedural "shortcuts" have cropped up in routine practice, divesting the system of the requisite safeguards to be considered a neutral arbiter of guilt.

One example of this is civil asset forfeiture. Under this practice, police and prosecutors can take your property without ever charging you with a crime. Further, the protections you would have if you are accused of a crime (such as a lawyer or a jury of your peers, just to name a few) are not due during forfeiture proceedings, because it is *the property itself* that is alleged to be guilty of the criminal offense.

Texans are not even made aware of how much civil forfeiture is being conducted in the state, as there are no requirements to post such numbers, only to inform the attorney general of the aggregate amount of property forfeited.

Further, the original intent of the Fourth Amendment was to allow for police officers to conduct reasonable detentions and searches, and to seize evidence to be later used in a criminal prosecution without a warrant. What it is not intended for is to, after a failure to produce any evidence of wrongdoing, allow the detention to be extended indefinitely until more invasive warrantless measures can be employed, such as a canine search. Such detention is permissible only if there is a reasonable suspicion of wrongdoing, said six of the U.S. Supreme Court justices in *Rodriguez vs. United States*, including the late Antonin Scalia.

Procedural soundness is not about helping the guilty go free. Those that would do harm to our families and communities must be duly punished under the law, and we must be certain that the punishment is delivered to the correct person. By ensuring that criminal procedure adheres to the intent of our founding documents, we can buttress the legitimacy of our criminal justice system.

# The Facts

Texas law is amongst the most permissive of civil asset forfeiture, requiring only
a preponderance of the evidence standard be met before the government can
take property.

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- Civil forfeiture is, more often than not, done without any representation of the interests of the property owner.
- In 2017 alone, over \$50 million was forfeited by agencies in Texas.
- Texas has a track record of enshrining procedural protections, such as with the codification of *Riley v. California* during the 84th Legislature.

## Recommendations

- Wholly eliminate civil asset forfeiture by requiring a conviction before property can be forfeited.
- Empower police and prosecutors by strengthening criminal forfeiture, allowing judges to declare property abandoned if the appropriate government entity has undertaken its due diligence in trying to locate the owner and if no one has come forward to claim the property, thereby bypassing the conviction requirement.
- Bolster the "innocent owner defense" for property owners, requiring the state to
  prove via clear and convincing evidence that the owner knew their property was
  being used for illegal activities.
- Divert forfeited cash and property to the purview of the jurisdiction's elected body, e.g., the city council or commissioners court—those with the authority to appropriate.
- Failing meaningful procedural reform, require forfeiting agencies to publicly report information on individual forfeiture proceedings including value of the property and whether a criminal conviction was obtained.
- Codify the standards established in Rodriguez v. United States, allowing Texas
  appellate courts to determine the legality of certain traffic stops under Texas law.

#### Resources

Rebutting Common Myths of Civil Asset Forfeiture by Derek Cohen, Texas Public Policy Foundation (Dec. 2016).

Asset Forfeiture by Texas Law Enforcement by Derek Cohen, Texas Public Policy Foundation (April 2016).

Without Due Process of Law: The Conservative Case for Civil Asset Forfeiture Reform by Derek Cohen, Texas Public Policy Foundation (Sept. 2015).

<u>Taking Contraband Without Taking Our Liberties: Civil Asset Forfeiture Reform in Texas</u> by Derek Cohen, Texas Public Policy Foundation (March 2014).

# **Corrections Budget**

# The Issue

Texas has the sixth highest incarceration rate in the nation and the most prisoners (147,000) of any state, about half of whom are nonviolent offenders. However, since 2005 when the state began strengthening probation and other alternatives to incarceration, the state's incarceration rate has fallen more than 20%. During this same period, Texas' crime rate has dropped more than 30%, reaching its lowest level since 1967.

In 2007, the Texas Legislature approved a justice reinvestment plan that avoided the construction of more than 17,000 new prison beds, which the Legislative Budget Board (LBB) had projected would be needed by 2012. Instead of spending between \$2 billion and \$4 billion to build and operate the projected new beds, lawmakers appropriated \$241 million for a package of prison alternatives, from drug courts to treatment beds. Funds were also used to clear out parolees not being released because of waiting lists for in-prison treatment programs that must be completed as a condition of release and halfway houses (paroled inmates are not actually released until they have a valid home plan). The new capacity brought online in the 2008-09 budget included 4,000 new probation and parole treatment beds, 500 in-prison treatment beds, 1,200 halfway house beds, 1,500 mental health pretrial diversion beds, and 3,000 outpatient drug treatment slots.

Given that nearly all offenses can result in either probation or prison, sentencing trends may reflect the confidence that judges, juries, and prosecutors have in the effectiveness of probation. Although the LBB had traditionally assumed an annual 6% increase in the number of offenders sentenced to prison due to population growth and other factors, sentences to prison actually declined beginning in 2009 as more nonviolent offenders went on probation. Similarly, members of the Board of Pardons and Paroles have suggested inmates who complete treatment programs are more attractive candidates for parole, which likely explains significant increases in the parole rate over the last decade even as new crimes by parolees have fallen.

Capitalizing on Texas' recent success, the state has closed eight prisons since 2007, avoiding millions in operating costs while also selling valuable land, such as the former Central Unit in Sugar Land.

# The Facts

- Prisons cost Texas taxpayers \$61.63 per inmate per day, which is \$22,495 per year.
- TDCJ's budget increased from \$793 million in 1990 to \$3.3 billion in 2018.

# **Recommendations**

• Fully implement Senate Bill 1055 (2011) to incentivize lower costs and less recidivism. SB 1055 provides that counties can use the share of the state's savings that they receive for community-based corrections programs, which include drug courts, specialized probation caseloads, and residential programs, including short-term use of the county jail to promote compliance. A provision is needed in the next budget authorizing TDCJ to implement SB 1055.

- **Revise probation funding formula.** Currently, state basic adult probation funds are distributed based solely on the number of individuals under direct supervision in that department. Distributing funding based on the number of adult probationers provides an incentive to keep probationers who have been compliant for many years, pose no risk to public safety, and are fully paying their fees on probation no longer than necessary. Also, because the current funding formula does not incorporate risk, there is a disincentive to put individuals on probation in lieu of prison who could be safely supervised but only with a lower caseload, specialized treatment, electronic monitoring, and/or other interventions that are costly, though far less so than prison. Furthermore, the current funding formula creates a disincentive for counties to offer precharge diversion to first-time, low-risk defendants from probation altogether, such as through the First Chance Intervention program spearheaded by the Harris County district attorney. Adopting a funding mechanism similar to juvenile probation that incorporates the population of the county but not the number of individuals on probation would address this. The new formula could also incorporate the following: an incentive for early termination of compliant probationers who have fulfilled all of their obligations and do not pose a risk to public safety, adjusted funding based on risk level of the caseload, and an incentive to reduce technical revocations so long as new crimes by probationers either remain the same or decline.
- Enhance use of alternatives to prison for drug offenders and problem-solving courts. Drug courts, mental health courts, DWI courts, and other problem-solving courts have been proven to reduce recidivism and lower costs by diverting appropriate offenders from incarceration while still holding them accountable. State funding should focus on felony offenders and be based on guidelines that ensure the lowest-risk, low-level drug possession offenders who can succeed with basic probation do not take up slots that could be better used to divert offenders who might otherwise be incarcerated. A presumption of a problem-solving court, probation with treatment, or other alternative to prison should be established for a third degree drug possession offense, which involves possession of one to four grams of most drugs. This presumption could be overcome if the court makes written findings that the offender is a danger to public safety.

#### Resources

<u>Texas Adult Corrections: A Model for the Rest of the Nation</u> by Greg Glod, Texas Public Policy Foundation (Oct. 2015).

<u>Unlocking the Key Elements of the Adult Corrections Budget</u> by Marc Levin, Texas Public Policy Foundation (May 2011).

*The Role of Parole in Texas: Achieving Public Safety and Efficiency* by Marc Levin and Vikrant Reddy, Texas Public Policy Foundation (May 2011).

<u>Incentivizing Lower Crime, Lower Costs to Taxpayers, and Increased Victim Restitution</u> by Marc Levin, Texas Public Policy Foundation (April 2011).

# Juvenile Justice

## The Issue

Juvenile offenders are more impressionable than adult offenders and have longer lives ahead of them. This raises the stakes for dealing with delinquent youth, as the success and failure of policies have a far-reaching effect on future public safety and taxpayer costs. Sentencing youth to ineffective, inappropriate programs and facilities could place a one-time nonviolent offender on a path of wrongdoing.

It costs some \$441.92 per youth per day to house juveniles in state lockups operated by the Texas Juvenile Justice Department (TJJD). Although this cost has been growing steadily, it stems in large part from successful efforts to reduce the population in these facilities from more than 5,000 in 2005 to less than 900 in 2018. As fewer kids are committed to the remaining five state-run institutions, the statewide system becomes less efficient as economies of scale are lost.

In 2015, a regionalization plan was enacted with the goal of further downsizing the state lockups by diverting youth to regional facilities. This allows youth to remain closer to their families and communities while shrinking costs for taxpayers. Regional facilities are smaller, more manageable environments that benefit juveniles in need of structured rehabilitative programming. Regionalization keeps juveniles in local settings for therapeutic treatment and allows for more seamless reentry back into the community.

To further ensure juvenile offenders are placed in the appropriate setting, Texas could expand the limit of juvenile court jurisdiction from 16- to 17-year-olds. Raising the age of juvenile jurisdiction would align Texas with 46 other states in the country. Juvenile probation is better situated to engage parents, who have no right to participate in the adult system. Moreover, juvenile probation typically works with schools to monitor attendance and behavior. The overwhelming majority of 17-year-olds in Texas are convicted of nonviolent misdemeanors. Importantly, though, if Texas enacted this reform, prosecutors may still ask the court to certify a youth to stand trial as an adult in crimes that are violent or sexual in nature.

Research suggests school disciplinary issues are often a precursor to cycling in and out of the juvenile and criminal justice systems. This is why school discipline policies that correct misbehavior can yield positive long-term outcomes for youth while creating safer learning environments. Zero tolerance policies mandate a certain punishment—usually suspension or expulsion—for a category of misbehavior. These rigid policies undercut proportionality and common sense by disallowing educators to appropriately assess each situation. To maintain order in the classroom and secure safety, exclusionary punishment may be the appropriate sanction for serious offenders. However, unnecessarily removing children from the classroom can lead to poor outcomes for Texan youth.

# The Facts

- A Texas-specific study suggests that youths sentenced to community punishment are less likely to reoffend compared to youths with similar risk factors and backgrounds sentenced to state-run facilities.
- As seen in Missouri, localized and regionalized treatment of juvenile offenders can reduce costs while lowering recidivism rates.

