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States at Work: Progressive State Policies to Rebuild the Middle Class

Karla Walter, Tom Hucker, and David Madland with Nick Bunker and David Sanchez March 2013



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Introduction and summary

As our country inches its way out of the Great Recession and looks toward the future, it is clear that we need a new framework to guide our economic growth. The old trickle-down economic model of the past several decades is failing nearly everyone, save those at the very top.

Incomes for the middle class and the poor are stagnant or falling, while the costs of life's necessities continue to rise, and the risks of falling behind economically grow. Our country faces a mounting economic opportunity deficit, as the American promise—the idea that if you work hard, you can achieve the good life, exemplified by a secure paycheck that grows year after year; a nice home in a safe neighborhood with decent schools; retirement savings; health care; some leisure time to spend with friends and family; and the ability to send your kids to college and pass them a bigger share of the American Dream—feels like it is slipping out of reach for far too many.

These problems are particularly acute for immigrants and people of color, who are rapidly becoming the majority population of the United States and will certainly be so by 2050.¹ If current racial and ethnic disparities in income, employment, education, health, and other social services continue, we will not fully capitalize on the global economic advantages that we can derive from our increasingly diverse population, and we will not meet the nation's 21st-century workforce requirements.

It is imperative that we chart a course that underscores American ideals of fairness, equity, and opportunity, recognizing that our country's greatest strength has always been our people. In short, we need to rebuild a strong and growing middle class. Doing so is essential for a vibrant democracy and a healthy economy—and for our conception of what America is all about.

Tackling the economic challenges that our country faces will require bold action, but no single report can cover all the progressive policies that state governments should adopt. This report represents the Center for American Progress Action Fund's best

thinking on policies that state governments can undertake to rebuild the middle class, while highlighting the work of outside researchers, analysts, and advocates and complimenting state policy agendas released by other progressive organizations.

This report contains more than 100 policy reforms that will improve job quality, reduce the costs of health care, reform the tax code, fix the housing market, improve the quality of education, ensure civil rights are respected so that everyone can fully participate in the economy, rebuild our crumbling infrastructure, and strengthen local communities. (see text box below for highlights of these policy reforms)

Our agenda is big and bold and rises to the scale of the challenges we face. Each individual policy in this report would be a big help to the middle class—creating a significant number of jobs, boosting incomes for a large percentage of the population, meaningfully cutting costs for middle-class necessities, considerably lowering the risks of falling behind, and boosting opportunity and fair treatment. Together, the policies approach the scale necessary to start rebuilding the middle class.

The policies will help not only those who are currently in or near the middle class but also those who are struggling to join the middle class. Focusing on both current and future members of the middle class is especially important, given existing racial and ethnic disparities and the dramatic demographic changes taking place over the next few decades.

Our recommendations highlight best practices already in use by at least one, and often several states, as well as more novel approaches where those are needed. There is much here for leaders of all states—these policies are specific and practical so that governors and state legislators can take full advantage of this report. Best practices have often passed with broad-based bipartisan support. Even states that are progressive leaders in some arenas have much to learn from what other states are doing in other areas.

For convenience, the policies in this report are grouped in eight broad categories: improving job quality; ensuring civil rights are respected so that everyone can fully participate in the economy; reforming the tax code so that it fairly and efficiently raises sufficient revenue; stabilizing the housing market, ensuring affordable rental housing, and helping rebuild communities affected by the foreclosure crisis; improving the quality of education for all students; ensuring affordable quality health care for all; rebuilding America's crumbling infrastructure; and strengthening local communities. Yet the policies we detail generally have mul-

multiple benefits and address more than just one aspect of the challenges facing the middle class—including high unemployment, stagnating incomes, rising costs of living, and increased risk of falling out of the middle class. Indeed, our entire agenda is geared toward rebuilding the middle class, creating jobs, and getting the economy going again.

Our policies to reduce the costs of college, for example, do far more than just lower higher-education expenses for middle-class families; they also reduce the risk that students will emerge from college saddled with excessive debt and work to help more people gain the income benefits of a college education. Likewise, policies to address our crumbling infrastructure will not only make our communities safer and create good jobs today; they also will provide the modern infrastructure needed to attract business and grow the economy of the future.

Even policies that may not seem to address more than one theme often do just that. Reducing health care costs not only helps families reduce medical expenses but can also boost worker income: The high cost of health care has caused many employers to divert money away from wage increases and toward health benefits.² Policies that can directly boost incomes such as inclusive capitalism, which rewards workers when firms do well, are also associated with greater job stability and fewer layoffs during economic downturns, providing a buffer against risks.³ Reforming unemployment insurance will not only help prevent families from falling out of the middle class but also will boost spending and create jobs. Rehabbing foreclosed properties to rent out can help create jobs, as well as lower rental costs in certain markets.⁴

Tackling the economic challenges our country faces will require bold action, and no single state can address all the problems we face alone. Accordingly, we will soon release a companion progressive agenda for local governments authored by the Center on Wisconsin Strategy, or COWS, the national high-road strategy center. That agenda dovetails well with the numerous federal policies to rebuild the middle class that American Progress has previously detailed. Indeed, as state governments adopt policies to rebuild the middle class, policymakers should encourage even stronger standards and experimentation at the municipal level by ensuring that state-level reforms set a floor—not a ceiling.

Why is action needed? Most Americans see the answer to that question every day. What they see is clearly reflected in the numbers.

Approximately 12 million people are unemployed, and the unemployment rate has been higher than 7.5 percent for four years, the longest sustained period of high unemployment since the Great Depression.⁵

Even for those with jobs, the economy has, for the most part, failed to deliver. Income for the typical household has stagnated over the past few decades and has actually fallen over the past 10 years: Median income for working-age households—meaning half of the population makes more, and half makes less—fell by 1.9 percent during the supposedly good economic recovery of 2001 to 2007 and fell by another 4.6 percent during the Great Recession of 2007—2009.⁶

As a result of stagnating incomes for the middle class and rising incomes for the rich, the share of the total national income earned by the middle 60 percent of households has been on the decline for decades. It is currently at its lowest level since the government began keeping track of the statistic in 1967.⁷

At the same time that incomes have stagnated, costs of living and risks for middle-class families have both increased dramatically. According to the Senate Committee on Health, Education, Labor and Pensions, between 1970 and 2009 the costs of gas went up by 18 percent, health care by 50 percent, college by 80 percent, and housing by 97 percent, net of overall inflation.⁸

The percentage of Americans who lost ground economically by either experiencing a major loss in income or incurring large out-of-pocket medical expenses has rapidly increased over the past two decades, reaching almost 19 percent in 2011, the last year for which complete data are available. That's up from 14 percent in 1986, according to research by Yale political scientist Jacob Hacker.⁹ Not surprisingly, most Americans haven't been able to save enough for retirement, and the risk of falling behind in retirement has increased significantly: The percentage of working-age households that are at risk of being unable to maintain their preretirement standard of living in retirement rose to 51 percent in 2009—up from 32 percent in 1983, according to the Center for Retirement Research at Boston College.¹⁰

Finally, it is becoming harder for Americans to join the middle class. According to research by Bhashkar Mazumder of the Federal Reserve Bank of Chicago, the likelihood that a child born poor will rise into the middle class has declined significantly over recent decades.¹¹ As a result, the United States has less economic mobility than almost every other high-income country.¹²

The scale of these problems is much greater for people of color. Communities of color suffer from elevated high school dropout rates, economic insecurity, and lack of quality health care, while wealth gaps expand to record highs between whites and communities of color—the largest gap, in fact, since the government began publishing such data in 1984.¹³ What’s more, in 10 states and the District of Columbia, the majority of children are children of color, and it is expected that by 2019 the majority of children in the United States will be of color.¹⁴

The weakened state of the middle class hurts all of us by stifling our country’s economic growth and undermining our democracy.¹⁵ A strong middle class is a prerequisite for robust entrepreneurship and innovation—a source of trust that makes business transactions more efficient and a source of sustainable demand that encourages businesses to invest. A strong middle class also promotes efficient delivery of government services, greater political participation, and forward-looking public investments in education and infrastructure.

In the American political system, states have tremendous power and responsibility. This proposed policy agenda will help states fulfill their responsibility to significantly improve the lives of their residents. This set of proposals is of vital importance to the future our country and should be a top priority for policymakers.

A sampling of policies included in this report

This report presents a middle-class agenda that is big and bold, and rises to the scale of the challenges we face. Doing so will require state governments to take a comprehensive approach, undertake a diverse set of reforms to improve job quality; reduce the costs of health care; reform the tax code; fix the housing market; improve the quality of education; ensure civil rights are respected so that everyone can fully participate in the economy; rebuild our crumbling infrastructure; and strengthen local communities.

Some of the policies described in the report are new ideas, while others have already been tested at the state level but merit much wider adoption. The examples below are emblematic of the sort of policies included in this report representing both the breadth and types of policies needed to rebuild the middle class:

- Prevent millions of workers from having to choose between going to work while ill or risking their jobs by staying home when sick by passing paid sick leave legislation
- Lift workers out of the ranks of the working poor, boost the wages of higher-wage workers, and ensure that living standards increase as the economy grows by raising and indexing the minimum wage to one-half the average wage and broadening its coverage
- Provide greater retirement security for workers and cut the costs of saving for retirement in half compared to a traditional 401(k) by creating a collective defined-contribution retirement plan—a hybrid plan that combines the best features of pensions and 401(k)s
- Ensure that when companies do well, so do their workers by encouraging private-sector businesses to share ownership with their workers or adopt other types of inclusive capitalism programs
- Invest in immigrant families by passing state-level DREAM Acts to permit qualified undocumented students to attend state colleges and universities at the in-state tuition rates and to access public financial aid
- Ensure that hard work is rewarded by enacting a state-level, refundable earned income tax credits
- Protect unemployment insurance and put it on a sustainable funding path by adopting state-level reforms
- Help rebuild the communities hardest hit by the foreclosure crisis by scaling up statewide land-banking efforts and assisting local entities with funding to stabilize at-risk neighborhoods and to keep homes occupied
- Eliminate funding disparities that contribute to unequal educational outcomes by adopting a state-centralized funding system
- Ensure that students make well-informed higher education choices by ensuring in-state colleges and universities provide important cost and outcome information via college “nutrition” labels
- Ease transfers across post-secondary institutions and guarantee that an associate’s degree fulfills the first two years of core studies at public four year institutions by adopting a statewide articulation agreement
- Reduce health care costs and improve outcomes by significantly curtailing the use of fee-for-service payment systems
- Strengthen families and improve economic security for gay¹⁶ and transgender families by enacting marriage equality legislation
- Create good jobs and help transition communities to the “green economy” by creating training programs and certification requirements for clean energy installation, energy efficiency retrofits, and green operations and maintenance jobs
- Improve government efficiency and ensure that social service programs help communities by adopting social impact bonds
- Help small businesses and in-state entrepreneurs by combining all statewide funding opportunities for technology, business development, economic development, and workforce training into a single common application

Endnotes

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- 16 In this report, the term "gay" is used as an umbrella term for people who identify as lesbian, gay, or bisexual.

Improve the quality of existing jobs

Ensuring that jobs provide good pay, benefits, and security is an essential component of rebuilding the middle class.

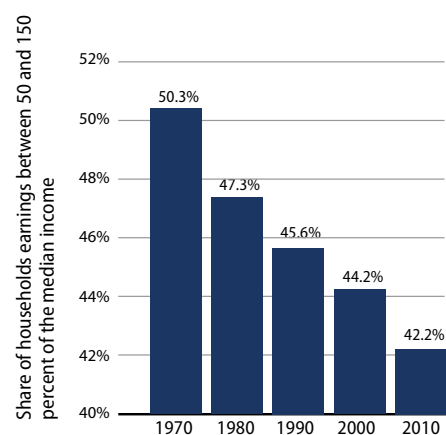
Income for the typical household has stagnated over the past few decades and has actually fallen over the past 10 years: Median income for working-age households—meaning half of the population makes more, and half makes less—fell by 1.9 percent during the supposedly good economic recovery of 2001 to 2007 and fell by another 4.6 percent during the Great Recession of 2007—2009.¹ Moreover, in recent decades, any income gains made by the middle class have been primarily the result of increased working hours and not higher wages, according to data analysis from the Brookings Institution.²

As a result of stagnating incomes for the middle class and rising incomes for the rich, the share of the total national income earned by the middle 60 percent of households has been declining for decades and is at its lowest level since the government began keeping track of the statistic in 1967.³ What's more, the share of households actually making near the median income has been in decline for four decades, according to calculations from Alan Krueger, the chairman of the president's Council of Economic Advisors.⁴ This means that jobs are increasingly either at the top or the bottom of the scale, with fewer and fewer jobs in the middle.

By other measures of job quality, American workers are also not faring particularly well. In the area of paid leave, for example, unlike most every other developed economy in the world, many American workers are not guaranteed the ability to stay home when sick or to take leave to care for a new baby or aging parent. Boston College's National Retirement Risk Index estimates that 51 percent of households are at risk of having an insecure retirement.⁵

FIGURE 1
The shrinking middle class

The share of households earning a middle-class income has been in decline for the past four decades



Source: Alan Krueger, "The Rise and Consequences of Inequality," Speech at Center for American Progress, Washington, D.C., January 12, 2012.

There are a number of reasons that too few jobs provide for a middle-class standard of living, but a major reason is that workplace standards have failed to keep pace with economic and societal changes and no longer help balance power in the economy. To boost job quality and ensure jobs pay adequate wages and provide necessary benefits, there are a number of actions that states can take, including setting and enforcing basic minimum standards, updating policies to reflect modern realities such as the prevalence of two-earner families, and encouraging high-road business practices.

Ensure that working families are able to take sick leave and care for young children and elderly relatives

Background

Millions of American workers are torn between their responsibilities to care for young children or elderly relatives, while simultaneously meeting their obligations to their employers.

American family structures have changed dramatically during the past two generations, but our employment policies have not kept pace. In the 1960s fewer than one-third of all women worked.⁶ Women today comprise nearly half of the workers on U.S. payrolls,⁷ and in nearly two-thirds of families with children the mother is either the breadwinner or shares that responsibility with her partner.⁸ Less than one-third of children have a stay-at-home parent either because they live with a single parent or are in a household where all the adults work.⁹

Just as the participation of women in the workforce has soared in recent decades, so too has the demand for medical care for an aging population.¹⁰ Millions of full-time workers have to find time to care not only for their children but for aging parents or in-laws, as well. Nearly 60 percent of the estimated 43.5 million caregivers for aging relatives in the United States also work outside the home, according to a 2009 survey by the AARP and the National Association for Caregiving.¹¹ Understandably, 31 percent of caregivers reported feeling highly stressed.¹² When adult children provide eldercare for their parents, their work often suffers as a result, with work hours decreasing in some cases by more than 40 percent.¹³

Modernized federal and state programs could go a long way toward solving this problem. But the United States falls far behind other countries in terms of paid

family, medical, and sick leave policies. Of the 173 countries surveyed for a 2007 study conducted by The Project on Global Working Families and the Institute for Health and Social Policy, 98 percent had paid maternity leave requirements, and 84 percent had paid sick day requirements—unlike the United States.¹⁴ The United States remains the only advanced economy without a national paid parental leave program and is also the only such country that does not guarantee paid leave for workers when they fall ill.¹⁵

Ensure workers receive paid family and medical leave

For some private-sector workers, the federal Family and Medical Leave Act guarantees unpaid leave for childbirth or to care for a sick family member. But the law excludes millions of workers because it only applies to employees who have worked 1,250 hours over the previous 12 months and only as long as their employer employs at least 50 workers living within 75 miles of their worksite.¹⁶ Further, 78 percent of American workers who qualify for leave under the Family and Medical Leave Act say they do not take it because they cannot afford to take unpaid leave.¹⁷ Currently, only 12 percent of American workers are granted paid family leave by their employer.¹⁸

States should expand on the federal guarantee of unpaid leave by ensuring that paid leave is available for all workers to care for a new child or a seriously ill family member, or to recover from their own serious illness or pregnancy.

Currently, only three states—California,¹⁹ New Jersey,²⁰ and Washington²¹—have passed paid family leave legislation, though the program in Washington has yet to be implemented.

California's paid leave law, enacted in 2002, provides qualified employees with 55 percent of their wages for six weeks—up to a maximum weekly benefit amount of approximately \$1,000—if they are unable to work due to the illness or injury of a family member or the birth, adoption, or foster-care placement of a child.²² Additionally, California has a long-standing state temporary disability insurance program that provides the same level of wage replacement for up to 52 weeks in the event of the worker's own serious illness.²³

California's paid family leave law covers nearly every Californian working in the private sector. Some self-employed workers are ineligible, but nearly all private-

sector workers are covered, including nonprofit-sector employees, regardless of the size of the employer. California public employees may be covered if their agency or unit opts into the program, but most are not eligible.²⁴

New Jersey's law, partially modeled on the California law and enacted in 2008, provides up to two-thirds of wages for six weeks. The program's maximum benefit is indexed to the average weekly wage in the state, and it is fully funded by an employee payroll tax.²⁵ New Jersey's family leave insurance program, mirroring California's, builds on New Jersey's temporary disability program, which provides up to six weeks of leave with the same level of wage replacement.²⁶ As of May 2012, four years after the law's approval, 80,000 New Jersey workers have benefited from an approved claim under the law. Most used the time provided to bond with a newborn or adopted child, but 15,000 workers reported using it to care for a sick family member.²⁷

A review of state paid leave policies by the Center for Economic and Policy Research, however, found that the workers who were the most likely to benefit from these laws were also the least likely to know about them.²⁸ In order to increase the use of state-mandated paid leave benefits, the Center for Economic and Policy Research recommends adopting a vigorous outreach and public education campaign targeted at affected workers; lifting exemptions for public employees; increasing the payout amount so more workers can afford to take leave; and extending job protections to every worker who qualifies for leave so they know they have a job to return to following their absence.²⁹

An additional approach available to lawmakers in states where it may be politically infeasible to pass paid family leave legislation is to extend unpaid leave to workers who do not qualify for it under the federal Family and Medical Leave Act. States can improve the federal mandate by extending unpaid leave protections to those employed by small businesses, employees with fewer hours on the job, and by requiring a longer leave period.

Allow workers to earn paid sick days

Currently, workers in 145 different nations have the right to a paid sick day, but most workers in the United States are not legally guaranteed that right.³⁰ Nearly 40 million American workers and 81 percent of low-income workers don't have a single paid sick day available to them.³¹ Millions more don't have the right to take paid leave to

care for a sick child or parent.³² Among America's lowest-paid workers, 80 percent lose income and may risk job discipline or job loss for taking a sick day.³³

The American public overwhelmingly supports the right to paid sick days. A 2010 poll by the Public Welfare Foundation found that three-quarters—fully 75 percent—of respondents favored a law providing a “minimum number” of paid sick days for all workers, and 86 percent favored a specific proposal that requires seven paid sick days annually for full-time employees.³⁴

Without paid sick days, workers are forced to choose between going to work while ill or risking their job and losing a day's pay by staying home, which in turn can create public health risks and impose costs on everyone. During the height of the H1N1 flu epidemic in 2009, for example, 26 million workers were infected, and as many as 8 million likely went to work while they were sick, potentially infecting up to 7 million healthy Americans.³⁵ Moreover, working parents are far more likely to send their children to school or childcare sick if the parents themselves lack the right to take a paid sick day to care for their child.³⁶ Finally, all taxpayers end up paying for employers who do not provide paid sick days; if workers had the right to paid sick leave, it is estimated that there would be 1.3 million fewer visits to emergency rooms each year, resulting in savings of \$1.1 billion.³⁷

Connecticut³⁸ and the District of Columbia³⁹ have passed landmark paid sick days legislation, as have major cities such as Seattle and San Francisco. Connecticut's law requires each employer with 50 or more employees to provide paid sick leave to each of their service workers at the rate of one hour of leave for every 40 hours of work, up to a maximum of 40 hours of paid leave per year.⁴⁰ Eligible workers must have averaged more than 10 hours per week and have worked more than 680 hours.⁴¹ Employers are required to post bilingual notices alerting their workers to their rights under the law, the fact that retaliation against a worker for requesting sick leave is prohibited, and the complaint process that is available to them.⁴²

Workers can use their sick leave to seek medical diagnosis, for care or treatment of their own illness or injury, or the diagnosis, care, and/or treatment of an illness or injury to their child or spouse. Workers are also allowed to use paid sick leave to seek preventive medical care for themselves, their child, or their spouse, or to get care or counseling if they are a victim of domestic violence.⁴³

Raise standards for government contracting

Background

State and local governments procure hundreds of billions of dollars in goods and services each year, contracting for everything from janitorial services to database management to highway construction.⁴⁴ Unfortunately, contracting out government functions too often resembles a race to the bottom that leads to low-quality jobs and inadequate value for taxpayers.

Many workers on state contracts, especially those in the service sector, receive lower wages and less valuable benefit packages than they would in comparable occupations in the public sector.⁴⁵ A review of state and local contracting practices by the National Employment Law Project finds that, “Better paid workforces typically enjoy decreased employee turnover (with corresponding savings in re-staffing costs), increased productivity, and improvements in the quality and reliability of the services that they provide.”⁴⁶ Consequently, taxpayers often receive low-quality work and bear additional costs through programs such as Medicaid when governments contract out services.⁴⁷

While many states make some effort to attach public values to the dollars they spend on private contractors, most states miss opportunities to use the leverage they have to raise standards.

By applying best practices to government contracting, state governments can raise and uphold job standards, ensure that only law-abiding companies receive government contracts, improve the quality of services provided to the government, and prevent waste of taxpayer dollars.⁴⁸ Best practices include careful review of decisions to contract out; adopting wage and benefit standards; enacting and enforcing responsible contractor requirements; and employing best-value contracting.

To be properly implemented, these contracting standards should have broad applicability to all government spending, including procurements by all government agencies and other taxpayer-financed institutions such as airports and public universities. In addition, they should have strong enforcement measures, including strict penalties, adequate inspectors, up-to-date information regarding wages, and a private right of action for workers.

Carefully review decisions to contract out

State and local governments seeking to protect taxpayers and workers and to promote quality services should begin by requiring careful review of decisions to contract out government work to the private sector. Review processes should ensure that the government contracts out only those services that public employees cannot capably and cost-effectively perform and that do not involve functions that should be performed by government for accountability or other public interest reasons.

Many governments have found that excessive use of contracting out has weakened their ability to oversee taxpayer-funded work. Contracting out also frequently results in poorer jobs for communities since many of the industries where privatization has been prevalent—such as building services, food services, and laundries—are characterized by poverty-level wages and widespread violations of basic workplace laws.⁴⁹

Governments should adopt consistent procedures for determining whether it is in the public interest to contract work out and then ensure that when privatization decisions are made, the process allows for strong government oversight, stakeholder input, and accurate analysis of the benefits and costs. Important factors to consider when deciding whether to contract out work include the quality and long-term sustainability of privatized services, working conditions for contracted workers, and additional costs of contracting out such as monitoring and enforcing existing contracts, “fixing” poorly executed contracts, and providing public assistance to the workers on government contracts who receive low wages and benefits.