- The crimes committed by 17-year-old offenders are substantively similar to the crimes committed by 15- and 16-year-olds, and their recidivism rates are reduced when processed through the juvenile system.
- Research indicates zero tolerance policies neither improve safety nor resolve
  the underlying issues of misbehaving students. Such policies cost millions in
  taxpayer dollars through costly alternative programs for suspended students,
  while other costs compound the investment, including lost educational hours
  and lost wages for parents taking time off work to care for a suspended child.

### Recommendations

- Regionalize the juvenile justice system by further diverting youths to community punishment and supervision, accounting for risk level of offenders to protect public safety. This will help create safer neighborhoods and produce better outcomes for Texas youth.
- Implement a community-based residential model to close more state youth facilities, thereby representing wholesale reductions in system costs. While public
  safety demands that dangerous, high-risk juveniles be incarcerated, facilities
  should be accessible to communities in order to foster family involvement and
  support systems.
- Raise the jurisdiction of the juvenile court to cover 17-year-old offenders, but maintain the process of certification, which allows transfer of juveniles to adult criminal court.
- Categorize all school disciplinary actions as discretionary offenses. This will
  prevent the unintended consequences of zero tolerance policies. While exclusionary discipline is a necessary practice to maintain classroom safety and
  productivity, each student should receive an individualized assessment.

#### Resources

Raising the Age of Juvenile Court Jurisdiction in Texas by Derek Cohen and Haley Holik, Texas Public Policy Foundation (April 2017).

*Texas' Regionalization of the Juvenile Justice System* by Dianna Muldrow, Texas Public Policy Foundation (Jan. 2017).

<u>School Discipline in Texas: Past, Present, and Future</u> by Dianna Muldrow, Texas Public Policy Foundation (Aug. 2016).

*The Texas Model, Juvenile Justice* by Dianna Muldrow and Derek Cohen, Texas Public Policy Foundation (Nov. 2015).

Expelling Zero-Tolerance: Reforming Texas School Discipline for Good by Jeanette Moll and Henry Joel Simmons, Texas Public Policy Foundation (Aug. 2012).

"Monthly Tracking of Juvenile Correctional Population Indicators," Legislative Budget Board (June 2018).

<u>Overview of Criminal and Juvenile Justice Correctional Population Projections, Recidivism Rates, and Cost Per Day, Legislative Budget Board (Feb. 2017).</u>

# Records and Reentry

# The Issue

In 2016, 67,603 adult inmates were released from Texas prisons and state jails. Approximately 20% of released state prison inmates and 30% of jail inmates are re-incarcerated within three years, either for a new offense or for violating the rules of their parole supervision.

Many offenders—but not all—who are released are placed on parole. As of May 2018, 83,845 Texans were under active parole supervision. In recent years, the number of parolees convicted of new crimes has been declining. This success may be due to recent strengthening of parole supervision and treatment, as well as graduated sanctions for technical violations.

Before 2011, state jail inmates served a flat sentence of up to two years. In the 82nd Legislature, however, the law was changed to award diligent participation credits to state jail offenders who make progress in educational, vocational, and treatment programs. This was further streamlined by HB 1546 in 2015 that allowed the Texas Department of Criminal Justice to implement these credits, saving judicial time and resources.

Immediately upon reentering society, ex-inmates face challenges such as obtaining employment and housing and establishing positive associations. Evidence shows ex-offenders who are employed are less likely to offend again, and those in higher-paying jobs, which are more likely to be licensed, reoffend at the lowest rate. There are several ways that the reentry process can be aided in order to maximize safety and employment. One key possibility is increasing the use of orders of nondisclosure. Orders of nondisclosure were expanded by the Legislature in 2015 and 2017 for certain offenders after specific periods of time. These orders allow a first-time offender who committed a nonviolent crime to request that their record be sealed after they have completed their sentence and a specified time frame has elapsed. Sealing these records means that these offenders can accurately state that they have not been convicted of a crime on an employment form. However, law enforcement as well as sensitive employers, such as schools and hospitals, are still able to access these records.

Nondisclosure has provided an opportunity for a second chance for those with criminal records, but it is also important that those criminal records be accurate in the first place. Errors or incomplete records in state and local databases can lead to inaccuracies in private companies' aggregated databases and affix innocent citizens with erroneous criminal records for an unknown amount of time. Further, false positives can result when private databases do not provide sufficient detail to link a record to a name, seemingly giving individuals with common names a record, or when the databases are not updated after an arrest failed to result in charges, or a conviction was overturned.

# The Facts

 In 2017, parole cost \$4.39 per day per offender, compared to \$61.63 a day per prison inmate.

#### 2019-20 LEGISLATOR'S GUIDE TO THE ISSUES

- Finding employment after release reduces the likelihood of recidivating by around 20%, according to a study by the Manhattan Institute.
- The FBI criminal database is estimated to have around 600 thousand errors or incomplete records, which are then transferred to private databases, to which employers and landlords often subscribe.

## <u>Recommendations</u>

- Continue to strengthen parole supervision and treatment programs that reduce recidivism and revocations.
- Implement HB 3130 passed in the 2017 session that authorizes the creation of a pilot job training and work release program for certain state jail offenders.
- Fully implement HB 722 (2017) that allows most individuals who successfully complete probation for a state jail offense to apply for reclassification of the offense to a misdemeanor.
- Expand orders of nondisclosure to cover first-time convictions for less than a gram of drugs.
- Increase accuracy standards in criminal record-keeping to minimize the number of incomplete records that are disseminated.

#### Resources

*The Role of Parole in Texas* by Marc Levin and Vikrant Reddy, Texas Public Policy Foundation (May 2011).

<u>Criminal Records, Their Effect on Reentry and Recommendations for Policymakers</u> by Derek Cohen, Greg Glod, and Dianna Muldrow, Texas Public Policy Foundation (April 2015).

<u>Adult Corrections Reform: Lower Crime, Lower Costs</u> by Marc Levin, Texas Public Policy Foundation (Sept. 2011).

<u>Keys to an Effective Parole Policy</u> by Marc Levin, Texas Public Policy Foundation (May 2009).

# Addressing the Growing Opioid Epidemic

## The Issue

A merica's growing spate of addiction and overdose deaths related to prescription and illicit opioids began almost 40 years ago with the formation of a slow-growing fissure among members of the medical community about limitations on the use of opioids for pain relief. This reluctance to use opioids for non-cancer pain completely dissolved by the time OxyContin—a new and potent opioid painkiller—hit the market for pain management. It was purported to feature low risk for addiction, which proved to be inaccurate.

America has been experiencing both the good and the bad consequences of this shift in medical practice. While tens of millions of people have been able to escape moderate-to-severe pain, America has also witnessed rising opioid usage and addiction. This problem with opioids began with prescription drugs, but the market has rapidly shifted into more dangerous illicit opioids, such as heroin and fentanyl. As a result, the number of overdose deaths caused by opioids nationwide has crossed into historic proportions.

Most of the medical community and advocacy space describe opioid addiction as a chronic, relapsing brain disease. But this theory on addiction has important drawbacks—notably, its inability to correlate closely with the real-world experiences and behaviors of drug addicts. To wit, most drug addicts who abandon drug use do so without formal treatment.

Instead, it is best to characterize drug addiction as a compulsive-learning habit. This conception faithfully explains the vast, global changes that occur in the brain during addiction while also providing an explanation of widely observable behaviors from addicts. This notion also explains why addiction is driven far more by one's underlying psychosocial environment, rather than any chemical "hook" a drug provides.

Nearly every part of the country has seen increases in the number of opioid overdose deaths. However, some sections have been hit particularly hard, such as the Appalachian and Rust Belt states. Texas has been largely immune to significant increases in overdose death rates caused by opioids that other states have witnessed, including next-door neighbor New Mexico. However, methamphetamine and cocaine remain stubborn problems in Texas.

Several putative explanations may exist to account for fewer opioid problems, including higher economic dynamism—e.g., greater job creation, low unemployment relative to other areas of the country, higher labor participation—which helps to blunt idleness and provide people a sense of dignity and purpose. As drug addiction is known to be strongly driven by a lack of social cohesion and increased isolation, various social markers throughout the state also deserve further investigation.

Ultimately, there is no cut-and-dried explanation for why Texas has experienced fewer negative consequences of opioid use compared to other states. Individual reasons for drug use and addiction will vary widely. Since 2006, Texas has had substantially lower rates of opioid prescriptions being written relative to the national rate, so this likely plays a partial role. Addiction, like all human behavior, is complex and multi-factorial.

# The Facts

- In 2000, America's overall drug overdose death rate stood at 6.7 deaths per 100,000 people. By 2016, this number leapt to 19.7 deaths per 100,000—a three-fold increase.
- Driving the increase in overdose deaths has been opioid abuse—deaths from which have increased by 50% in the last two years alone.
- In Texas, prescription rates for opioids have long been lower than in the country at large. In 2006, Texas' prescription rate per 100 residents stood at 66.8, while the U.S. rate was 72.4. In 2016, this trend continued: Texas' prescribing rate was 57.6, while the U.S. rate was 66.5 (per 100 residents).

#### Recommendations

- Encourage the formation of Law Enforcement-Assisted Diversion (LEAD) programs. LEAD programs place an emphasis on reducing the harm associated with certain low-level crimes—particularly drug possession and prostitution—by diverting offenders away from the traditional criminal justice system. Program participants receive a variety of social and psychological supports rather than simple warehousing, and as a result, researchers have found that LEAD reduced recidivism among participants by 22 percentage points when compared to the control group that went through the traditional criminal justice process. Funding for such programs can be made available through criminal forfeiture accounts, and by changing the state probation funding formula to accommodate use of LEAD.
- Enhance use of problem-solving courts and other alternatives to incarceration. Specialty courts help to root out the underlying socio-behavioral dysfunctions that give rise to drug use. As a result, they are far more likely to produce favorable outcomes than simple warehousing and this has been shown to be the case. State funding for such courts should focus on felony or repeat offenders, and be based on guidelines that ensure the lowest-risk drug possession offenders who can succeed on basic community supervision do not take up slots better apportioned for diverting offenders who might otherwise be incarcerated.

#### Resources

<u>Pre-Arrest and Pre-Booking Diversion and Mental Health in Policing</u> by Randy Petersen, Texas Public Policy Foundation (updated Jan. 2018).

<u>Drug Courts: The Right Prescription for Texas</u> by Marc Levin, Texas Public Policy Foundation (Feb. 2006).

# Pretrial Justice and Indigent Defense

# The Issue

There are some one million annual bookings into Texas jails. Texas counties face significant expenses associated with pretrial detainees, who account for 60% of county jail inmates. Additionally, for any offense that carries the potential of jail time, such as possession of the smallest amounts of marijuana, counties are constitutionally required to bear the cost of providing counsel for the indigent.

Several programs that aim to reduce the jail population while protecting—or enhancing—public safety have been implemented in Texas.

A pilot program proposed by the Texas Public Policy Foundation in 2009 and subsequently funded by the Texas Indigent Defense Commission allows indigent defendants in Comal County to choose their attorney among a list of qualified counsel maintained by the county. This consumer choice model provides greater fidelity in the attorney-client relationship rather than having the judge, who works for the government, appoint the counsel. An independent published evaluation found that this program has improved client satisfaction.

Diversion program models such as the Law Enforcement Assisted Diversion (LEAD) program in Seattle, the 24-hour crisis center for the mentally ill in San Antonio, and the First Chance Intervention Program in Houston have proven that empowering police to divert appropriate individuals without bringing them to jail can not only save taxpayers millions of dollars on jail costs, but also lead to greater public safety. Research has found that, as each 24 hours goes by in jail, a person is more likely to lose their job, family, and home, and in the case of mentally ill individuals, to decompensate.

Finally, counties across the state are inconsistent when it comes to promptly assessing pretrial defendants' risk level and mental health status as well as expeditiously providing counsel. These steps are vital to ensuring that costly jail space is prioritized. Prompt administration of an actuarial risk assessment is the equivalent of a prompt diagnosis by a doctor and is essential to making an informed decision about whether someone should be released prior to trial, and if so what, if any, conditions are necessary. Similarly, representation is essential, as pretrial detainees are ill-equipped to challenge the amount at which bail has been set, which may not take into account factors, such as strong community ties indicating they pose a low risk of flight.

# The Facts

- As of March 2018, there were 66,108 individuals in county jails, of which 35,375 were pretrial defendants. Jails are among the largest items in county budgets—Harris County spends more than \$170 million each year on its jail while Dallas County spends in excess of \$110 million.
- Approximately 30% of Texas county jail inmates are receiving mental health services.
- On an annual basis, attorneys are provided in about 460,000 cases to indigent defendants at a cost of \$238 million.

#### Recommendations

- Expand voucher pilot program for indigent representation.
- Enhance use of police diversion. Police diversion efforts can be strengthened by enhancing Texas' cite and summons law. Passed in 2007, it ensures prosecutors treat these cases similarly to those in which a custodial arrest is made and creates a presumption that the authority should be exercised unless the officer determines the person is a danger to public safety or a flight risk.
- Ensure rapid assessment and provision of counsel for pretrial defendants and
  create presumption of release for defendants for whom an assessment does not
  indicate a high risk to public safety. The Legislature should ensure that pretrial
  defendants are promptly assessed and that those who do not pose a significant
  danger to public safety do not remain in jail at taxpayer expense simply because
  of excessive bail amounts.

#### Resources

*Improving Indigent Defense in Texas* by Vikrant Reddy, Texas Public Policy Foundation (July 2012).

Bringing Balance to Pretrial Proceedings: Solutions for Early Representation of Indigent Defendants by Marc Levin, Texas Public Policy Foundation (April 2015).

<u>Public Safety and Cost Control Solutions for Texas County Jails</u> by Marc Levin, Texas Public Policy Foundation (March 2012).

<u>Open Roads and Overflowing Jails: Addressing High Rates of Rural Pretrial Incarceration</u> by Marc Levin and Michael Haugen, Texas Public Policy Foundation (May 2018).

# Overcriminalization

#### The Issue

n 1790, there were 23 federal crimes. By 2008, there were over 4,450 federal criminal offenses and over 300,000 regulatory offenses that carried a criminal penalty. These regulatory offenses, promulgated not by Congress but by unelected bureaucrats, generally criminalize everyday business activity traditionally left for civil and administrative remedies. Many of these "crimes" do not require the actor to even know he or she has committed an offense, also known as mens rea—one of the earliest pillars of our common law system.

Texas is not immune. The state has over 1,700 criminal offenses, of which roughly 300 are found within the Penal Code. The rest (without even counting "catchall" provisions that make violations of certain sections of agency rules a criminal offense) originate outside the Penal Code and regulate traditionally non-criminal activities in areas such as health care, natural resources, insurance, agriculture, and fishing. For example, in Texas it's a crime to shake a pecan tree, and the state has some 11 felonies relating to harvesting oysters. Some burdensome and often conflicting local ordinances can also carry criminal penalties.

Texas also has criminal and administrative procedural issues that undermine transparency and fairness. Defendants prosecuted for frivolous criminal charges are denied access to grand jury proceedings and have little recourse to reclaim their reputations prior to trial, as is afforded in civil proceedings via "motions to dismiss" and "summary judgments."

Administrative agencies act as quasi-judicial bodies capable of doling out harsh penalties and fines for ordinary business activity with few of the same protections afforded individuals during a criminal or civil proceeding. Texas law generally requires that you exhaust all administrative remedies prior to receiving judicial review. Some exceptions within jurisprudence allow for immediate judicial review, but they are not consistently applied. Exhausting all remedies wastes time, money, and resources unnecessarily in certain situations when immediate judicial review is appropriate. Even when you are afforded judicial review, great deference is generally given to the administrative agency decision. Further, there are few provisions preventing criminal prosecution ("safe harbor" provisions) when administrative remedies would suffice. Finally, even when a person or business prevails before an administrative law judge, the state agency in question may refuse to implement the decision, forcing the claimant to proceed to district court.

Grand jury proceedings are ripe for abuse and inconsistent outcomes. In general, all felony cases must go before a grand jury, a group of 12 citizens who will hear evidence only from the state to determine whether probable cause exists to charge the defendant. The suspect is not (usually) present at the grand jury proceeding, nor does he or she have counsel present in the grand jury room. Witnesses have no right to counsel, even though they could be criminally charged based upon their own testimony. Additionally, during a grand jury proceeding, prosecutors are under no obligation to present exculpatory evidence they have come across during their investigation and can bring multiple grand jury proceedings for the same charges if the grand jury doesn't indict the defendant because jeopardy has not yet attached.

# The Facts

- Texans can be arrested for any crime—even traffic offenses such as failure to signal and broken tail light—with the exception of driving with an open container of alcohol and speeding.
- Passed in 2015, HB 1396 established a volunteer panel called the Commission
  to Study and Review Certain Penal Laws, which was renewed in 2017, to make
  recommendations on repealing all criminal laws outside the Penal Code that
  are "unnecessary, unclear, duplicative, overly broad, or otherwise insufficient
  to serve the intended purpose of the law." The bill also codified the Rule of
  Lenity for laws outside the Penal Code. The Rule of Lenity is an age-old canon
  of law that requires an ambiguous criminal law to be interpreted in favor of the
  defendant.

## Recommendations

- Adopt recommendations from the Commission to Study and Review Certain Penal Laws.
- Require the Sunset Advisory Commission to review criminal penalties for violations of statutes outside the Penal Code within the pertinent agency's purview.
- Preclude the state from bringing a case before the grand jury after a previous grand jury has declined to bring charges against a defendant, unless there is new material evidence to be presented.
- Expand access for defense counsel in grand jury proceedings to provide greater balance in the proceedings. For example, allow defense counsel to be present when a witness/accused is being questioned.
- Require witness testimony to be transcribed and automatically entitle an accused individual a copy of the proceedings following an indictment.
- Require prosecutors to disclose certain exculpatory information to the grand jury that they come across during their investigation.
- Reform the Code of Criminal Procedure to allow for "as applied" constitutional challenges to a penal statute in a pretrial habeas corpus proceeding.
- Allow for a "motion to dismiss" for non-constitutional "as applied" challenges to charges.
- Allow for a "mistake of law" claim as an affirmative defense for statutes outside the Penal Code during a criminal prosecution.
- Expand and codify exceptions for judicial review of administrative agency suits and alleged violations prior to exhausting all administrative remedies.
- Implement "safe harbor" provisions to all administrative agency codes that give
  many respondents an opportunity to come into compliance before legal action
  commences.

continued

# Overcriminalization (cont.)

- Require trial *de novo* for every administrative decision in a contested case.
- Require state agencies to implement the decision of an administrative law
  judge favorable to the petitioner, unless the agency obtains an emergency stay
  from a district court upon finding that implementing the decision pending the
  agency's appeal would cause grave and irreparable harm to the public.
- Establish default provision for state preemption of local criminal laws.
- Prohibit arrest for fine-only misdemeanors.
- Eliminate catch-all provisions that improperly delegate the power to regulatory bureaucracies to create criminal laws.
- Enhance Texas' default mens rea provision by requiring that, for violations of laws not listed in the Penal Code as well as crimes created by regulatory agencies, the conduct must be knowingly or intentionally committed. Recklessness would remain the default standard for those traditional offenses listed in the Penal Code.

#### Resources

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<u>Time to Rethink What's a Crime: So-Called Crimes are Here, There, and Everywhere</u> by Marc Levin, Texas Public Policy Foundation (Feb. 2010).

Annotated Criminal Laws of Texas by Diane Beckham, Texas District & County Attorney's Association (2016).

Exhaustion of Administrative Remedies in Texas: First Principles and Recent Developments by Steven Baron and Susan Kidwell, University of Texas School of Law (Aug. 2013).

# **Property Rights**

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# Property Rights and the Texas Courts

### The Issue

n the wake of the 2005 *Kelo v. New London* decision, Texas courts have made significant headway in the direction of protecting property rights, and correcting weaknesses in the protection thereof.

For example, in *Laws v. Texas*, a couple sought to prove that a tract of land condemned by the state was, in fact, capable of being divided into several self-sustainable economic subunits, whose value collectively was greater than the value viewed in the greater unit by the state. The Supreme Court, examining this situation, agreed that the Lawses, and by extension anyone else whose land is under government scrutiny, could provide evidence in court that their property is more valuable than the state estimates. The courts still make final decisions, but the state cannot constrain evidence in such proceedings.

In another important case, the city of Dallas declared Heather Stewart's long-vacant home a public nuisance, demolished it, and refused to pay compensation, due to its prior declaration. However, the courts determined that she was, in fact, due compensation, because the condemnation was based only on facts presented by the city exercising its taking powers. The Supreme Court determined that the "protection of property rights...cannot be charged to the same people who seek to take those rights away."

In another case, the Supreme Court continued to re-emphasize the importance of private rights to property over supposed public interest. In *Texas Rice Land Partners v. Denbury*, Denbury received permission from the Railroad Commission to claim land for a  $\mathrm{CO}_2$  pipeline as a common carrier, and argued that such permission precluded a court case. However, the Supreme Court disagreed, saying that, in fact, just "checking the right boxes" to become a common carrier doesn't provide protection from suits to determine if the use is public rather than private.

More recently, the Texas Supreme Court issued its decision in *Severance v. Patterson*, in which the state of Texas was claiming that a rolling easement to beach access can eliminate a property owner's right to use her own property in the case of a rapid erosion event, such as a hurricane.

However, the Supreme Court determined there was simply no evidence in the record of an easement by prescription or dedication on such land, nor has the public had a "continuous right" to use it. Based on this, the Court ruled (twice) that while the public has acquired the right to access many beaches over time, it does not suddenly acquire the right to access private property that becomes the beach because of a major storm. Unfortunately, the Texas Legislature changed the law in 2013 to reduce the protection of property rights under *Severance*. This might ultimately lead to another lawsuit in time.