Few governments have developed comprehensive reforms and adequate enforcement in this area, but many are taking first steps to increase oversight and rationalize procedures when deciding whether to contract out services. The American Federation of State, County, and Municipal Employees has cataloged existing state laws to help protect workers and taxpayers from excessive use of contracting out.⁵⁰

Oregon, for example, passed legislation in 2009 requiring a written cost analysis before contracting out any services valued at more than \$250,000. The legislation requires state and local agencies to demonstrate that contracting out work would reduce costs as compared to using its own personnel and resources, unless the agency “reasonably determines in writing” that using government personnel is not feasible.⁵¹ The government agency is also prohibited from privatizing services if the cost analysis demonstrates that the lower wages and benefits paid by the contractor

is the sole reason why contracting out is cheaper.⁵² Progressive state activists continue to work to ensure that these requirements are consistently enforced.⁵³

Adopt wage and benefit standards

Prevailing and living wage laws and project labor agreements all aim to provide wage and benefit standards for workers on government contracts. While the three are distinct policies, they share much in common and can work together to raise standards.

Living wage laws set a wage threshold to ensure that any company providing services for the government pays their workers a wage that provides a decent standard of living.⁵⁴ Prevailing wage laws require that contractors pay wages and benefits at least equal to the wages and benefits paid on similar projects in a local area, helping to ensure that workers will benefit from government contracts and that contracting does not drive down wage and benefit standards.⁵⁵ Project labor agreements are comprehensive prehire agreements that establish the wage and benefit rates, as well as other terms and conditions of employment such as the site work schedule and training requirements.⁵⁶ These agreements apply to specific construction projects, usually large public-works projects, to ensure an adequate supply of skilled workers and to minimize coordination problems among various employers.

Maryland is the first and only state to pass a living wage law, enacted in 2007 (though more than 120 localities have passed such standards).⁵⁷ Maryland's living wage is indexed to annually increase with the Consumer Price Index and has two wage tiers that reflect the significant cost-of-living differences between large urban jurisdictions and rural ones.⁵⁸

The first state prevailing wage law was passed more than 100 years earlier in Kansas in 1891.⁵⁹ Since then 31 other states have enacted similar legislation. States such as Connecticut, New Jersey, and New York have extended prevailing wage laws—long used to protect contracted construction workers—to low-wage service-sector contractors.⁶⁰

The third policy—project labor agreements—has been promoted by state law since 1994, when an executive order encouraging their use of was first signed by the then-governor of Nevada. In 2003 Illinois's governor issued an executive order committing the state to using project labor agreements on state-financed projects following a determination that such agreements were in the interest of the state.⁶¹

In 2011 Illinois lawmakers passed H.B. 2987, which largely codified the previous executive order, as well as established a goal for the number of apprenticeship hours on a project and the number of work hours to be performed by minorities and women.⁶² And in 2006 New York’s governor issued Executive Order 29 to encourage the use of project labor agreements, explaining that such agreements would help the state in “obtaining the best work possible at the lowest possible price” and “preventing favoritism, improvidence, fraud and corruption in the awarding of public contracts.”⁶³ That executive order was adopted by the subsequent administrations.⁶⁴

Critics claim that these types of policies drive up costs, but the majority of studies show that this is not the case. Prevailing wage laws, for example, have little or no effect on net costs of contracting to the state.⁶⁵ Moreover, any higher wage costs associated with these policies can be offset by reduced turnover and higher-quality work with fewer delays and cost overruns.⁶⁶

Further, these laws have been found to improve the competitiveness of government contracting. An official state study of Maryland’s living wage law found that the average number of bids per contract increased nearly 30 percent after the law was passed, and nearly half of contracting companies interviewed by state researchers said that the new labor standards encouraged them to bid on contracts because it “leveled the playing field.”⁶⁷

Enforce responsible contractor requirements

State and local governments have sought to improve the quality of their contractor pools over the past decade by instituting more rigorous screening of prospective vendors. Their aim is to do a better job of weeding out companies with histories of committing fraud, wasting taxpayer funds, violating workplace laws and other important regulatory protections, or lacking the proper experience and licensure. States and localities have found that adoption of such programs—often termed prequalification or responsible bidder programs—result in higher-quality and more reliable services; increased competition among responsible contractors; reduced project delays and cost overruns; reduced monitoring, compliance, and litigation costs; and stronger incentives for compliance.⁶⁸

Best practices incorporate a front-end prescreening process before selection of a winning bid—a more reliable approach than a responsibility review conducted

only for the lowest-cost or presumed winning bidder. This prescreening should involve a review of the bidders' legal compliance, financial records, and proof of insurance, licensing, and certification statements proving that the companies have the qualifications to succeed.⁶⁹

Many states, including California, Illinois, New York, and Oregon, as well as major cities such as Los Angeles and New York City, have responsible contractor policies.⁷⁰ Among the best policies is the one used in California, where its Department of Industrial Relations has developed a model prequalification questionnaire that is used by several state agencies for public works contracts.⁷¹

Employ best-value contracting

The practice of lowest-responsible-bidder procurement—the traditional method of determining which bidder wins the right to a public-works contract—is often ineffective at delivering projects on time and on budget. In lowest-responsible-bidder procurement, once the procurement officer determines which contractors are considered responsible, the officer is only allowed to compare the bidders on the basis of lowest cost rather than consider other factors that may impact the value taxpayers receive such as the contractors past performance or technical expertise.

An alternative approach to procurement—often called best-value contracting—evaluates contractors based on a range of performance factors rather than just price. Best-value contracting is widely used in federal contracting, as well as in Pennsylvania and several other states. In 2001, the U.S. Navy released findings showing that when compared to lowest responsible bidder (or “low bid”) contracting, best-value contracting produced better quality products in less time and at lower costs.⁷²

In Pennsylvania, the state's best-value contracting law allows a team of professionals to assess each bidder based on multiple ranking factors,⁷³ including price and technical qualifications such as past performance, staff qualifications, and safety. States could also adopt the practice to evaluate the workplace practices of contracting companies in a best-value review—El Paso, Texas, for example, evaluates whether a company imposes health care costs on the government by failing to provide coverage for its workers.⁷⁴

Maine's H.B. 1167, passed in 2011, authorized its Department of Transportation to use either best-value or low-bid contracting within their procurement require-

ments.⁷⁵ Likewise, Minnesota’s statute allows its transportation department to use best-value contracting, as does Texas, while Vermont’s law allows either best-value or low-bid.⁷⁶ New Jersey’s “competitive contracting” laws empower municipalities and towns to evaluate bidders on a range of performance factors such as technical, management, and cost-related criteria.⁷⁷

Raise the minimum wage

Background

When President Franklin Delano Roosevelt proposed passing a federal minimum wage law, his goal was to establish a wage floor that would not only reward work and protect workers from exploitation, but that would also spur the economy by increasing consumer purchasing power. President Roosevelt insisted the goal was not to keep workers at “a bare subsistence level” but rather to be “living wages” that would provide “the wages of a decent living.”⁷⁸ In his message to Congress in 1937 urging the passage of the law, Roosevelt emphasized the economic development that would follow from hiking “the purchasing power of industrial workers,” which would “strengthen and stabilize the markets for the farmers’ products.”⁷⁹

At its current rate of \$7.25 per hour,⁸⁰ the federal minimum wage not only fails Roosevelt’s standard of providing “the wages of decent living,” it often fails to provide even a bare level of self-sufficiency for workers and their families. A full-time minimum wage worker makes just more than \$15,000 per year—that’s more than \$8,000 below the poverty line for a family of four.⁸¹ All totaled, 10.5 million Americans are now among the working poor—persons who spent more than half the year in the labor force but whose incomes still fall below the official poverty level.⁸² In no state in the nation can a full-time worker earning the minimum wage afford even a two-bedroom apartment at fair market rent.⁸³

Sadly, the real value of the minimum wage has declined sharply during a period of increased worker productivity. Over the past four decades, workers have become far more productive, making their employers far wealthier, yet they have not shared in that prosperity. In fact, since 1968 the inflation-adjusted value of the minimum wage has declined by 31 percent, while productivity (measured as output per hour of work) has increased by 123 percent.⁸⁴

Fortunately, states are allowed raise their minimum wage above the federal standard—and by doing so, would realize multiple benefits. Raising the minimum would lift workers out of the ranks of the working poor and closer to self-sufficiency, along with boosting the wages of higher-earning workers through a spillover effect.⁸⁵ Further, research shows that additional dollars added to the paychecks of minimum-wage workers tend to be spent quickly in the local economy and produce a multiplier effect that boosts local economies.⁸⁶ An increased minimum wage would also help our economy by increasing productivity through higher morale and effort, as well as reducing turnover.⁸⁷ Raising the minimum wage would also lower the number of low-wage workers, which in turn reduces demand for public assistance.

Finally, this reform would receive broad popular support—supermajorities of voters routinely express their support for significant increases in the minimum wage.⁸⁸

Opponents commonly argue that minimum wage increases benefit teens and part-time workers that do not rely on these jobs to support their families, but research shows only 12 percent of workers fit this description.⁸⁹ In fact, 80 percent of minimum-wage workers are older than 20,⁹⁰ 64 percent are women,⁹¹ and 78 percent work at least 20 hours per week.⁹² Contrary to other common arguments cited by opponents, raising the minimum wage does not reduce job opportunities, even during periods of high unemployment.⁹³

Raise, index, and expand the minimum wage

In order to ensure that the minimum wage works best, states should do three things: raise the minimum wage, index the rate so that inaction doesn't decrease its value, and broaden its coverage.

Nineteen states and the District of Columbia had a higher minimum wage than the federal rate, the highest being Washington state, which increased its minimum wage to \$9.19 per hour on January 1, 2013.⁹⁴

Indexing the minimum wage not only ensures that workers do not lose purchasing power over time, it also provides employers with predictability in their budgeting and ensures that minimum-wage policy is separated from cyclical politics, which creates pressure to raise it as each election year approaches.⁹⁵

Ten states—including Arizona, Colorado, Florida, Missouri, Montana, Nevada, Ohio, Oregon, Vermont, and Washington—now index their minimum wage.⁹⁶ Oregon and Washington, for example, index their rate to inflation as measured by the U.S. City Average Consumer Price Index for All Urban Consumers.⁹⁷ Another beneficial approach would be to index the wage to one-half the average wage of a state or the nation to ensure that living standards rise as the economy grows, rather than merely keeping pace with inflation.⁹⁸

States should index the rate only as a companion to or after raising the base rate. Indexing the rate when it is at a low level may produce the unintended consequence of locking in the rate at that level by reducing the political appetite for increasing it.⁹⁹

Finally, states should expand coverage to other workers who are allowed to be paid less than minimum wage. The federal minimum wage for tipped employees—which includes waiters and waitresses, bussers and other restaurant employees, nail salon workers, bellhops, and parking attendants—is only \$2.13 an hour and has not increased since 1991.¹⁰⁰ Seven states (Alaska, California, Minnesota, Montana, Nevada, Oregon, and Washington), however, require tipped employees to be paid 100 percent of the state minimum wage, while Illinois requires 60 percent, and New York and Connecticut require around 70 percent.¹⁰¹

Many other workers, including those who provide home care to the elderly or disabled, also are exempt from the federal minimum wage. Dozens of states have laws addressing these exemptions,¹⁰² including Massachusetts, which has a model law ensuring home care workers are paid the minimum wage.¹⁰³

Protect workers from wage theft and discrimination

Background

Employers should not be able to cheat workers out of wages that are due to them or discriminate against them because of employment status, personal financial difficulties, their sexual orientation, or because they are pregnant.