A more recent ongoing property rights action by the courts is less positive to date. A trial court and an appellate court have both upheld the city of Rowlett's taking of a driveway across a retail development to improve customer access to a grocery store on a neighboring tract. This was despite the fact that the

#### 2019-20 LEGISLATOR'S GUIDE TO THE ISSUES

neighboring developer refused to pay market value for the access but did pay most of the city's condemnation costs, all in an attempt to increase the value of the lease from its tenant and reduce the cost of acquiring access. The case, KMS Retail v. City of Rowlett, is currently pending before the Texas Supreme Court.

There is still much more to be done in the sphere of property rights. However, these decisions help protect those rights from executive and legislative abuse of takings powers, and the discussion of these rights and the threats to them —such as takings powers and taxation—is essential for moving our state and country forward economically.

## The Facts

- Property rights are essential for economic prosperity and development.
- The Supreme Court of Texas has made many strides of late in protecting property rights from abuse by executive agencies and legislative acts, and has turned away from strict deference to the Legislature.

#### Recommendations

- Amend statute to shift the burden of proof in all property rights cases from the land owner to the condemnor.
- Reduce judicial deference to the decisions of executive agencies and local governments.
- Restore the constitutional right to both own and use property. Current case law, as held by the Texas Supreme Court, says, "Property owners do not acquire a constitutionally protected vested right in property uses."

#### Resources

Amicus Letter in Support of Texas Property Rights by Kathleen Hunker, Texas Public Policy Foundation (Oct. 2014).

<u>Senate Bill 18: Presumption</u> by Ryan Brannan and Bill Peacock, Texas Public Policy Foundation (Feb. 2011).

*Amicus Brief in Beach Access Case* by Vikrant P. Reddy, Texas Public Policy Foundation (June 2011).

<u>Property Rights in Texas: Heading in the Right Direction</u> by Bill Peacock, Texas Public Policy Foundation (Oct. 2011).

Amicus Brief in KMS Retail v. City of Rowlett by Bill Peacock and Robert Henneke, Texas Public Policy Foundation (March 2018).

# Regulatory Takings

## The Issue

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

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

### The Facts

- Article I, Section 17, of the Texas Constitution states, "No person's property shall be taken, damaged or destroyed for or applied to public use without adequate compensation being made, unless by the consent of such person."
- The RPPRPA does not apply this constitutional protection to actions by municipalities—like zoning—that result in a reduction of property value, i.e., a taking. Section 2007.003(a) exempts the actions of municipalities from the provisions of the act.
- The RPPRPA, in Section 2007.002, excludes from the compensation requirement any government action that reduces the market value of private property up to 25%.
- Texas case law also makes it very difficult for property owners to receive compensation for regulatory takings. The Texas Supreme Court has stated that property owners do not acquire a constitutionally protected vested right in property uses.
- Dallas opted to re-zone around Ross Avenue to increase the number of luxury condominiums and improve the aesthetic beauty of its eastern gateway to downtown. The practical effect was to prevent many of the property owners already working on Ross from continuing to operate their businesses. One operator was allowed to continue operating his auto body shop, but at a cost of close to \$100,000 in legal fees and property modifications. Another was sued by the city when he resisted and is being threatened with hundreds of thousands of dollars in fines.

#### Recommendations

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

#### Resources

*Private Property Interrupted* by Kathleen Hunker, Texas Public Policy Foundation (July 2014).

"The Story of Texas Begins with Respecting Private Property" by Kathleen Hunker, *Austin American-Statesman* (July 29, 2014).

<u>Regulatory Takings: The Next Step in Protecting Property Rights in Texas</u> by Ryan Brannan, Jay Wiley, and Bill Peacock, Texas Public Policy Foundation (July 2010).

<u>Private Real Property Rights Preservation Act Guidelines</u>, Attorney General of Texas. Article 1, Section 17, Texas Constitution.

Article 1, Section 17, Texas Constitution.

Texas Real Private Property Rights Preservation Act.

City of University Park v. Benners, 485 S.W.2d 773 (Tex.1972).

# **Government Reform**

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# **Unions and Labor Policy**

## The Issue

Texas is a Right to Work state, meaning Texans cannot be forced to join a union to get a job. Unlike states that do not have this employee protection, Texas employees and employers have not seen control of wages, work standards, and other labor-management policy shift almost entirely to unions. However, Texas' growing influence on national policy has made it a target for Big Labor in recent years, and there are problems that need to be addressed.

In the private sector, unions like the Service Employees International Union, National Nurses United, and the Communications Workers of America have used federal law or pressure tactics, such as "corporate campaigns," to make significant inroads into Texas. A number of union officials have either tacitly or explicitly asserted they and their agents have a right under federal labor law to stalk employees and supervisors of targeted businesses, even if that causes them to fear for their persons or property.

One tactic often used is negative publicity to push companies into "neutrality agreements," under which companies might provide personal contact information for employees, give unions access to employees in the workplace, and prevent employees from voting in secret-ballot elections. Neutrality agreements often prevent employers from disseminating information to employees about the downsides of unionization.

Section 617.002 of the Texas Government Code states that an official of the state or a political subdivision of the state may not enter into a collective bargaining contract with a labor organization regarding wages, hours, or conditions of employment of public employees. However, a number of legal loopholes allow public employers to break this law and make special deals with labor organizations. One example is Section 174.023, Texas Local Government Code, of the "Fire and Police Employee Relations Act," which excludes firefighters and police officers from Texas' collective bargaining ban. Furthermore, the state boosts public employee membership for unions by acting as the agent for the payment of employee dues by deducting them from paychecks.

Public school districts have their own loophole: adopting "exclusive consultation" policies that allow only one designated organization to meet and confer with the school board about educational issues and employment conditions. As a result, Texas school board decisions often closely resemble what union officials advocate, and their employment policies impose the same "single salary schedules" that are pervasive in states where teachers are overwhelmingly unionized.

Unions have recently increased their influence over labor policy in Texas hospitals, airlines, janitorial companies, and government. Unfortunately, many employees never receive the benefits they expect from unionization due to the fact that benefits are allocated according to union standards, such as seniority or level of education, that benefit the union instead of the workers they supposedly represent. There is no magic formula through which firms can promptly and sharply raise the pay and benefits of their employees, without cutting jobs or hours, while continuing to offer their clients a competitive price for their services and turn a profit. Unions do not offer stable economic solutions, nor do they offer

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balanced relationships in the workplace. These costs are detrimental to employers and workers while union leaders benefit from dues.

Texas has led the nation in economic growth and job creation for much of the last two decades, not by handing employer and employee rights over to Big Labor but by protecting their rights to communicate directly and create mutually beneficial arrangements. Private sector employers have had more flexibility to innovate, generate better production levels, and pay productive employees more.

Prioritizing individual preferences by ensuring contributions and union membership are voluntary in the private and public sectors is important because it could affect all Texans. Policies on organized labor should emphasize transparency and protect an individual's choice regarding union involvement. No person should be forced to join a union as a condition of employment or devote part of their paycheck toward political causes with which they disagree.

### The Facts

- Texas' government unionization rate is roughly 20%.
- The current "meet and confer" agreement between the city of Houston and the Houston Organization of Public Employees union is more than 100 pages.
- 17 Texas cities have passed referenda allowing exclusive union bargaining in fire departments.
- 30 cities have allowed exclusive union bargaining in police departments.

## Recommendations

- Prohibit automatic deduction of union dues from public workers' paychecks.
- Eliminate all practices and repeal all provisions that are inconsistent with Texas' ban on exclusive union bargaining for public employees (Sec. 617.002, Government Code).
- Empower employees to seek injunctive relief against union officials and employers who violate Texas' Right to Work law.
- Prohibit employers from handing over employees' names, addresses, and other personal information to union organizers.
- Prohibit employers from entering into neutrality agreements with unions.
- Prevent union representatives from participating in government inspections of non-union worksites without employer consent.

#### Resources

A Labor Market Comparison: Why the Texas Model Supports Prosperity by Vance Ginn, Texas Public Policy Foundation (Oct. 2015).

<u>State Labor-Management Policy and the Texas Model</u> by Stanley Greer, Texas Public Policy Foundation (Feb. 2015).

*The Texas Miracle and Labor Policy* by Bill Peacock, Texas Public Policy Foundation (April 2015).

# Corporate Welfare

# The Issue

Corporate welfare is when the government favors certain businesses in the form of direct subsidies, tax credits, or favorable regulatory schemes. Sometimes this practice is referred to as "economic development." This label creates a damaging misconception about corporate welfare, which leads to economic contraction rather than expansion.

Corporate welfare is abundant in Texas, and so are its negative economic effects. Direct subsidies are paid to politically adept corporations through the Texas Enterprise Fund, the Texas Emissions Reduction Plan, and the Texas Film Commission. The Property Tax Abatement Act and the Texas Economic Development Act give preferential tax treatments to corporations through tax abatements. Other forms of special treatment include grants, loans, sales tax funds, and even regulatory privileges; biased policies such as those relating to title insurance regulation and condemnation compensation are buried in Texas' legal framework.

Corporate welfare is economically harmful for a number of reasons. It attempts to grow the economy providing cash and other benefits to businesses, but in the process it takes money from taxpayers and consumers in order to fund the handouts. Because corporate welfare disrupts natural market processes, it shifts money from the most productive economic actors to those less productive but politically connected. This method creates economic inefficiency and stunts competition.

Unconnected businesses struggle to compete with recipients of handouts, and they are unable to reap the just rewards of their merit. Additionally, corporate welfare undermines consumer choice: it overturns the decisions of millions of Texans and redirects the outcomes in the marketplace through subsidies and regulations. Because of these economic costs, corporate welfare fails to achieve its stated goal of creating economic growth.

Despite its challenges with corporate welfare, Texas has generally had a more free-market approach to economic development than other states. Sometimes referred to as the Texas Model, the approach is simple: lower taxes, less regulation, fewer frivolous lawsuits, and reduced reliance on the federal government. It is also very successful. The results speak for themselves, with Texas leading the nation in just about every economic category over time.

However, corporate welfare turns profit seekers into rent seekers, and businesses' market-oriented focus on consumer satisfaction into a government-oriented focus on handouts and special privileges. Creating a conflict of interest between businesses and consumers does not benefit the economy. The Texas Model, on the other hand, aligns these interests and creates a win-win situation for all participants.

# The Facts

- In Texas, corporate welfare spending totals more than \$2 billion annually.
- In a study of 32 states plus the District of Columbia, Texas ranked 17th in 2015 for the value of incentives as a percentage of state private industry value-added, and 19th as a percentage of gross taxes collected.
- States that spend less tend to have better economic performance.