Unfortunately, several relatively widespread practices prevent millions of workers from receiving the wages and benefits they are owed. An estimated 10 percent to 30 percent of employers wrongly claim their employees are independent contractors,

for example.¹⁰⁴ This practice renders workers ineligible for overtime pay protections, forces them to pay additional taxes for Social Security and Medicare that are the employer's responsibility, and leaves workers without coverage under laws regulating health and safety, family and medical leave, and antidiscrimination and labor.¹⁰⁵

Fully two-thirds of low-wage workers reported at least one pay-related violation in their previous work week—including one-quarter of workers who were paid less than minimum wage and three-quarters who were not paid the overtime wages owed to them—according to a 2009 study by the Center for Urban Economic Development, National Employment Law Project, and the Institute for Research on Labor and Employment surveying 4,500 workers.¹⁰⁶

Some employers also discriminate against unemployed workers and those with low-credit scores, preventing qualified job seekers from gaining employment. A four-week review of national job-listing websites by the National Employment Law Project in 2011 found more than 150 job postings that explicitly discouraged the unemployed from applying for jobs.¹⁰⁷

Finally, far too often employers discriminate against gay¹⁰⁸ and transgender workers and refuse to accommodate pregnant women, making it difficult for them to remain in the workplace. According to the Williams Institute on Sexual Orientation Law and Public Policy, 15 percent to 43 percent of gay and transgender workers have experienced some form of discrimination on the job.¹⁰⁹

These kinds of practices hurt those who are directly affected, depriving them of income and career-advancement opportunities and driving down wages for other workers. This law-breaking shortchanges taxpayers and harms law-abiding businesses that are forced to compete with unscrupulous businesses.

States are responding to these issues with an array of strategies to protect workers on the job. There are strong laws on the books in many states, but these laws need to be accompanied by adequate resources for enforcement so that workers are informed of their rights in the workplace, are encouraged to report violations, and are afforded whistleblower protections to guard against employer retaliation.

Prevent wage theft

Too often workers—especially low-wage workers but also many in the middle class—are paid less than they are legally owed in violation of minimum wage, overtime, and other laws. Wage theft often occurs when employers pay workers under the table at rates below the minimum wage. Additionally, low-road employers that are willing to break wage laws also frequently commit payroll fraud by misclassifying their employees as independent contractors. This tactic can save bad-actor employers as much as 30 percent of payroll and related taxes, and puts competitors who obey the law at a competitive disadvantage.¹¹⁰

The National Employment Law Project has summarized the research on wage theft,¹¹¹ but even surveys by the U.S. Department of Labor highlight major problems—finding, for example, that 50 percent of restaurants in Pittsburgh, 74 percent of day care centers in Georgia, 50 percent of nursing homes in Louisiana, and 38 percent of hotels and motels in Reno, Nevada, violated wage and hour laws.¹¹²

To address this type of abuse, states such as New York,¹¹³ California,¹¹⁴ and Massachusetts¹¹⁵ have some of the strongest wage-theft laws in the country. Legislation in New York, for instance, has helped recoup nearly \$3 billion in lost worker wages and recapture hundreds of millions in lost state taxes.¹¹⁶ More states are also taking action to improve enforcement of wage laws. Delaware passed a law that makes the names of employers who misclassify workers available online,¹¹⁷ and Louisiana enacted legislation to protect temporary workers from misclassification.¹¹⁸ Yet most state laws are far too weak: The Progressive States Network recently surveyed wage-theft prevention laws in 50 states, and found that 44 states did not deserve a passing grade.¹¹⁹

The AFL-CIO has identified a comprehensive strategy states can adopt to combat wage theft.¹²⁰ Ideal wage-theft legislation would:

- Require employers to provide workers with clear notices informing them how much they will be paid, when they will be paid, who the employer is or employers are, including any names under which the employer does business, and the employer's contact information
- Require employers to maintain thorough and accurate payroll records

- Require employers to pay at least the minimum wage (or any required higher wage such as a living wage or prevailing wage requirement) and any applicable overtime
- Empower the state's commissioner or secretary of labor or the state department of labor equivalent to enforce the law
- Allow affected workers to file complaints regarding violations of the law or bring a suit in civil court and provide for attorney's fees for these actions
- Provide for immediate protection of workers from employer retaliation
- Include sufficiently strong civil and criminal penalties to provide a deterrent effect
- Specifically address employee misclassification by establishing a task force to study the prevalence and effect of misclassification; create a presumption of "employee" status and adopt objective tests to determine employment status; target industries with rampant misclassification problems; increase penalties for misclassification; and allow harmed parties to recover civil penalties or other monies owed to them¹²¹

Finally, states need adequate resources to enforce wage and hour laws. According to a nationwide survey, states have the equivalent of one wage and hour inspector for every 146,000 workers. Most states have fewer than 10 inspectors for all their worksites.¹²²

Ban employment discrimination against the unemployed

Sadly, the very fact that an applicant is unemployed is frequently cited as a reason that employers do not offer positions to qualified job applicants. Worse, many employment ads specifically state that unemployed candidates should not apply for the advertised position. A four-week review of national job-listing websites by the National Employment Law Project in 2011 found more than 150 job postings that explicitly discouraged the unemployed from applying for jobs.¹²³ Yet 63 percent of the public supports a ban on discrimination against the unemployed, according to Hart Research.¹²⁴

Rep. Rosa DeLauro (D-CT) and Sen. Richard Blumenthal (D-CT) introduced the Fair Employment Opportunity Act (H.R. 2501, S.1871) in 2011 to ban such

discrimination,¹²⁵ and a similar prohibition on refusing to consider applications from unemployed workers was included in the American Jobs Act of 2012.¹²⁶

Several states have taken action to protect the rights of the unemployed. In April 2011 New Jersey became the first state to prohibit in job advertisements language saying employers will not accept applications from unemployed applicants,¹²⁷ and Oregon has passed similar legislation.¹²⁸ Employers, however, are still allowed to consider job status in hiring decisions.

In 2012, 16 states and the District of Columbia introduced legislation to ban employment discrimination based on employment status.¹²⁹ The District of Columbia, which passed legislation in 2012,¹³⁰ not only bans discriminatory language in advertisements, but also prohibits the actual discrimination in employment itself.¹³¹ The National Employment Law Project has drafted model legislation—the Fair Chance for Employment Act—that states can use to address the issue of employment status discrimination.

Ban credit-check discrimination in employment

Credit checks have been run for years on applicants for jobs in which employees would have access to large amounts of cash, valuable merchandise, or confidential information. More recently, however, many employers hiring manual laborers, teachers, mechanics, entry-level service positions such as servers and cashiers, and gym trainers are also conducting credit checks, according to the AFL-CIO.¹³² A survey by the Society for Human Resource Management found that 60 percent of employers conduct a credit check for at least some open positions.¹³³

Also, many workers have fallen behind on their bills due to persistent high unemployment following the Great Recession. They may have a diminished credit score but have a history of being successful employees. Further, many individual credit scores have inaccuracies: A 2007 survey by pollster Zogby study found that 37 percent of consumers found faulty information on their credit reports.¹³⁴ Yet state laws allow credit reports with inaccurate or meaningless information to exacerbate high unemployment.

In 2012 at least 40 bills to ban credit-check discrimination in 20 states were introduced or pending.¹³⁵ Seven states have passed limits on employers' use of credit information in employment, including California, Connecticut, Hawaii,

Illinois, Maryland, Oregon, and Washington.¹³⁶ Additionally, model legislation is available from the AFL-CIO,¹³⁷ and particularly strong legislation was introduced in New York in 2011.¹³⁸

Protect gay and transgender workers from workplace discrimination

Nearly 9 out of 10 Americans mistakenly believe it is illegal under federal law for a worker to be fired for being gay or transgender, but this type of discrimination is perfectly legal under federal law.¹³⁹ States have the power to protect gay and transgender people from workplace discrimination, but most states still do not have nondiscrimination laws based on sexual orientation and gender identity. Under current state laws, it is legal to fire someone based on sexual orientation in 29 states and based on gender identity in 34 states.¹⁴⁰

Without a clear federal law in place barring this type of discrimination in the hiring and firing of gay and transgender workers, states should work to pass their own laws that include sexual orientation and gender identity as a protected class. A number of states—including Connecticut, Hawaii, Massachusetts, and Nevada—took action to expand their workplace discrimination laws to cover transgender workers in 2011.¹⁴¹ In Nevada, Republican Gov. Brian Sandoval broke ranks with most Republican state legislators by signing into a law a measure to protect transgender workers from discrimination.¹⁴²

Protect the rights of pregnant women in the workplace

Approximately 75 percent of women who enter the workforce will become pregnant at some point during their employment,¹⁴³ so state laws need to protect the rights of pregnant women in the workplace. Women should be able to request reasonable accommodation for pregnancy and related medical conditions without having to worry about dismissal or demotion. Unfortunately, the outdated federal Pregnancy Discrimination Act is more than 30 years old and does not guarantee that right.¹⁴⁴

Rep. Jerrold Nadler (D-NY) has introduced legislation in Congress to protect the right to ask for reasonable accommodation,¹⁴⁵ but states should pass this legislative protection, as well. Seven states—Connecticut, Hawaii, Louisiana, California, Alaska, Texas, and Illinois—now explicitly require certain employers to provide reasonable accommodation to pregnant employees.¹⁴⁶ California's

law may be the broadest—providing for reasonable accommodations, transfers, and leave for pregnant workers—and has been described as a model of success in the 12 years it has been in place.¹⁴⁷

Protect unemployment insurance and use it to avoid layoffs

Background

Unemployment insurance is critical for working families and the American economy during hard times. The program helps cushion the blow of a job loss for workers who lost their jobs through no fault of their own, and helps fight recessions by allowing unemployed workers to continue to spend money on essentials when the economy needs more demand. In 2009 alone, unemployment benefits prevented 3.3 million families from falling into poverty, and studies by economists estimate that unemployment benefits reduced the gap in economic output caused by the Great Recession by about one-fifth.¹⁴⁸ These accomplishments are impressive, considering the average unemployment benefit in 2010 and 2011 was only about \$300 a week.¹⁴⁹ Clearly, unemployment insurance is a vitally important program that has tangible benefits for our economy.

Unfortunately, the unemployment insurance system is on shaky ground. Years of a declining tax base have denied the system an adequate source of revenue. State unemployment insurance systems were underfunded before the onset of the recession, but the high levels of unemployment and weak labor market recovery has strained the system. Many states have depleted their trust funds and have had to borrow from the federal government in order to continue paying out benefits. As of December 2012, 19 states plus the U.S. Virgin Islands were borrowing funds to cover unemployment benefits, and many others have borrowed previously.¹⁵⁰

The federal government and the states run the unemployment insurance system together. Any comprehensive plan to reform the system therefore requires federal legislation.¹⁵¹ States, however, can take the steps profiled below to protect unemployment insurance and put it on a sustainable funding path. Moreover, states should modernize program rules to provide fair and adequate benefits and use unemployment insurance to avoid layoffs and reduce unemployment during recessions.

Index the taxable wage base

States should raise and then index the wage base subject to state unemployment taxes to the average annual wage in the state. Unemployment benefits are financed by taxes on employers that are levied on a portion of employees' wages. The wage base is set by law, and the unemployment tax can only be applied to wages up to that amount. Increasing the taxable wage base would allow states to raise more revenue without increasing the tax rate.

The federal government sets a minimum taxable wage, which has not been raised from its current level of \$7,000 per employee since 1983.¹⁵² States cannot set their taxable wage level below \$7,000 but are free to set it above the federal minimum. Only two states—Arizona and California—have not raised the taxable wage level above the federal minimum of \$7,000.¹⁵³

We recommend states set their taxable wage base to \$19,055 or higher, and then index its growth to the growth of average annual wages. This wage base would be roughly the same share of the average wage as the current wage base was in 1983.¹⁵⁴

This would also bring states closer to the average taxable wage base of states that have built up trust funds and are prepared for the next recession. The National Employment Law Project has found that states with trust funds that meet recommended solvency levels have an average taxable wage base of \$18,669 compared to states that are insolvent or near insolvent, which have an average taxable wage base of \$11,350.¹⁵⁵

Indexing the wage base to the growth of the average wage in the state so that it would adjust upward automatically as the average wages increases would ensure that the state has a tax base that adequately funds the program. Currently 14 states have tax bases that are set as some percentage of the average wage, while four others have flexible tax bases linked in some other way to the average wage.¹⁵⁶ In states that link the tax base to a percentage of the average wage, the percentage ranges from 46.5 percent to 100 percent.¹⁵⁷ Hawaii and Idaho currently set the wage base at 100 percent of the average wage.¹⁵⁸

These automatic increases to the tax base have helped these states with keep their trust funds well-funded. According to analysis by the Government Accountability Office, states with a flexible tax base have higher annual average reserve ratios for their trust funds and fewer instances of trust fund insolvency.¹⁵⁹

Adjust maximum and minimum tax rates to ensure trust funds are adequately prepared for a severe recession

States should set their unemployment tax schedules so that maximum and minimum rates are adjusted at times of trust-fund underfunding in a manner that emphasizes experience rating.