## Recommendations

- Allow the Property Tax Abatement Act (Chap. 312) and the Texas Economic Development Act (Chap. 313) to expire.
- Repeal existing exceptions to transparency laws for economic development located in sections 551.087 (Open Meetings) and 552.131 (Public Information) of the Government Code.
- Reduce direct and indirect economic development programs and use the savings from the direct programs to cut taxes for all Texans.
- Eliminate or modify regulatory regimes and agencies designed to benefit specific industries or workers at the expense of most Texas consumers, workers, and businesses and increase freedom to work:
  - Introduce competition into the title insurance market;
  - Reduce excessive occupational licensing, including scope of practice issues in health care:
  - Adopt paycheck protection and ensure secret ballots in union elections;
  - Eliminate laws that protect some industry actors from true competition, such
    as in the three-tier system of alcohol distribution, and harm customers and
    businesses that are less politically connected; and
  - Reduce local economic regulation of the economy by removing excessive restrictions on the sharing economy and requiring voter approval for annexation anywhere in Texas.
- Reduce taxes and spending:
  - Adopt a Conservative Texas Budget for 2020-21 that increases spending by less than population growth plus inflation;
  - Eliminate the business margins tax and school M&O property taxes; and
  - Require local government entities to get voter approval for increasing property tax revenue more than 2.5% or population growth plus inflation, whichever is less.

#### Resources

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

"Rivalry Helps Drive Florida and Texas to Economic Success" by Bill Peacock, Orlando Sentinel (May 24, 2016).

Economic Development – Texas Style by Bill Peacock, Texas Public Policy Foundation (March 2010).

"Greg Abbott says if Texas were a country, its economy would rank 10th in world" by W. Gardner Selby, *Politifact Texas* (Sept. 15, 2016).

A New Panel Database on Business Incentives for Economic Development Offered by State and Local Governments in the United States by Timothy J. Bartik, W.E. Upjohn Institute for Employment Research (2017).

<u>Rich States, Poor States</u>, 9th Edition, by Arthur B. Laffer, Stephen Moore, Jonathan Williams, American Legislative Exchange Council (2016).

# Sunset Review

# The Issue

n 1977, Texas created the Sunset Advisory Commission (SAC) to make government more efficient.

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

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

However, while early on the SAC was able to eliminate a lot of archaic or duplicative agencies, today few agencies are eliminated, or streamlined for that matter. Instead, the process is generally to grow government. The "must pass" nature of sunset bills make them ripe for special interests to include provisions to increase government that never could pass on their own.

#### The Facts

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

# **Recommendations**

- Eliminate the "must pass" provision of the statute by repealing Section 325.013
  and Section 325.015 of the Texas Government Code. This will help reduce the
  special interest policy initiatives and allow the commission to concentrate on
  reducing the size, scope, reach, and cost of government.
- The SAC should conduct its evaluation of an agency once every 12 years, focusing on abolishing/eliminating agencies, committees, boards, and statutes. Reducing the commission's ability to change the scope of agencies will make their mission more about whether to eliminate or consolidate agency functions.
- Every six years the relevant jurisdictional standing committees within the
  Legislature should review the regulations and policies of agencies, committees,
  boards, and statutes. Regulations have the potential to substantially diminish
  the freedom of citizens and businesses in their everyday activities. A regulatory
  review process would allow the commission to get rid of outdated, redundant,
  or "ultra vires" regulations.

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- Every two years agencies should undergo operational reviews through the
  appropriations process to determine whether specific programs should
  continue to exist. To facilitate this, the appropriations bill should be changed
  to a program-based bill pattern to allow appropriators to identify individual
  programs within each agency.
- Require all sunset legislation to go through the substantive, jurisdictional legislative committees. This would also allow the SAC staff and members to focus on reducing the size, scope, reach, and cost of state agencies, as well as eliminate the access point for those interested in subverting due legislative process.
- Consider assigning the sunset review process of smaller agencies to the Senate Committee on Government Organization and House Committee on Government Efficiency & Reform.

#### Resources

*Improving the Effectiveness and Efficiency of Texas Government* by Maurice P. McTigue, Texas Public Policy Foundation (March 2015).

Sunset in Texas, Texas Sunset Advisory Commission (Jan. 2012).

# Gambling

## The Issue

t has often been suggested that Texas expand state-controlled gambling to increase state revenue in order to address the funding priorities *du jour*. For instance, one group suggested that gambling is a good way to "generat[e] more tax revenue for the state" in order to "rectify the anticipated budget imbalance." However, turning to gambling for more government revenue is wrong on several counts.

First, raising revenue to keep up with calls for increased spending is not the right answer. Instead, Texas should restrain government spending at a level to keep it within available revenue. This approach of "living within one's means" is simple and very similar to what most Texas families practice every day.

Second, whether the increased revenue comes from expanding an existing tax like the margins tax, from instituting a new tax like a tax on gambling, or from expanded economic growth, the result is the same: more government and more government spending. And the bigger the government and the more government spends, the more it can regulate. We will not have a "wise and frugal Government," or liberty, if our default is to squeeze every penny we can out of the economy.

Third, a significant body of research has shown that gambling expansion does not increase state revenues to the level suggested by proponents. As the Foundation noted in a 2005 study:

The economic impacts of gambling have been examined by a large body of national and international research; however, the research findings are mixed. While there is general agreement that gambling can provide large state revenues and that there are socioeconomic costs attached to these revenues, researchers disagree about the dollar value assigned to these costs and whether the net fiscal impact is positive or negative. ...

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. . . .

According to some research, the economic impact of gambling is positive—however, most of these studies acknowledge limited or no calculation of costs.... Other research, however, indicates the economic costs associated with gambling cancel out the revenues with net-zero financial gains or result in an overall financial loss at the end of the day. For example, research conducted by Florida's Office of Planning and Budgeting concluded in 1994 that Florida would experience a significant deficit if the state expanded gambling; although tax revenues were projected to reach almost \$500 million annually, gambling costs were projected to total at least \$2 billion annually.

Finally, past experience has proven that allowing gambling can result in what is known as "regulatory capture." The Texas Racing Commission is a perfect example.

In 2014, in an effort to help the horse racing industry, the commission allowed historical racing at racetracks in the Lone Star State, bypassing the Legislature which has the sole authority to allow new forms of gambling. Members of the Texas Legislature challenged the commission's authority to authorize historical racing, while a state district judge ruled that it did not. The commission, filled largely with members from or sympathetic to the racing industry, persisted. It was not until the Texas governor replaced some members of the commission that it eventually repealed the rule in 2016.

The Texas Model (i.e., low spending and taxes; a predictable, low level of regulation and strong property rights protection; a sound civil justice system; and minimal dependence on/interference from the federal government) has helped make Texas the nation's leader in job creation over the last decade. It has also helped us successfully meet past budget shortfalls without increasing taxes on hardworking Texans.

Rather than turn to gambling, or other sources, for new revenue, Texas should live within its means through reducing wasteful or unnecessary government spending.

# The Facts

- Researchers have found that the economic costs associated with gambling cancel
  out the revenues with net-zero financial gains or result in an overall financial loss.
- Costs associated with gambling include:
  - · reduction of state lottery revenues,
  - · increased regulatory costs for gambling,
  - criminal justice spending to counter an 8% to 13% increase in crime,
  - lost state and local revenue resulting from diversion of spending from goods and services to gambling, and
  - lost jobs resulting from decreased spending on non-gambling goods/services.

# Recommendations

- Do not expand or further legalize gambling in Texas.
- To address any potential budget shortfalls, Texas policymakers should reduce wasteful or unnecessary government spending.

#### Resources

<u>VLTs — What Are The Odds Of Texas Winning?</u> by Chris Patterson, Texas Public Policy Foundation (March 2005).

Gambling in America: Costs and Benefits by Professor Earl L. Grinols, Cambridge University Press (Dec. 2009).

*Gambling Economics: Summary Facts* by Professor Earl L. Grinols, Baylor University (Nov. 2004).

Racing Commission Should Abandon Effort to Legalize "Historical Racing" Slot Machines by Bill Peacock, Texas Public Policy Foundation (Aug. 2014).

# Cracking Down on Mail-In Ballot Fraud

## The Issue

Mail-in ballot fraud is "the tool of choice' for those who are engaging in election fraud." Once rare and only used when voters knew they were going to be out of town on Election Day, mail-in ballots have become commonplace in Texas and around the nation. The advent of early voting has largely addressed the originating rationale for mail-in ballots. Instead, mail-in ballots are now mostly used for convenience or by people who, due to illness, injury, or disability, find traveling to the polls to be arduous. In Texas, mail-in ballots bypass the state's voter ID law. Mail-in ballots are vulnerable to electoral fraud when voters, especially the aged and the disabled, are encouraged by paid political operatives to apply for a mail-in ballot and then "assisted" in filling out the ballot and handing it over to the operative for delivery.

Voter ID is not required before voting from home. Ballot harvesters, otherwise known as *politiqueras*, exploit the proven vulnerabilities of mail-in balloting by approaching seniors to sign up, "helping" them fill in their ballot and then carrying the ballot to the mail. This mode of fraud appears to be particularly hard to address. The fact is a formal polling facility is the only place where the sanctity of the secret ballot, free from coercion, can be monitored.

House Bill 658, signed into law in 2017, closes one avenue of mail-in ballot fraud while simultaneously making it easier for voters in nursing homes to participate in elections by allowing residential care facilities with five or more voters to become early voting centers. Some 3,000 assisted living facilities statewide might benefit. However, assisted living centers include memory care facilities, a class of facility that is growing rapidly, where the residents have compromised mental capabilities. Memory care facilities do not yet appear to be a large source of ballot fraud. Research by the Foundation examined voter registration and voting records of 40 facilities that exclusively provide memory care in Texas and found only 19 registered voters at 11 facilities having cast five votes of which three were mail-in ballots in the 2016 general election.

To preserve the integrity of the vote, Texas Election Code restricts candidates, bystanders, sound trucks, election-related badges, and other activities from polling places. Further, it is unlawful to influence voters at the polls. In addition, the Election Code specifies that election judges must be affiliated or aligned with different political parties. Yet voters, often elderly or disabled, receive no such protections when voting by mail. With the use of mail-in ballots growing, why aren't these votes given the same protections as votes at the precinct polling place? The practice of employing mail-in ballot harvesters, or *politiqueras*, needs to be ended. Election law prohibits a polling place staffed by paid agents of one candidate or one political party, yet, ballot harvesters are functionally the same in many key respects as election judges.

# The Facts

- Texas first allowed absentee voting in 1917; voting by mail followed.
- In the 2016 general election, 41% of registered voters in Texas' 15 most-populous counties—more than four million voters—had voted by mail-in ballot or by early voting.

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- Since the 2004 primary election, of 93 election law violations pursued by the Texas attorney general, almost half were cases of mail-in ballot fraud.
- A non-exhaustive survey of mail-in ballot fraud incidences in Texas includes:
  - 2016: 700 suspicious mail-in ballots sequestered in a Dallas County voter fraud case,
  - 2012: six Cameron County mail-in ballot harvesters, known in Texas as politiqueras, accused of fraud; guilty pleas for illegally assisting voters followed;
  - 2010: justice of the peace race in Dallas County;
  - 2008: illegal vote harvesting in Jim Wells County during the primary;
  - 2006: Duval County, almost half of the ballots cast in the primary were mail-in; and
  - 1994: two Falfurrias addresses account for more than 120 mail-in ballot requests.

#### Recommendations

The Election Code should proscribe the practice of ballot harvesting. As much as is practicable, mail-in ballots should be treated with the same legal protections as ballots cast at a polling location. The chain of custody for mail-in ballots should be limited to ballots in an envelope expressly for the purpose of transmitting a mail-in ballot, sealed, and signed by the registered voter:

- Mailed from an international or out-of-state location;
- Deposited into the U.S. Postal Service by the voter themselves or by an immediate relative; and
- Presented by the voter to two people, both election judges, affiliated or aligned with different political parties, and assigned the duty to collect mailin ballots.

#### Resources

Who's Counting?: How Fraudsters and Bureaucrats Put Your Vote at Risk, by Hans von Spakovsky and John Fund, Encounter Books (Aug. 14, 2012).

"Early voting wraps up in Texas with record turnout," by Taylor Goldenstein, Austin American-Statesman (Nov. 4, 2016).

"<u>Texas' controversial voter ID law can't stop mail-in ballot fraud</u>," by Nicole Cobler, *News21* (Aug. 20, 2016).

"Prosecutors issue first arrest warrant in West Dallas voter fraud case," by Naomi Martin and Robert Wilonsky, *Dallas Morning News* (June 2, 2016).

"Texas may expand ballot access for elderly and voters with disabilities," by Jim Malewitz, *Texas Tribune* (June 2, 2017).

"Demand for mail-in ballots in Texas is growing, as are the risks," by Anna M. Tinsley, Fort Worth Star-Telegram (July 9, 2012).

<u>Texas Election Code. Title 3. Chapter 32</u>. Subchapter A. Appointment of Election Judges.

# Paycheck Protection

# The Issue

The state of Texas and most local governments, including school districts, provide automatic deduction of union dues from public workers' paychecks. However, it is not the role of government to serve as the dues collector for unions, or as a revenue collector for any private organization. Along those lines, many states have already adopted laws prohibiting state and local governments from collecting union dues.

The statutes now on the books in states like Wisconsin, Michigan, North Carolina, and Alabama do not limit in any way the ability of members of government unions and other public employees to pay dues to their labor organization or to contribute to union PACs. But the statutes do require public union officials to make their own arrangements with union members regarding dues collections, rather than rely on the public employer to deduct union dues automatically out of employee paychecks.

The experience of these states in the relatively short time that the bans on automatic payroll deduction have been in effect suggests that, in many cases, once employers cease collecting union dues out of their paycheck, and they have to take active measures to continue bankrolling their union, public employee union members conclude the organization does not merit their financial support after all.

Requiring union members and all government employees to make private arrangements with unions is important, given that unions such as the American Federation of State, County and Municipal Employees and the Service Employees International Union use funds collected from public sector employees to fund their private sector unionization drives. It is not the role of government at the state or national level to act as the middleman and dues collector for private organizations like unions. Prohibiting the state government from acting as a dues collector for private organizations is restoring government to its proper role.

# The Facts

- Texas' government unionization rate is roughly 20%.
- Currently the state of Texas collects dues on behalf of public sector unions.

# Recommendation

Prohibit deduction of union dues from public workers' paychecks.

#### Resources

<u>State Labor-Management Policy and the Texas Model</u> by Stanley Greer, Texas Public Policy Foundation (Feb. 2015).

*The Texas Miracle and Labor Policy* by Bill Peacock, Texas Public Policy Foundation (April 2015).

# Taxpayer-Funded Lobbying

### The Issue

According to reports filed with the Texas Ethics Commission by lobbyists required to register in the state of Texas, as much as \$376.6 million was spent to influence state policymakers in 2017. Given the state of Texas spent about \$116 billion in 2017, spending \$376.6 million to have a say in how those billions are spent can be seen as a wise investment, the equivalent of spending \$3 to try to shape \$1,000 of spending.

So long as government is large and powerful—taxing, spending, and regulating in ways that can significantly affect the profitability of businesses and the well-being of people—individuals will be driven to influence government. Much of this effort is defensive and some is opportunistic, leading to crony corporatism with the government actively encouraged to pick winners and losers. In either case, lobbying is a form of free speech and is considered a basic right of the people as enshrined in the First Amendment in our Bill of Rights as, "the right of the people … to petition the Government for a redress of grievances."

Lobbyists, powerful members of the so-called third house, write bills, assemble coalitions, and pass or stop legislation. When they work for trade groups, unions, businesses, or other special interests, they are participating in free speech. But, does government itself have that same right? It is properly said that only people have rights, whereas governments have powers.

In 2017, lobbying disclosure forms also reveal an interesting data point: 11% of lobbying dollars spent that year, as much as \$41 million, was spent by government to hire outside lobbyists to lobby government. This figure excludes government employees who may spend some of their time lobbying other parts of government for their agency. This taxpayer-funded lobbying is problematic. How can one part of a representative government petition itself for a "redress of grievances" to another part of government?

Elected members of the Texas Legislature as well as the governor and political appointees are all highly motivated to listen to the elected members of local government bodies. When any elected member or key staff member from a local elected entity is concerned enough about an issue to contact a lawmaker or executive branch official, they are likely to pay attention.

Unfortunately, many local jurisdictions, from counties, to cities, to school districts, and even municipal utility districts (MUDs), have outsourced a very basic part of their job as elected officials by hiring professional lobbyists to lobby state government. Even worse, the up to \$41 million in taxpayer money spent on hired lobbyists to influence the state government in 2017 was often spent on behalf of measures that are contrary to the interests of their own constituents. For instance, funds were spent to lobby against annexation reform, which allows individual Texans the right to decide for themselves if they want to join a neighboring city, and were also spent against efforts to limit the high yearly increase of property taxes.

continued

# Taxpayer-Funded Lobbying (cont.)

There are two other less well-known ways that local governments lobby in the state Capitol.

The first is through public agency associations. These associations are not accountable to voters. Their very nature allows them to insulate the elected officials in their membership from the consequences of promoting higher taxes and bigger government. These associations often charge membership dues to raise a small portion of their budget. Few members spend their own personal money on these dues—for instance, many members of a professional prosecutors association use civil asset forfeiture funds taken from citizens without benefit of a trial and guilty verdict to pay their dues. The majority of funds raised by these associations typically come from the ad space they sell in their trade association-like magazines to private sector companies seeking government contracts. The ad space is bought, typically at a premium high above what the subscription base would justify, for the purpose of funding the associations' operations and lobbying efforts. Thus, this money does not directly flow from taxpayers, but rather is provided by firms that supply goods and services to government and, as a result, benefit from greater government spending.

The other form of off-the-record lobbying is to assign government employees the task of lobbying state government. This is a common practice in Austin during session when dozens of local government employees can be found on any given day lobbying lawmakers for more power and more taxpayer money. In 1997 a two-sentence bill was introduced in Texas (HB 2501) that would have prohibited any political subdivision of the state from using public funds to hire someone whose main job was to lobby any governmental entity. It failed.

The city that hosts the Texas state Capitol, Austin, spends about \$1 million per year to lobby, employing 14 lobbyists, both contract lobbyists as well as city employees.

In addition to the up to \$41 million spent in 2017 on hiring outside lobbyists by government entities in Texas, there is another factor to consider: many of the lobbyists hired by local government have other clients in the commercial arena. This amplifies their ability to direct donations and gifts to lawmakers, making their entreaties on behalf of local governmental entities all that much more difficult for lawmakers to resist.

Local governments' use of taxpayer dollars to lobby for higher taxes, greater spending, and more regulatory power is nothing more than taking taxpayer dollars to take more taxpayer dollars. Individual Texas taxpayers are largely outgunned by this lobbying firepower.

# The Facts

• Up to \$41 million was spent by local government in 2017 to hire outside lobbyists to lobby state government.

- In addition, hundreds of local government employees descend on the state Capitol every session to lobby for more power and money for local government—these people do not register as lobbyists.
- Lastly, public agency associations such as the Texas Municipal League sell
  advertising to government contractors with the income from this advertising
  going to pay for lobbyists.

### Recommendations

- Ban the ability of local government to hire outside lobbyists.
- Prohibit any political subdivision of the state from using public funds to hire someone whose main job was to lobby any governmental entity.
- Prohibit any public funds from going to public agency associations.

#### Resources

HB 2501. 1997. Introduced. 75th Texas Legislature (R).

Texas Ethics Commission (2017).

# Consumers

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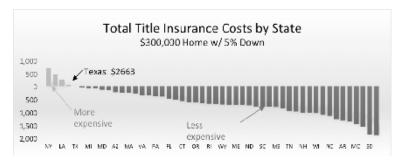
# Title Insurance

### The Issue

Texas has the most heavily regulated title insurance market in the country. The Texas Department of Insurance (TDI) sets the price and coverage of residential and commercial title insurance. The TDI also promulgates the division of premiums between title companies and agents. As a result, competition is eliminated from the title insurance market, and costs increase for both consumers and businesses.

There is 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. Consumers understand this: a recent poll found that 91% 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.

Texas has some of the highest title insurance rates in the nation. According to a study by the LBJ School of Public Affairs (2011), Texas has the highest title insurance premium for a \$200,000 home among states that require comprehensive coverage. The Foundation's research shows that Texas has the fifth highest total title insurance cost for a \$300,000 home.



Consumers are not only burdened by high prices, they are also deprived of choice. Since the government sets coverage, many Texans must pay for things they do not want—and what they do get is often of inferior quality. So long as the government regulates their business, title insurance companies have no incentive to meet the needs of their customers.

The current regulatory system not only adds significant costs for homeowners but also for businesses engaging in real estate transactions. While high residential rates discourage homeownership in Texas, high commercial rates burden businesses and can negatively impact their relocation and expansion.

The current system is far removed from the Texas Model of low taxes and regulations, which has made Texas the nation's economic leader for the last 15 years. Texas can easily introduce competition and choice into title insurance by applying the same file-and-use system that is used for auto and home insurance. Making

title insurance consistent with the Texas Model will lead to lower rates, higher quality coverage, and more consumer choice. Additionally, it will lower the cost of business in Texas, which can lead to more jobs and a stronger economy.

### The Facts

- The Texas "title insurance tax" on Texas homeowners in 2016 was between \$111.1 million and \$186.5 million, averaging \$342 to \$574 per home sale.
- Texas had the 12th highest price for title insurance among the 50 states for a policy on the average priced home (\$260,064) sold in Texas in 2016.
- Texas has the most restrictive regulation of title rates and forms (policies) in the
  nation. It allows no opportunity for insurers to innovate with their products or
  to lower rates in order to compete for consumers' business.
- Much of the revenue from title insurance policies is wastefully spent to the benefit of the industry; on average, only 13% of the cost of a title policy on a \$260,064 home is spent benefiting consumers by reducing risk or paying claims.
- Higher prices in Texas do not benefit Texas consumers; higher prices do not make titles in Texas any safer than titles in other states.