State unemployment taxes are “experience rated,” meaning an employer’s history of laying off workers determines their tax rate. The theory behind this design is that employers should have to contribute toward the benefits for workers they lay off. Companies that lay off large numbers of workers are burdening the resources of a state by increasing the number of workers collecting unemployment benefits. A higher tax rate for these companies discourages large layoffs, as the firm faces a higher tax rate later.¹⁶⁰

States, however, have minimum and maximum tax rates that limit the range of the experience rating and how much the state collects. A low maximum rate will limit tax liability for companies that layoff large numbers of employees and burden the unemployment insurance system. A high minimum tax increases taxes for employers that have sterling records. These limits can be adjusted to help increase revenue flowing to the state trust fund so it can pay out benefits through a severe recession.

All states have provisions to increase revenue when their trust funds are not adequately funded, but the increased revenue doesn’t necessarily come from increasing unemployment tax rates, and the changes do not necessarily emphasize experience rating.¹⁶¹ Many states have solvency adjustments that are added on to employer contributions via the unemployment tax. When the rates are changed, they often mitigate the effects of experience rating. When Montana’s trust fund is underfunded, for example, the state increases the minimum rate, hitting firms that withdraw less from the trust, while keeping the maximum rate constant.¹⁶² In contrast, states such as New Hampshire, Rhode Island, and Missouri raise the maximum tax rate by much more than they raise the minimum rate, if they raise it at all.¹⁶³ These schedules increase revenues to help trust funds in a way consistent with experience rating.

Close legal loopholes that allow firms to unfairly lower their unemployment tax rates

Because unemployment tax rates are based upon the history of layoffs by a specific employer, firms have an incentive to reduce their overall burden on the state unemployment insurance system. One way firms can do this is to minimize the number of workers they lay off when the business is in economic trouble. Firms have found ways to reduce their experience rating, however, without changing their practices. They do this by acquiring other firms, transferring their payroll to the new shell firm and then firing workers from the newly acquired firm. This practice is known as “SUTA (State Unemployment Tax Act) dumping,” and helps reduce the unemployment tax rate for the original firm.

SUTA dumping was addressed in part by a 2004 law signed by President George W. Bush, but the law has several flaws.¹⁶⁴ A major gap was that the law did not include the use of professional employee organizations as a form of SUTA dumping. When a company uses such an organization, it sells part or all of its workforce to the organization, which can then fire workers. Because the professional employee organization and the original firm are not considered to be under the same control, the experience rating for the firing of the workers goes toward the professional employee organization’s history and not that of the original firm. The original firm then has a much lower rate than it would have had if it laid off the workers itself. Michigan, Minnesota, North Dakota, Pennsylvania, and Washington state all considered including the use of professional employee organizations in the definition of SUTA dumping when they passed laws to comply with the federal law, but as yet none has done so due to strong industry opposition.¹⁶⁵

Eliminate waiting week requirements

State governments should eliminate so-called waiting week requirements, which make laid-off workers wait until their second week of unemployment to begin collecting benefits and often deny unemployed workers their first week’s benefits entirely.

When the unemployment insurance system was originally created, state agencies required time to manually process claims. Information technology, however, has advanced considerably, and states can process applications in a much shorter time than previously was possible. In states that have waiting weeks, the unemployed worker only receives the first week of benefits if they reach the end of the period

they can collect unemployment benefits without getting a job. Since many workers do not reach the end of their benefit period, workers therefore are denied a week of benefits.

Eliminating waiting weeks would allow workers to immediately start receiving benefits from the unemployment insurance system. Proponents of these waiting periods claim that these weeks save money for the state and that newly unemployed workers are those who can best handle a week less of benefits.¹⁶⁶ Unfortunately, workers “get no waiting week on their mortgages, utility bills, or credit card statements,” as the National Employment Law Project points out.¹⁶⁷ Furthermore, states can strengthen the finances of their unemployment insurance trust funds without reducing benefits for workers.

As of 2011, 13 states did not impose a waiting week.¹⁶⁸

Use short-time compensation programs to avoid layoffs

Short-time compensation programs are one approach to avoid layoffs and reduce unemployment during a recession. At times of low labor demand, these programs provide employers with the option of retaining all workers but reducing their weekly hours instead of laying them off. Workers are then allowed to keep their jobs, and all workers can also collect partial unemployment compensation to ensure that they do not lose income from their reduced hours.

This policy helps boost employment by spreading out work hours among a greater number of people while keeping pay constant. If workers’ purchasing power is held constant even as they work fewer hours, then more total people will be employed in the economy. Estimates indicate that each dollar spent on short-time compensation produces a \$1.70 boost to the economy.¹⁶⁹ Furthermore, work sharing can also benefit overburdened workers and help struggling employers reduce costs, while maintaining morale and retaining valuable employees so that companies can more easily ramp up production when the economy improves.

Twenty-three states and the District of Columbia have short-time compensation programs,¹⁷⁰ but most are smaller and not as well-used as they could be, and are far less developed than programs in other countries. During the Great Recession, for example, Germany managed to expand participation in its short-time compensation program from 50,000 participants to 1.46 million in 2009, partly by extend-

ing to 24 months the maximum length a worker can participate in a short-time compensation program.¹⁷¹ Washington state and Rhode Island ramped up participation dramatically during the Great Recession of 2007–2009, with an average of 4,000 people per week claiming benefits in Rhode Island, which prompted one employer to call the program “a lifeline.”¹⁷²

To maximize its impact, a 2011 report from the Big Ideas for Jobs project of the University of California, Berkeley recommended that an ideal short-time compensation program disseminate information about the program to employers and workers, ensure that the program is easy to implement at the onset of a recession, treat the payment of benefits as noncharged benefits in the experience-rated unemployment system, and segregate short-time compensation benefit payments from regular unemployment benefits.¹⁷³ California also places no limits on the number of weeks a worker can receive benefits from a short-time compensation program, although they do limit the total benefits an employee can receive.¹⁷⁴ Additionally, most states limit the number of weeks an employer may operate a short-time compensation plan, but New York, for example, has no limit.¹⁷⁵ Moreover, these time-period limits can be different, as the number of weeks a worker receives benefits can be shorter than the number of weeks an employer can run a program.

Following passage of the Middle Class Tax Relief and Job Creation Act of 2012 (also known as the payroll tax cut extension), the U.S. Department of Labor offered guidance to states, including the new definition of short-time compensation used in federal unemployment compensation law, and is expected to release model state legislation in the near future.¹⁷⁶ The Center for Economic Policy and Research estimated that states with short-time compensation programs could save \$1.7 billion through reduced unemployment and unemployment insurance costs over three years if they take advantage of the act’s provisions.¹⁷⁷

Boost retirement security

Background

Far too many Americans lack adequate retirement savings. Social Security, of course, provides an essential baseline of income for retirees and must be strengthened to ensure that it continues to do so for generations to come, as American Progress has already proposed.¹⁷⁸ But Social Security was never intended to be the

sole source of income for retirees. As a result, there is a significant role for states to play in boosting retirement security for their residents by shoring up workplace retirement savings plans.

Currently, private and employer-based retirement savings plans are failing to provide an adequate supplement for far too many Americans. The typical near-retirement-age worker with a 401(k) has accumulated enough money to provide a monthly retirement payment of only about \$575.¹⁷⁹ Making matters worse, less than half of all workers even have a retirement plan at their jobs, and that figure has been declining over the past few decades.¹⁸⁰

Americans, therefore, are deeply worried about their ability to retire, with half of all workers saying they are not confident they will have enough money for retirement.¹⁸¹ Indeed, the accounting firm Ernst & Young estimates that 59 percent of new middle-class retirees will outlive their retirement savings,¹⁸² while Boston College's National Retirement Risk Index estimates that 51 percent of households are at risk of having an insecure retirement, meaning they will be unable to maintain their pre-retirement standard of living.¹⁸³ Similarly, researchers at the University of California, Berkeley, Center for Labor Research and Education estimate that, "Nearly 50 percent of middle-income California workers will retire at or near poverty."¹⁸⁴

States that had expected to face increased pressure on their social services from a growing population of retirees may now face additional risk because of the inadequate retirement savings of many of those retirees. Indeed, the California State Legislature recently concluded that, "The lack of sufficient retirement savings poses a significant threat to the state's already strained safety net programs and also threatens to undermine California's fiscal stability and ongoing economic recovery."¹⁸⁵

Compounding the problem is that a formerly solid pillar of the employer-based retirement savings framework—pension plans for state employees—are not fully funded: The average state plan is around 75 percent funded,¹⁸⁶ but there is significant variation in funding ratios, ranging from just 45 percent funded in Illinois to Wisconsin's state employee pension plan, which has remained at 100 percent funding over the past several years.¹⁸⁷ This means that in some plans, current assets are not sufficient to pay all promised benefits, which poses challenges for workers, retirees, and taxpayers.

To address these retirement challenges, states can increase retirement savings options for private-sector workers and shore up the underfunded retirement plans of public-sector workers.

Create opportunities for more workers to save

When workers are offered convenient, safe retirement savings options, most choose to participate. Indeed, around 70 percent to 80 percent of employees participate in a workplace savings plan if they are eligible, though enrollment rates are significantly lower for low-wage workers and communities of color.¹⁸⁸ As a result, policymakers are seeking strategies to expand retirement options for private-sector workers.

The most advanced state effort to boost retirement security is occurring in California. California's S.B. 1234, the California Secure Choice Retirement Savings Trust Act, passed both chambers of the California State Legislature on August 31, 2012, and was signed by Gov. Jerry Brown on September 28 of that year. The new law will allow private-sector workers to contribute to a state-run retirement savings plan called the California Secure Choice Retirement Savings Trust. The bill, which includes a feasibility study, would require private employers with more than five employees that do not offer a retirement savings plan to offer a payroll-deposit retirement savings arrangement so that eligible employees could contribute a portion of their salary or wages to an account in the California Secure Choice Retirement Savings Program.¹⁸⁹

The California Secure Choice Retirement Savings program would ensure that workers whose employers don't offer retirement plans will have access to a retirement plan at work—the most effective place to encourage workers to save. In addition, the plan will have several notable features that are designed to ensure savings are secure and efficiently managed. Savings will be professionally invested and maintained over a long time horizon to insure against temporary fluctuations in the markets.¹⁹⁰ To minimize expenses and maximize returns, administrative costs will be paid from earnings and limited to less than 1 percent of fund assets.¹⁹¹

Another option to expand savings options for private-sector workers who lack a retirement plan at their workplace is for states to create a new collective defined-contribution plan—a retirement plan that combines the best features of pensions and 401(k) programs to cut the costs of savings for retirement in half, compared to a traditional 401(k), while providing greater security.¹⁹²

In recent years, related legislation to expand access to retirement savings vehicles has been introduced in at least eight other states,¹⁹³ and Connecticut's Joint Committee on Aging passed legislation creating an 11-member task force to study the need for a public retirement plan.¹⁹⁴

Shore up public-sector retirement plans

Largely because pension plan assets were dramatically reduced by the 2007 market crash,¹⁹⁵ states face a significant challenge to address the underfunding of state employee pension plans and to provide promised benefits to workers and retirees. For most states the level of shortfall does not present an immediate crisis, and therefore there is time to develop smart responses. At the current level of shortfall, the typical state defined-benefit pension plan can afford to pay at least 100 percent of benefits over the next 15 years to 20 years.¹⁹⁶