### 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.

#### Resources

"The Texas Title Insurance Market Should be Freed from Overregulation" by Brooke Rollins and Bill Hammond, *TribTalk* (Feb. 12, 2016).

"Commentary: Why Texas Needs Competition in the Title Insurance Market" by Bill Hammond and Bill Peacock, *Austin American-Statesman* (March 07, 2016).

<u>Deregulating Title Insurance</u> by Bill Peacock, Texas Public Policy Foundation (April 2013).

*Title Insurance Regulation in Texas: Challenges and Opportunities*, Lyndon B. Johnson School of Public Affairs (2011).

# Homeowners' Insurance

### The Issue

Reform of the Texas homeowners' insurance market in 2003 called for a file-and-use regulatory system. However, in 2009, the Sunset Advisory Commission's Staff Report on the Texas Department of Insurance (TDI) rightly concluded that the "Legislature cannot judge the success of the shift to file-and-use rate regulation because the system has not been fully implemented." Conditions have little improved since the report was issued.

One reason for the incomplete implementation is TDI's use of both pre-market and post-market regulatory tools—the Insurance Code grants TDI authority to reject rates both before and after being used in the marketplace. Failure to implement file-and-use is a problem because pre-market regulation hinders timely entry of rates into the marketplace and disrupts market pricing.

The price disruption is aggravated by Texas' non-renewal law, which prohibits insurers from non-renewing high claims policies, even when the damage was a product of policyholders' own negligence. This forces insurers to base their coverage and rates on non-actuarial principles and discourages insurers from establishing specialized markets to cover high-risk areas.

A related problem is TDI's focus on "affordability." Ultimately, a regulatory stance focused on affordability reduces investment, hinders competition, and puts insurers at risk of insolvency. An example of the danger of focusing on affordability—rather than solvency—is the failure of Texas Select Lloyds in 2006, at a time when TDI was committing significant resources to pursuing legal actions against two major insurance companies for excessive rates.

Furthermore, statutory calls for rates neither "excessive" nor "inadequate" are at odds with each other, creating regulatory uncertainty. This conflicting statutory guidance stands in the way of true file-and-use rate regulation in the Texas homeowners' insurance market.

- Senate Bill 14 (2003) called for a transition to a file-and-use regulatory system for homeowners' insurance, with the intention of having a file-and-use system in place as of December 1, 2004.
- Texas' system of rate regulation for homeowners insurance includes pre-market
  and post-market regulatory tools, where rates can be rejected before or after
  they are first used in the marketplace. This prevents insurers from basing rates
  on actuarial principles and reduces competition in the marketplace.
- TDI's belated implementation of a 1997 provision allowing insurers to use national forms, along with lawsuit abuse, caused premiums to rise dramatically. This delay ultimately cost consumers more than \$900 million. After TDI allowed insurers to use non-standard forms in 2002, mold claims plummeted and rates stabilized.

### Recommendations

- Adopt a true file-and-use system allowing the commissioner to disapprove only rates in use.
- Shift the focus from blocking "excessive" rates to guarding against inadequate or discriminatory rates.
- Implement a true file-and-use system for policy forms, and focus policy-form regulation on the wording and clarity of an insurance form rather than the content of a form.
- Allow the commissioner to place under prior approval only those companies whose financial positions warrant increased supervision in order to maintain solvency.
- Permit insurers to non-renew, or add a premium surcharge to, high claim policies, especially where those claims were a product of negligence or misuse of the claims process.

### Resources

<u>Non-Renewal of Policies in Texas' Homeowners Insurance Market</u> by Kathleen Hunker, Texas Public Policy Foundation (Aug. 2014).

<u>Consumers, Competition, and Homeowners' Insurance</u> by Bill Peacock, Texas Public Policy Foundation (May 2010).

<u>More Intervention in the Insurance Marketplace: SB 871</u> by Bill Peacock, Texas Public Policy Foundation (March 2011).

<u>Freedom of Contract Creates Regulatory Certainty and Lower Insurance Rates</u> by Ryan Brannan, Texas Public Policy Foundation (March 2011).

*Homeowners' Insurance: The Problem with Prior Approval* by Bill Peacock, Texas Public Policy Foundation (May 2009).

# Short-Term Consumer Lending

### The Issue

n the wake of the 2008 financial crisis, lenders and consumers alike have had concerns regarding the state of the credit market. Traditional banks have tightened restrictions on lending, making it more difficult to obtain credit, especially when the need arises very suddenly and unexpectedly.

For consumers who do not meet banks' lending criteria, options are limited, especially when the necessary funds are too "small" for the bank, and when borrowers do not have proper credit ratings and cannot obtain credit cards. One option for these individuals is payday lending.

Contrary to popular opinion, the individuals seeking such lending are not undereducated or unemployed; rather, they are normal people who need a short-term loan to cover unexpected expenses.

Credit service organizations (CSOs) will often help loan-seekers locate third-party lenders for a fee; the lenders then deposit money in an individual's account against a future paycheck. However, these fees, and payday lending in general, are often targeted by governments. Each session, multiple bills target the practice, including some that would place restrictions on charging fees.

These types of bills would have likely driven many payday lenders out of the business, as happened when New Hampshire created new regulations. Rather than protecting consumers, these actions could have dried up consumers' credit options, preventing them from meeting sudden needs, often at great personal cost.

Fortunately, no major regulatory bill has passed in recent sessions. However, more than 40 Texas cities have adopted strong local payday and auto title ordinances restricting these short-term consumer lending practices. Advocates have pledged to encourage more communities to do the same. New regulations are bound to harm the market and are unnecessary; consumers are able to make their own decisions as to whether the fees and costs are worth the value of the loan. Calls for regulation also incorrectly assume that CSOs are unregulated, which is not true.

Those who need access to credit already face a challenge. New regulations of the market would make that challenge more difficult, and possibly impossible. On the other hand, consumers benefit when they are able to secure credit in a timely fashion. Keeping short-term lenders open extends credit opportunities to all those who need it.

- An estimated 40% of payday loan recipients seek such loans only after rejection by traditional lenders.
- Payday borrowers, contrary to popular belief, are educated and employed.
- Regulations in other states have forced many such lenders out of business, limiting credit options for those the laws were supposedly designed to protect.

More than 40 Texas cities have adopted ordinances that restrict payday lending and title loans, creating a patchwork of inconsistent financial regulation throughout the state.

### **Recommendation**

No attempts should be made to add further barriers to payday lending.

### **Resources**

"Restrictions on Payday Lenders Cost Texas Jobs" by Bill Peacock, *Dallas Morning News* (Dec. 2, 2015).

<u>Evaluating Consumer Access to Short-Term Lending</u> by Ryan Brannan, Texas Public Policy Foundation (April 2011).

<u>Consumer Benefits of Access to Short-Term Credit</u> by Ryan Brannan, Texas Public Policy Foundation (March 2011).

# Tax Lien Lending

### The Issue

every year thousands of Texas property owners find themselves in the unenviable position of falling behind on their property taxes either because of a temporary financial setback or some other lack in liquid capital.

Fortunately, the competitive market has stepped in to offer these property owners a way to satisfy their tax debt without having to trek through the delinquency process, whose penalties, fees, and interest can add close to 50% onto a property owner's final tax bill after just one year.

Called a tax lien transfer, this specialized lending practice offers Texas property owners a reasonable means to take control of their outstanding tax debt by negotiating a short-term loan with a licensed tax lender and then transferring the tax lien that the government automatically attaches to the property as collateral for the loan. This allows property owners to spread out their tax obligation over several years rather than paying in a lump sum as is typically demanded by state law.

Over the past few years, Texas taxpayers have expressed a strong demand for property tax lending services, driven in large part by sharp increases in Texas property taxes, which have risen almost three times faster than household income. That demand will not dissipate so long as property taxes continue to overburden Texas taxpayers.

Nevertheless, despite the high demand for tax lien transfers, and despite their appreciable benefit to Texas taxpayers, an ensemble of special interests have incited fears over business practices within the tax lending market and have pushed for legislation that restricts, if not eliminates, taxpayers' access to much needed tax assistance.

The effort has had some success. The Texas Tax Code already puts up extra barriers for Texans with mortgaged properties, demanding that they wait until their taxes turn delinquent before initiating a tax lien transfer. Put differently, these Texans can only take action to resolve their tax debt after they start accumulating penalties and interest.

In addition, the Texas Legislature considered no less than eight bills last session aimed at curtailing tax lien loans, all of which failed. Proposed changes in HB 3222 and SB 1956 would have eliminated the tax lien's superior priority over other secured interests. Had it been enacted, the amendment would have effectively ended tax lien lending as a sustainable commercial practice, denying Texas property owners a cost-effective means of rectifying their tax debt. Such legislation would not help Texas property owners; it would simply force them to confront the penalties and foreclosure proceedings that accompany delinquency with no prospect for relief.

## The Facts

 The Office of Consumer Credit Commissioner reports that 72 licensed lenders issued <u>12,960</u> property tax loans in 2016.

- Texas' <u>property taxes</u> climbed 233% statewide from 1996 to 2016 or an average of 6.3% per year. Conversely, <u>personal income</u> increased by 199% or an average of 5.7 per year.
- After one year of delinquency, a property owner will have added 12% in interest, 12% in late penalties, and somewhere between 15-20% in collection fees onto their original tax bill.
- The Finance Commission reports that a tax lien transfer could cost a taxpayer substantially less than remaining in delinquency.

### Recommendations

- Amend §32.06(a-2) of the Texas Tax Code to eliminate its two-tier treatment
  of Texans with mortgaged properties, specifically the requirement that these
  property owners wait until their taxes have become delinquent before initiating a tax lien transfer.
- Make no attempt to eliminate or alter the tax lien's high priority status after it's been transferred to a third party.
- Refrain from enacting any additional barrier to tax lien lending that restrict and/or deny Texas property owners access to market-based tax relief.

### Resources

<u>Property Tax Lending Consolidated Volume Report Calendar Year 2016</u>, Texas Office of Consumer Credit Commissioner (Nov. 2017).

<u>Tax Lien Lending Benefits Property Owners and Consumers</u> by Bill Peacock, Texas Public Policy Foundation (April 2015).

<u>Tax Lien Transfers: A Reasonable Means of Rectifying Property Tax Debt</u> by Kathleen Hunker, Texas Public Policy Foundation (Dec. 2014).

<u>Tax Lien Lending is a Cost-Effective Way to Manage Property Tax Debt</u> by Bill Peacock, Texas Public Policy Foundation (May 2014).