State should address pension underfunding in the following three ways:¹⁹⁷

- Make necessary changes to fix plan finances
- Reform plans so they are secure for the long haul
- Avoid drastic “reforms” that will actually cost more money and undermine retirement security

Relatively modest changes to existing defined-benefit pension plans such as increasing contributions from employers and workers and adjusting benefits should significantly correct much of the underfunding problem that many public pensions currently face.¹⁹⁸ Indeed, in recent years at least 43 states have cut benefits, increased contributions, or implemented both options, which will help improve plan funding.¹⁹⁹

The exact combination of benefit and contribution changes depends on several factors, including public employees’ Social Security coverage, current benefits and contributions, and states’ human resource needs. States still want to make sure that their benefits allow them to hire the most effective employees. If benefit adjustments are unavoidable, states should seek to spread the pain between existing workers and new hires—for example, by guaranteeing already-earned benefits but not those not yet earned, as the private sector does. This has previously been suggested by Christian Weller, American Progress Senior Fellow and professor at the University of Massachusetts, Boston.²⁰⁰

Second, to shore up defined-benefit plans for the long haul and minimize the need to make additional contributions during hard times, states should adopt the best practices highlighted by the National Institute for Retirement Security: requiring annual contributions from employers; actuarially valuing any benefit improvement before adoption; closely evaluating cost-of-living adjustments; adopting “anti-spik-

ing” measures to prevent techniques that can result in significant pension increases for some individuals but not others; and reasonable assumptions for inflation and investment returns.²⁰¹ Indeed, Wisconsin’s pension plan remained fully funded over the past several years, indicating it is designed for the long haul.²⁰²

Finally, states should look very skeptically at making drastic changes to their pension plans such as converting to 401(k)-style plans, as they tend to reduce retirement security and are unlikely to save money.²⁰³ A state opting to convert would need to run two retirement plans simultaneously, which would increase administrative costs and the costs of the defined-benefit plan, which would primarily be for retirees instead of for a mix of young and older workers and retirees. Converting to a 401(k)-style plan would become more expensive because a state’s investment strategy would need to become more conservative, as young workers would no longer be joining the pension plan. Any potential long-run savings from such a switch would come from providing lower benefits—something that could be done more cost-effectively by making adjustments to the existing pension plan.

Indeed, estimates of Nevada’s proposal to put new hires in a 401(k)-style defined-contribution plan showed that the state’s total pension costs would increase by approximately 10 percent.²⁰⁴ Similarly, studies in Kentucky find that a conversion to a defined-contribution plan would increase the state’s costs for nearly two decades before taxpayers realized any savings.²⁰⁵ Analysis of a proposed defined-contribution plan for New Hampshire finds that the reform would be “more expensive for the employees and employers than maintaining the current Defined Benefit plan.”²⁰⁶

Ensure that when companies do well, workers also do well by promoting inclusive capitalism

Background

When a company does well, so should all of its workers. American workers help the economy grow by becoming ever-more productive, but they currently receive only a small share of the wealth they help create.

Broad-based sharing programs—such as granting workers an ownership stake in a company or a share of profits based on workers’ collective performance—help ensure that workers are rewarded for the wealth they generate. These programs

not only benefit workers; research shows that firms and investors also receive tangible benefits from sharing with their employees such as increased productivity, profitability, and likelihood of company survival, as well as greater worker loyalty and effort, lower turnover rates, and a greater willingness on the part of workers to suggest innovations.²⁰⁷ Specifically, inclusive capitalism includes everything from worker cooperatives and employee stock-ownership programs to broad-stock options and profit sharing.

Far too few companies and less than half of all American workers benefit from inclusive capitalism today—in part because companies are unaware of inclusive capitalism programs and the mutual benefits they provide. This ignorance extends to government: State governments do little to support greater adoption of broad-based sharing programs, and too often government policies unintentionally stand in the way of more sharing programs.

State government can begin to bridge this knowledge gap and encourage companies to adopt broad-based sharing programs by increasing awareness of inclusive capitalism and by providing technical assistance to private-sector businesses, providing legal protections for companies with these sorts of programs, and providing financial assistance to companies with these structures.

Promote awareness and provide technical assistance to private-sector businesses

Inclusive capitalism programs are not always well-understood by the business community. Companies are often unaware of the benefits of empowering their workforce by sharing capital income and ownership broadly, and lack the technical knowledge to evaluate whether to adopt these programs or even how to do so.

Inclusive capitalism can provide important benefits to many small and medium-sized privately held businesses. Many business owners of the baby-boom generation, for example, must soon decide what to do with their businesses when they retire. Selling to employees rather than to a competitor who may ship the company's equipment and jobs overseas is one way for these owners to preserve local jobs and the legacy of their company, yet few of these business owners know that employee ownership is an option. Small, privately held companies also are often unaware of how inclusive capitalism programs paired with strong employee involvement can improve business performance.

States should fund efforts, including establishing centers to promote inclusive capitalism and democratic workplace culture by providing education and outreach, technical assistance, and training.²⁰⁸

This approach builds on a successful model for increasing one type of sharing—the Employee Ownership Center. Both Vermont and Ohio have launched Employee Ownership Centers that have been successful in increasing awareness throughout the state and facilitating the conversion of small and medium-sized businesses to employee-ownership structure.²⁰⁹ Historically, both centers have received funding from the state, but budget constraints caused the state of Ohio to withdraw its support in fiscal year 2012.²¹⁰

Designate a privileged company structure

Traditional business structures can inhibit companies from adopting inclusive capitalism policies. Chief executive officers, for example, could, in theory, be sued by stockholders if profit-making is not their sole objective,²¹¹ and worker cooperatives often lack sufficient capital to leverage private financing.

State governments should enact laws that both allow businesses to more easily adopt sharing policies without fear of shareholder reprisal and that leverage capital for start-up companies.

Since 2010, 12 states have passed laws creating a new class of corporation known as a benefit corporations, which offer legal protection to owners to look beyond short-term financial gains.²¹² By law, these companies must create a material positive impact on society; consider how corporate decisions affect employees, community, and the environment; and publicly report companies' social and environmental performance annually.²¹³ Companies applying for this status must complete an assessment that evaluates whether firms have an employee-ownership structure or offer broad-based stock, stock equivalents, or stock options to employees, among other factors.²¹⁴ This does not guarantee that every benefit corporation will offer inclusive capitalism programs, but it can provide a significant legal protection to companies with sharing programs.

Iowa, Minnesota, and Wisconsin have all passed laws to help cooperatives leverage capital to finance their businesses.²¹⁵ Most states allow cooperatives to have only one class of voting member-owners, often making it difficult for them to raise sufficient

capital to obtain loans. By allowing cooperatives to have at least two classes of members—patron and investor members—these states help cooperatives to more easily raise the capital necessary to secure loans.²¹⁶ This is particularly valuable during the incubation period, when cooperatives typically have difficulty accessing credit.

Provide direct government financing and encourage private lending to companies with inclusive capitalism policies

Private lenders and even government agencies may be hesitant to provide financing to current and start-up worker cooperatives because they are unfamiliar with the company structure; fear that workers will have too much influence over governance; and are confused about who the responsible parties are in the event of a default. Although employee stock ownership plans do not share the same challenges, their unique ownership structure can preclude them from participating in government programs.

State governments should create programs to provide loans or encourage private lending to cooperatives and employee stock ownership plans. Indiana’s employee stock ownership plan “linked-deposit” program allows the state treasurer’s office to link its routine purchase of certificates of deposit from state financial institutions to companies in need of capital to complete an employee stock ownership plan transaction.²¹⁷ The Indiana treasurer’s office regularly invests state funds by purchasing certificates of deposit. In order to assist companies forming an employee stock ownership plan to borrow funds at a low interest rate, the treasurer purchases certificates of deposit that provide a slightly lower interest rate but in exchange requires the financial institution to reduce the interest rate on the loan made to the company.

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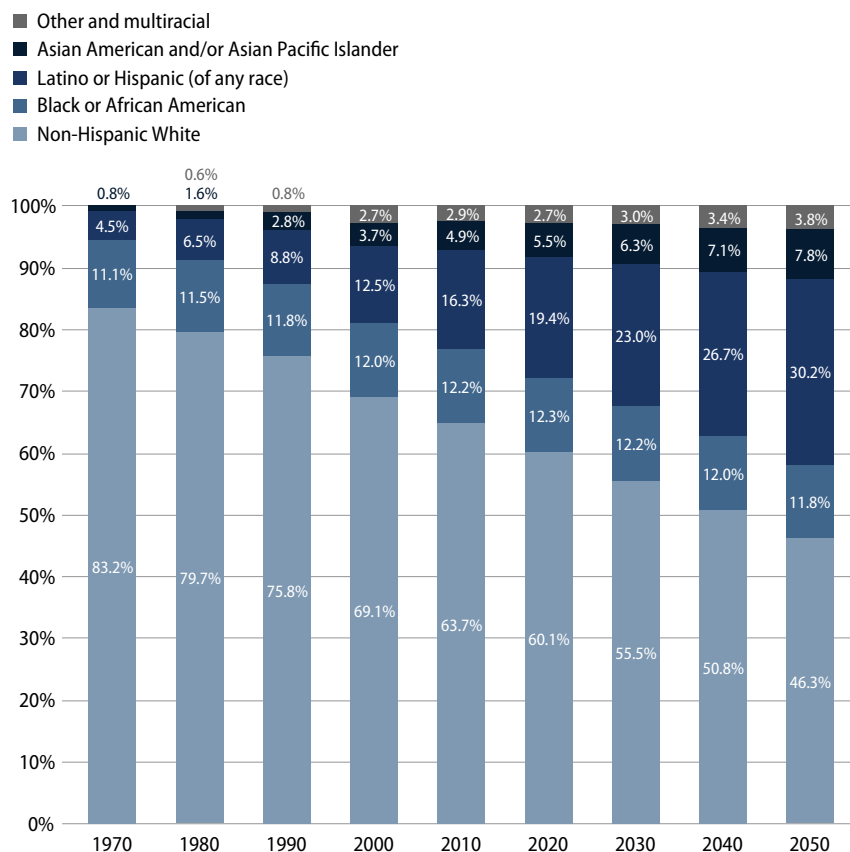
Ensure civil rights are respected so that everyone can fully participate in the economy

The increasing diversity of our country will create many opportunities, but we must make a concerted effort to fully extend the promise of the American Dream to everyone.

By 2050 the majority of Americans will be people of color, and many of them will be immigrants or the children of immigrants. Unfortunately, the core economic problems that the middle class faces—stagnating incomes, rising risks, and growing costs for necessities such as health care and higher education—are more acute for people of color.¹ If current racial and ethnic disparities in income, employment, education, health, and other social services continue, the United States will be losing out on the potential contributions of these Americans.

Currently, there are many barriers standing in the way of the full inclusion of many Americans in the economy. The nation's extremely high level of incarceration—nearly

FIGURE 2
The racial and ethnic composition of the United States, 1970–2050



Sources: Data for 1970 and 1980 from Statistical Abstract of the United States. Data for 1990, 2000, and 2010 from the U.S. Census Bureau. Data for 2020 through 2050 from the U.S. Census Bureau Population Projections by Race and Ethnicity (2008).

1 out of 100 American adults are in jail or prison²—is costly for state government budgets and a waste of human potential. Immigrants face discrimination, as many states have passed draconian immigration laws, and are denied access to important social services, including higher education. At the same time, same-sex couples are denied a marriage license, which denies them the rights and responsibilities, as well as the economic benefits, afforded by marriage.

States must take proactive steps to bring down barriers—for example, passing laws to establish marriage equity and encouraging all eligible residents to vote—but they must also be sure not to erect new obstacles. Yet several states have recently passed laws requiring voters to show photo identification at the polls, despite evidence that voter fraud is incredibly rare.³ These laws disproportionately affect people of color and low-income voters,⁴ and can have economic ramifications. Likewise, bans on same-sex marriage have considerable economic consequences for the entire state economy.⁵

Improving the opportunities for all Americans—including people of color, immigrants, and gay and transgender Americans—is not only a moral obligation, it is also an economic necessity. Here’s what should be done to bring down these barriers to civil rights and expand opportunity for all.

End marriage discrimination by enacting marriage equality

Background

State laws grant hundreds of rights and responsibilities to married couples. In New York state alone, there are 1,324 rights and responsibilities conferred by state law upon married couples that are denied to unmarried couples.⁶ Many of these rights are fundamental to a family’s security, including the ability to qualify for family discounts for medical insurance, to visit one’s spouse in the hospital after an accident or an illness, to make medical decisions on a spouse’s behalf if necessary, to claim insurance benefits in the case of a spouse’s wrongful death, and to automatically inherit a spouse’s property.

Essential rights such as these strengthen families and provide confidence and security for those who enjoy them. According to the American Psychological Association, “research has shown that marriage provides substantial psychologi-

cal and physical health benefits due to the moral, economic and social support extended to married couples.”⁷

Yet in most states, laws or even constitutional amendments bar same-sex couples from being married, meaning thousands are denied access to the basic legal rights that are granted to legally married straight couples. The American Psychological Association also points out that research indicates the human cost of this discrimination, stating that, “Recent empirical evidence has illustrated the harmful psychological effect of policies restricting marriage rights for same-sex couples.”⁸

Adoptive and foster gay parents who are denied a marriage license face additional problems. Without access to a marriage license, one parent could be registered as the adoptive parent, while the other parent may have no legal relationship to their adopted child—essentially rendering them legal strangers.⁹ A nonadoptive parent may then be denied the right to make parental decisions at a school or doctor’s office; cover the child under employer-provided health insurance; or even visit the child in the hospital. If the couple were to divorce, the nonadoptive parent would have a significant disadvantage in a child custody dispute. Gay families where one parent is an immigrant face the additional risk of deportation tearing the family apart, since the U.S. partner or spouse cannot sponsor their foreign-born partner or spouse for permanent residency or citizenship, as is the case for Americans in heterosexual relationships.¹⁰

Enact freedom to marry

States should not continue to deny same-sex couples a basic civil right—the ability to get married—that it grants to heterosexual couples. Moreover, all children should have the same protections under the law—including access to insurance coverage, social security, emergency care, and inheritance rights—no matter if their parents are a gay or lesbian couple or a straight couple. For this reason child health and welfare advocates including the American Academy of Pediatrics,¹¹ the National Association of Social Workers,¹² the American Psychiatric Association,¹³ the American Academy of Nursing,¹⁴ and the American Psychological Association,¹⁵ support the freedom to marry.¹⁶

While the central reason to eliminate marriage discrimination is to guarantee all citizens equal civil rights protections, marriage equality also produces benefits to the economy. If same-sex marriage became legal in every state, weddings for same-

sex couples would result in an estimated \$9.5 billion windfall for the American economy.¹⁷ In its first year after enactment, the New York marriage equality law is estimated to have generated \$259 million for the New York City economy in marriage license fees, local celebrations, and wedding-related purchases alone.¹⁸

More important, enacting marriage equality can help end financial penalties borne by same-sex couples that want security for their families. Not only are same-sex couples and their children frequently unable to purchase health insurance at a discounted family rate, but many couples also spend considerable resources on lawyers to help them maximize the legal protections for their families—legal protections that straight couples can obtain simply by getting married. As life-long same-sex partners age, they are excluded from important benefits to ensure financial security in retirement that are available to heterosexual couples such as Social Security spousal benefits, survivor benefits, or death benefits.¹⁹ A same-sex couple’s “lifetime cost of being gay” can rise to as much as \$467,562.²⁰

Nine states and the District of Columbia have completely ended marriage discrimination against same-sex couples.²¹ They issue marriage licenses to same-sex couples and recognize legal marriages between same-sex couples that were performed in other states. State legislatures in Maryland, New Jersey, and Washington passed freedom to marry bills in 2012. Voters in Maryland and Washington defeated referenda placed on the November 2012 ballot by opponents seeking to overturn marriage equity laws passed by the legislature and signed by the governor of these states.²² Activists in New Jersey are working to override the governor’s veto of the legislature-passed bill.²³ In Maine, voters passed a ballot measure to allow marriage equity.²⁴

Other states with marriage equity include Connecticut (2008),²⁵ the District of Columbia (2010),²⁶ Iowa (2009),²⁷ Massachusetts (2004),²⁸ New York (2011),²⁹ Vermont (2009),³⁰ and New Hampshire (2010),³¹ where a repeal effort was defeated in 2012.³²

Grant civil unions and domestic partnerships in states where political realities prevent passage of marriage equity

In states where political realities may prevent passage of full marriage equality, state governments can enact laws granting some state-level spousal rights to same-sex couples such as civil unions and domestic partnerships.

Nine states plus the District of Columbia have laws granting some state-level spousal rights to same-sex couples. They are: California (domestic partnerships, 2007); Delaware (civil unions, 2012); District of Columbia (domestic partnerships, 2002); Hawaii (civil unions, 2012); Illinois (civil unions, 2011); New Jersey (civil unions, 2007); Nevada (domestic partnerships, 2009); Oregon (domestic partnerships, 2008); Rhode Island (civil unions, 2011); and Washington (domestic partnerships, 2009).³³ While these laws represent more relief for spouses than having no rights at all, they continue discrimination and are inferior to marriage equality legislation.

Maryland (2010) and Rhode Island (2007) also recognize same-sex marriages legally entered into in another jurisdiction.³⁴

Protect immigrants from discrimination

Background

The United States is a nation of immigrants. There were nearly 40 million foreign-born people living in America in 2010.³⁵ While more than 70 percent are citizens or legal residents—and undocumented immigrants make up only about 5 percent of the nation's population³⁶—a number of states have passed discriminatory anti-immigrant initiatives over the past two years that hurt documented and undocumented workers alike and inhibit states' economic growth.

Six states—Arizona, Utah, Georgia, Indiana, Alabama, and South Carolina—have enacted broad immigration enforcement laws that target undocumented immigrants and authorize local police to enforce immigration laws.³⁷ These laws have all been challenged in federal courts, and many of the most severe provisions have been temporarily or permanently struck down.³⁸ Still, litigation over a number of provisions continues, leaving open the question of how far the states may go in enacting policies targeting undocumented immigrants. To be sure, the U.S. Supreme Court's ruling in the Arizona case involving its immigration law made it clear that as a constitutional matter, states have very little room to maneuver in this area.³⁹ But in upholding the provision of Arizona's law that requires state officials to check the immigration status of anyone they suspect is undocumented,⁴⁰ the Court has left the door open to policies that will almost certainly lead to discriminatory profiling.

Even setting aside the constitutional questions, there are powerful policy reasons to reject these initiatives, which create a deeply hostile environment for all people of color regardless of their immigration status. Sixty-one percent of Latinos, for example, describe discrimination as a “major problem.”⁴¹ Nearly 20 percent of Asian Americans say they have encountered discrimination in the past year, and 13 percent describe it as a major problem.⁴²

But these harsh laws targeting immigrants don’t just hurt people of color.

Discriminatory immigration policies inhibit economic growth: Due to backlash against its anti-immigrant policy, Arizona’s tourist economy lost an estimated \$217 million that would have been spent by attendees to cancelled conferences after the law was enacted in 2010.⁴³ It was projected that Alabama would lose up to \$10.8 billion and 140,000 jobs after passing the nation’s toughest immigration law in 2011.⁴⁴

Rebuilding the middle class means enacting policies that view immigrants not only as individuals with civil rights but also as an asset to the nation, not a liability. To offer equal opportunity to all, state and local governments must expose and counter discrimination—whether it appears in outdated statutes and government policies or in daily practices in the commercial marketplace.

Strengthen community relations and defend civil rights through targeted enforcement of immigration law

State governments can help local law enforcement prioritize serious crimes—rather than expending valuable time and resources arresting and holding nonviolent undocumented immigrants in custody—by opposing the Department of Homeland Security’s Secure Communities program. Secure Communities, launched by the George W. Bush administration in 2008, requires local law enforcement officials to check the fingerprints of anyone in their booking units against the FBI’s criminal database, which then automatically shares information with the Department of Homeland Security’s immigration database.⁴⁵ Additionally, the federal government requests that anyone who shows up as being in violation of immigration laws be held until they can be turned over to federal law enforcement.

Among the stated goals of the Secure Communities program is to prioritize and focus law enforcement efforts on the most serious criminals among the undocumented immigrant population.⁴⁶ But its rapid expansion under the Obama administration has generated widespread criticism⁴⁷ for having undermined community

safety—for example, by damaging the immigrant community’s trust in local law enforcement and preventing otherwise law-abiding immigrants from reporting crimes—rather than prioritizing serious criminals. What’s more, the program has imposed the significant cost of holding detainees onto state taxpayers, while depriving innocent detainees from working in the local economy. Worse still, it has led to the deportation of the parents of children who are American citizens and robbed families of needed income.⁴⁸

States should pass legislation that ensures that only individuals charged with serious and violent crimes are detained for the federal government. Moreover, governors should use their executive powers to lobby the federal government to reform the Secure Communities program to comply with its original intent to prioritize and focus law enforcement efforts on the most serious criminals.

California’s TRUST Act—while not yet enacted—provides a powerful example of how state governments may limit enforcement of the Secure Communities program. The legislation would ensure that an individual would not be detained for a period longer than what is required under state law, unless the person has been convicted of a serious crime.⁴⁹ This change would have a significant impact: As of March 31, 2012, 70 percent of the more than 70,000 people deported under Secure Communities in California either had no criminal convictions or were picked up for minor offenses such as traffic tickets.⁵⁰

California is on solid legal ground because the detainer warrants that the Department of Homeland Security sends to a local government are simply a request for intergovernmental cooperation. Because they are not arrest warrants, nor are they legally binding on state law enforcement, states have the legal authority to reject them.⁵¹ Under the proposed legislation, law enforcement leaders would be able to redirect police resources from immigration enforcement back to protecting communities and will allow officers would regain the trust of their neighborhoods once they are no longer seen as substitute immigration agents.⁵²

Although California Gov. Jerry Brown vetoed a version of the TRUST Act in 2012 due to concerns that the list of crimes included for detainment was too narrow,⁵³ legislative leadership has signaled that they will take up a revised version of the bill in 2013.⁵⁴

Governors in other states with large immigrant populations, including Illinois Gov. Pat Quinn,⁵⁵ Massachusetts Gov. Deval Patrick,⁵⁶ and New York Gov.

Andrew Cuomo,⁵⁷ as well as District of Columbia Mayor Vincent Gray,⁵⁸ are refusing to participate in the Secure Communities program. A statement released by Gov. Cuomo's counsel explains that, "The heart of concern is that the program, conceived of as a method of targeting those who pose the greatest threat to our communities, is in fact having the opposite effect and compromising public safety by deterring witnesses to crime and others from working with law enforcement."⁵⁹

These declarations may be largely symbolic because the federal government has clarified that the check of the immigration database for all individuals arrested by local governments is mandatory. Still, the stances of these governors provide critical pressure on the federal government to reform the Secure Communities program and to shift its focus to only the most violent criminals.

Prohibit racial profiling

State governments should adopt legislation to prohibit racial profiling following the lead of Connecticut, which recently adopted a law that takes steps to do so.⁶⁰

Following a high-profile federal investigation of racial profiling by police in East Haven, Connecticut, the Connecticut Assembly passed S.B. 364 to require all local governments to formulate their own "written policy that prohibits the stopping, detention or search of any person when such action is solely motivated by considerations of race, color, ethnicity, age, gender or sexual orientation, and the action would constitute a violation of the civil rights of the person."⁶¹ In addition, each local policy would require enhanced data collection and reporting of traffic stops.⁶² Once the law goes into effect, any driver stopped by police must be given a copy of the report containing details about the driver and the case. Anyone who feels he was profiled due to race, color, ethnicity, gender, or sexual orientation can file a complaint, which must be reviewed by the local police and forwarded to a state agency.⁶³

Prohibit state and local governments from requiring E-verify

The U.S. Department of Homeland Security's E-Verify program requires federal contractors to check their payroll records to ensure that the names and Social Security Numbers of each of their employees appear in a national internet database of eligible

workers.⁶⁴ There are concerns, however, about the accuracy and completeness of the federal database⁶⁵ that have led to widespread criticism of the program.