# **Telecommunications**

### The Issue

Texas has recently been one step ahead of the rest of the country in telecommunications, passing major telecom reform legislation in both 1995 and 2005. Thanks to a bill passed by the 79th Legislature—SB 5—local telephone service for more than 15 million Texans was significantly deregulated as of January 1, 2006. This was a major step forward in reducing costs and bringing new technologies and services to millions of Texans.

Texas again took the lead in 2011. The Legislature passed SB 980, an omnibus telecommunications deregulation bill. This legislation allows new technology and innovation such as VOIP, broadband, and cable to compete in the market. The law ended specific tariffing requirements and removed monopoly relic regulation. Ultimately, it will increase competition in the marketplace and lower costs for Texas consumers.

There is nevertheless still room for improvement. Texas consumers are particularly burdened with high tax rates on telecommunications services. The taxes and fees that consumers pay include state and local sales taxes, municipal franchise fees, and charges for the Texas Universal Service Fund (USF). In fact, Texans pay higher rates on the purchase of most telecommunications services (except satellite) than they do on fireworks and hard liquor. Only cigarettes are taxed at a higher rate.

During the 85th Legislature, the House State Affairs Committee passed legislation that expanded USF for small providers. The bill reversed the previous glide path phasing out the USF as improvements in technology make accessibility easier and cheaper. The federal government already subsidizes broadband access in rural areas. Expanding the state USF is an unneeded and expensive redundancy that stands in sharp contrast with the state's decade-long commitment to a freer telecommunications market.

- The current Texas Universal Service Fund is 3.3% of taxable communications receipts. It funds a collection of programs, including Tel-Assistance, Lifeline, the Small Local Exchange Carriers Universal Service Fund, and the Texas High-Cost Universal Service Plan.
- Upon deregulation, interstate long distance rates fell 68% from 1984 to 2003, while intrastate rates fell 56%. The slower decline of intrastate rates is due largely to state regulators who have kept intrastate access charges artificially high in order to maintain subsidies of local phone rates.
- Texas has slowly been phasing out the Universal Service Fund. Total expenditures in FY2013 amounted to \$335.9 million. By FY2015, that number had been reduced to \$251.4 million.

### 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.
- Eliminate the "tax on a tax" aspect of the state and local sales taxes.
- Restructure Municipal Franchise Fees to reflect the marginal costs of providing services through the right-of-way.

#### Resources

A Glide Path to Market-Based Universal Service: Eliminating the Texas Universal Service Fund by Bill Peacock, Texas Public Policy Foundation (March 2017).

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

<u>Testimony Presented to the House Committee on Regulated Industries: Regarding Telecommunications Taxes and Technology Deployment</u> by Bill Peacock, Texas Public Policy Foundation (June 2008).

Q&A on the Texas Universal Service Fund by Bill Peacock, Texas Public Policy Foundation (Aug. 2006).

<u>Consumer Choice and Telecommunication Contracts</u> by Chris Robertson, Texas Public Policy Foundation (April 2009).

<u>Testimony Regarding the NFL Network Dispute</u> by Bill Peacock, Texas Public Policy Foundation (Dec. 2007).

# Windstorm Insurance

### The Issue

The Texas Windstorm Insurance Association (TWIA) provides windstorm and hail coverage in the 14 coastal counties and a few other specially designated areas. All property insurers in Texas must participate in TWIA and must help pay losses. Although TWIA was intended to provide windstorm insurance coverage only to those who could not purchase insurance in the voluntary market, it is no longer an insurer of last resort.

While TWIA may have been intended as a residual provider, it has become anything but that. Its unrealistically low rates have made TWIA an unbeatable competitor and are crowding out the private market. TWIA's market share along the coast grew from 17.9% in 2001 to 51% in 2017. As of June 8, 2018, TWIA had 221,770 policies in force.

Yet the artificially low rates that make TWIA an unbeatable competitor do not result in sufficient reserves to pay for the most likely claims caused by a major hurricane. At the end of the 2017 hurricane season, TWIA had \$900,387 in the Catastrophe Reserve Trust Fund to pay claims. As of June 2018, TWIA had received 70,209 claims after Hurricane Harvey that made landfall on August 25, 2017, as a Category 4 hurricane with sustained winds of 130 mph. TWIA expects total losses and loss adjustments to be in the ballpark of \$1.6 billion.

Direct insurance in force along the coast ranged from \$20.5 billion in Galveston County to \$12.2 billion in Nueces County to \$1.1 billion in Harris County. Altogether, TWIA's direct liability exposure was \$63.8 billion.

This inefficient and woefully inadequate funding scheme presents a grave risk to all Texans in the event of a catastrophe, from TWIA policyholders whose policies have no definite funding source, to private insurers who remain vulnerable to unlimited assessments, and average taxpayers who could see a potential impact on the general revenue fund.

- TWIA's market share along the coast grew from 17.9% in 2001 to 51% in 2017.
- Here is the exposure for TWIA in three areas of the coast:
  - Galveston County: \$20.5 billion
  - Nueces County: \$12.2 billion
  - Harris County: \$1.1 billion
- At the end of the 2017 hurricane season, TWIA had \$900,387 in the Catastrophe Reserve Trust Fund to pay claims but increased to \$2.9 million by May 31, 2018.
- The number of TWIA policyholders increased from 68,756 in 2001 to 221,770 at the end of June 2018.

## Recommendations

- Eliminate the Texas Windstorm Insurance Association.
- Replace TWIA with a true provider of last resort, much like the Texas FAIR plan for automobile insurance policies.
- Require that the new windstorm rates be actuarially sound.
- Require that the new windstorm rates be higher than any competing private sector offers.

### Resources

*Texas Windstorm Insurance Association Overview* by Texas Department of Insurance (June 2018).

*The Great Windstorm Divide: Isolating the Texas Coast* by Bill Peacock, Texas Public Policy Foundation (May 2015).

<u>Texas' Windstorm Insurance System Still Does Not Work</u> by Bill Peacock, Texas Public Policy Foundation (March 2013).

<u>Next Steps to Reforming Texas Windstorm Insurance</u> by Bill Peacock and Ryan Brannan, Texas Public Policy Foundation (Nov. 2010).

# **Experts**

Kara Belew, Senior Education Policy Advisor, Center for Innovation in Education kbelew@texaspolicy.com AREAS OF EXPERTISE: State Budget, Taxes, Public Education Finance and Policy, Public Education Accountability

**Derek Cohen, Ph.D.,** Director, Center for Effective Justice and Right on Crime dcohen@texaspolicy.com AREAS OF EXPERTISE: Juvenile Justice Reform, Victims' Rights, Overcriminalization, Constitutional Limitations on Corrections

**The Hon. Chuck DeVore,** VP of National Initiatives; Senior Fellow for Fiscal Policy cdevore@texaspolicy.com AREAS OF EXPERTISE: Tax and Fiscal Policy, Elections, Foreign Affairs, Military Affairs, Energy and Environmental Policy

Vance Ginn, Ph.D., Director, Center for Economic Prosperity; Senior Economist vginn@texaspolicy.com AREAS OF EXPERTISE: State Budget and Tax Reform, National and State Labor Market Trends, Tax and Expenditure Limits, Energy Markets and Policy

**Michael Haugen,** Policy Analyst, Center for Effective Justice and Right on Crime mhaugen@texaspolicy.com AREAS OF EXPERTISE: Civil Forfeiture, Overcriminalization, Substance Abuse Policy

**The Hon. Talmadge Heflin,** *Director, Center for Fiscal Policy* theflin@texaspolicy.com AREAS OF EXPERTISE: State Budget and Taxation, Economic Stabilization Fund, Local Government Spending, Pension Reform, Federal Funds

**Haley Holik,** Attorney, Center for Effective Justice and Right on Crime hholik@texaspolicy.com AREAS OF EXPERTISE: Juvenile Justice, Grand Jury Reform, Constitutional Limitations on Search and Seizure, Overcriminalization

Marc Levin, Esq., VP of Criminal Justice and Right on Crime mlevin@texaspolicy.com AREAS OF EXPERTISE: Adult Corrections, Juvenile Justice, Overcriminalization, Victim Empowerment and Restitution, Law Enforcement, School Discipline

**Thomas Lindsay, Ph.D.,** *Director, Center for Innovation in Education* tlindsay@texaspolicy.com AREAS OF EXPERTISE: Higher Education, Culture Wars (Political correctness, cultural decline, etc.), America's Founding Principles, Online Learning, Federalism, Tenth Amendment, Interstate Compacts

**Brandon J. Logan, Ph. D.,** *Director, Center for Families & Children* blogan@texaspolicy.com AREAS OF EXPERTISE: Child Welfare Policy, Foster Care, Adoption, Family Law, Parental Rights

**Bryan Mathew,** *Policy Analyst, Center for Local Governance* bmathew@texaspolicy.com AREAS OF EXPERTISE: Local Economic Regulation, Local Economic Development, Municipal Annexation, Housing Affordability, Property Rights, Special Districts

### **Stephanie Matthews,** VP of Public Affairs

smatthews@texaspolicy.com AREAS OF EXPERTISE: Workforce Development, Charter Schools, School Choice, Virtual Learning

**Jennifer Minjarez**, *Policy Analyst, Center for Health Care Policy* jminjarez@texaspolicy.com AREAS OF EXPERTISE: Medicaid Reform, Mid-Level Providers, Medical and Dental Licensure Reform

### Bill Peacock, VP of Research

bpeacock@texaspolicy.com AREAS OF EXPERTISE: Electricity Markets and Renewable Energy, Insurance, Technology and Telecommunications, Tort Reform, Property Rights, Economic Development, Consumer Issues

Randy Petersen, Senior Researcher, Center for Effective Justice and Right on Crime rpetersen@texaspolicy.com AREAS OF EXPERTISE: Policing Policy, Diversion Programs, Civil Asset Forfeiture

**James Quintero,** *Director, Center for Local Governance* jquintero@texaspolicy.com AREAS OF EXPERTISE: Budgets, State and Local Spending, Debt, Taxes, Transparency, Pensions

### Kevin D. Roberts, Ph.D., Executive Director

kroberts@texaspolicy.com AREAS OF EXPERTISE: K-12 Education Growth, Increasing Public School Efficiency, Education Choice, Higher Education, Tenth Amendment

**Emily Sass**, *Policy Analyst, Center for Innovation in Education* esass@texaspolicy.com AREAS OF EXPERTISE: K-12 Education, Education Choice, School Finance, Civic Education, Charter Schools

**Deane Waldman, Ph.D.,** Director, Center for Health Care Policy dwaldman@texaspolicy.com AREAS OF EXPERTISE: Health Care, Medicaid, Telemedicine, Scope of Practice, Regulatory Issues

The Hon. Kathleen Hartnett White, Distinguished Senior Fellow-in-Residence; Director, Center for Energy & the Environment khwhite@texaspolicy.com AREAS OF EXPERTISE: EPA Regulation, Energy and Environmental Policy, Free Market Environmental Policies, Endangered Species Act, Water Rights

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