Even though the federal government launched E-Verify “as an experimental and temporary system available to employers on a voluntary basis,”⁶⁶ some state and local governments have passed overreaching legislation requiring all employers to check their payroll records against the system.⁶⁷

Despite Arizona passing a law requiring private employers to use E-verify, only about half of new hires were vetted by the system in the fiscal year following the law’s adoption, which ended in September 2009.⁶⁸ For employers that do use the verification system, the effect of the law has been to drive undocumented workers further underground and off the books.⁶⁹ This situation hurts the state’s ability to regulate and protect its workforce and it undermines its fiscal self-interest by losing tax revenues.⁷⁰

In response, states such as California and Illinois have passed laws to prohibit state and local governments from requiring the use of E-Verify.⁷¹

California’s “Employment Acceleration Act of 2011,” for example, prohibits the state or local governments from requiring employers to use E-Verify unless it was required of them by federal law or as a condition of receiving federal funds. California decided that, “Mandatory use of an electronic employment verification program would increase the costs of doing business in a difficult economic climate,” and that, “California businesses would face considerable odds in implementing such a program. Employers using the program report that staff must receive additional training that disrupts normal business operations.”⁷² According to the act, “If E-Verify had been made mandatory for all employers in 2010, it would have cost businesses \$2.7 billion, \$2.6 billion of which would have been borne by the small businesses, which drive our economy.”

Unless and until the federal government enacts legislation enabling undocumented workers to earn legal status, mandatory E-Verify in states and communities will only exacerbate the negative consequences of a large and exploitable workforce.

Enforce health, safety, and worker protection laws without regard to immigration status

States should also enact policies ensuring that state and local government agencies will enforce health, safety, and worker protection laws for all residents regardless of immigration status. Moreover, state agencies must target outreach to immigrant workers, who are less likely to report violations for fear of deportation.

Employers in low-wage, high-risk occupations often hire immigrant workers, who are at particular risk of being taken advantage of by employers who cut corners when it comes to health and safety and worker-protection laws.⁷³ Moreover, undocumented workers and new immigrants who do not know their rights may be fearful of the repercussions of reporting workplace violations.

To underscore the point—fatalities among immigrant workers are a serious problem. While the overall number of workplace fatalities dropped by nearly 25 percent between 1992 and 2010, fatalities among foreign-born workers increased by 26 percent, and fatalities among Hispanic workers—many of whom are immigrants—increased by 33 percent.⁷⁴

In 2002 California passed legislation specifying that state labor, employment, civil rights, and employee housing laws will be enforced without regard to a person's immigration status, and that state agencies will not make inquiries into workers' immigration status unless required to do so by federal law.⁷⁵ The state's Department of Industrial Relations, which enforces the state's labor and workplace safety and health laws, will process wage claims; hold hearings to recover unpaid wages and represent workers; and investigate retaliation complaints and file court actions to collect back pay owed to any victim of retaliation without regard to a worker's immigration status.⁷⁶

In New York, Eliot Spitzer, while the state's attorney general, established a clear firewall between immigration and labor law enforcement,⁷⁷ while the former New York state Commissioner of Labor Patricia Smith prioritized outreach to immigrant workers by creating a mobile "labor-on-wheels" van to target workers during community events and establishing temporary bilingual labor offices in trusted community organizations.⁷⁸

Invest in the most vulnerable within the immigrant workforce

Background

States aspiring to expand and strengthen their middle class must eliminate discrimination and other barriers that hamper immigrants' ability to join the middle class, as well as take additional steps. State governments must also proactively support immigrant workers and families. Undocumented immigrants function on the fringe of our economy without access to these government services.

Undocumented youth graduating from state high schools, for example, often face significant barriers in accessing affordable post-secondary education. Thanks to a new federal deferral on deportation for young people who arrived in the United States as children, these youth have the potential to work their way into the middle class. But in most states, undocumented youth are not eligible for in-state college tuition, putting post-secondary education out of reach for most undocumented immigrants of modest means.

Undocumented immigrants are also prohibited from obtaining driver's licenses in most states, hampering their ability to travel to job sites and participate in the workforce.⁷⁹ Without a driver's license, it becomes nearly impossible to establish credit or open a bank account. Undocumented workers are commonly paid in cash and can become targets for street crime because they have to carry large sums of cash. The harm caused by the prohibition on driver's licenses goes beyond undocumented immigrants since law enforcement officers find it difficult or impossible to identify and prosecute unlicensed drivers who commit traffic violations or cause accidents.⁸⁰

Blocking undocumented immigrants from accessing these government services hurts everyone in our community. Inaccessibility to affordable post-secondary education means that too often the state's best and brightest students are confined to low-paying, dead-end jobs making it difficult for them to fulfill their economic potential. When undocumented immigrants drive without a license—and consequently without insurance—premiums for insured drivers increase.⁸¹ When New York considered legislation to extend licenses to undocumented drivers, the state's department of insurance estimated that subsequent drop in premiums would save insured drivers \$120 million annually by reducing premium costs associated with uninsured motorists by 34 percent.⁸²

Pass a state-level DREAM Act to allow undocumented students to attend state colleges and universities at the in-state tuition rates and to access public financial aid

State governments can invest in immigrant families by passing legislation authorizing qualified undocumented students to attend state colleges and universities at the in-state tuition rates and providing access to public sources of financial aid. Twelve states—California, Connecticut, Illinois, Kansas, Maryland, Nebraska, New Mexico, New York, Texas, Utah, Washington, and Wisconsin—have enacted legislation, sometimes referred to as state DREAM Acts, to allow undocumented immigrants who graduate from state high schools and meet certain requirements to pay in-state tuition at public universities.⁸³

The Maryland General Assembly passed a DREAM Act in 2011, and voters approved the law in a November 2012 referendum.⁸⁴ In Rhode Island, the Board of Governors for Higher Education approved a policy to allow undocumented students to pay in-state tuition at public universities.⁸⁵ California, New Mexico, and Texas also allow undocumented students to access public financial aid.⁸⁶

State DREAM Act campaigns received an unexpected boost recently when President Barack Obama announced the Deferred Action for Childhood Arrivals program, which will allow up to 1.76 million qualified undocumented immigrant youths to apply to remain in the United States without fear of deportation.⁸⁷ Prior to the announcement, DREAM Act opponents could argue that there was no point in providing taxpayer-subsidized college education to undocumented students since their lack of a work permit would prevent them from entering the workforce upon graduation.

The Deferred Action for Childhood Arrivals program means millions of qualified students and recent graduates will now bring new energy to state workforces. Individuals qualify to apply for deferred action if they immigrated to the United States when they were younger than age 16; were older than age 14 and younger than age 31 on June 15, 2012; had been in the United States for five years; were in or had completed high school or were in the armed services or had been honorably discharged; and had not been convicted of a felony, significant misdemeanor, or multiple misdemeanors.⁸⁸ Unfortunately, the program excludes many undocumented students—for example, based on their date of entry or their age. State governments should craft DREAM Acts with the broadest possible reach and do not need to track with the deferred action policy's requirements.

A recent report by the Center for American Progress found that federal legislation providing undocumented youth legal status and the opportunity to pursue higher education would have a positive economic impact nationally of \$329 billion over the next 20 years.⁸⁹ Individual states stand to gain significantly from this combination of legal status and incentivized higher education, as well.⁹⁰

Issue drivers licenses to all qualified residents regardless of status

The states of Washington and New Mexico have passed strong laws granting driver's licenses to qualified drivers regardless of immigration status.⁹¹ Legislators, advocates, and organizers have successfully defended these policies in Washington and especially in New Mexico, where Gov. Susana Martinez (R) has tried unsuccessfully to repeal the driver's license law on three separate occasions.⁹² While not ideal, Utah maintains a two-tier system that issues a driving privilege card for undocumented residents.⁹³

Prior to the terrorist attacks of 9/11—which sparked significant opposition to any privileges extended to undocumented immigrants—far more states issued driver's licenses to undocumented immigrants for the common-sense reason that it made the roads safer.⁹⁴

States fully extending driving privileges to undocumented immigrants will face additional challenges when the federal REAL ID Act of 2005 is fully implemented (which is scheduled to occur in early 2013).⁹⁵ The law mandates that states issue driver's licenses only to U.S. citizens or documented immigrants. States can choose to opt out of the program, but residents of states that do so would be forced to obtain a U.S. passport or alternate form of federal identification for federal identification purposes such as boarding airplanes and entering federal buildings.⁹⁶

President Obama's announcement of the Deferred Action for Childhood Arrivals program, however, has created momentum for the enactment of driver's license laws that are more limited in scope. Several states, including Virginia, Texas, California, Illinois, Indiana, Michigan, New York, and Ohio, have announced that youth who receive deferred action will also be eligible for driver's licenses.⁹⁷ Legislation in California, sponsored by state Assemblyman Gil Cedillo and signed in to law by Gov. Brown on September 30, 2012, will allow undocumented youth who receive work authorization under the program to qualify for driver's licenses.⁹⁸ Also, Illinois enacted legislation early this year to allow about 250,000 undocumented immigrants

that have lived in Illinois for at least a year to apply for driver's licenses that would look different than standard licenses and may not be used for other identification purposes such as for boarding an airplane or buying a gun.⁹⁹

In Oregon, Gov. John Kitzhaber (D) announced his support and promised in a letter to convene a working group to plan for the issuance of driver's licenses to undocumented immigrants. The goal, according to Gov. Kitzhaber's letter, is to encourage "people to come out of the shadows and contribute to our state's economic recovery."¹⁰⁰ In the meantime, according to his letter, the Oregon State Police will begin accepting identification issued by the Mexican government as a valid form of identification during traffic stops and other instances.¹⁰¹

Additional activity is expected in 2013 in Connecticut, California, Colorado, Florida, Vermont, and Maryland.¹⁰²

Issue substitute identification cards to undocumented workers

Legislators should consider adopting substitute identification cards for undocumented workers in states where issuing driver's licenses regardless of immigration status would be politically infeasible. Substitute identification cards are far more limited in scope, but for municipalities without the power to license, they have proved an effective tool in allowing undocumented residents to emerge from the shadows.

In California, Los Angeles, San Francisco, and Richmond are pioneering the use of an enhanced municipal library card as an identification card. Los Angeles, for example, will soon contract with a private vendor to allow individuals to use their enhanced library cards to open bank accounts, enabling them to deposit and withdraw money and send and accept wire transfers abroad.¹⁰³ San Francisco's enhanced identification card includes the individual's street address and medical conditions and is accepted as a form of identification by most of the city's banks and businesses.¹⁰⁴

In 2007 New Haven, Connecticut, became the first city in the nation to roll out its municipal identification—the Elm City Resident Card.¹⁰⁵ Hundreds of residents lined up to apply for the cards during the first few days the city accepted applications.¹⁰⁶ After five years, more than 10,000 residents have obtained a card.¹⁰⁷ Local officials report that this has not only helped undocumented residents access services but also increased community safety, as undocumented residents who witness crimes feel empowered to come forward.¹⁰⁸

Require governments to provide services without regard to immigration status

States should revise their state codes to clarify that within the limits of federal law, state and local governments are required to provide human services to any residents regardless of immigration status.

More than a dozen states now provide free prenatal care to pregnant women regardless of immigration status using either federal or state funds.¹⁰⁹ In 2011 Nebraska enacted L.B. 599, which established the right of undocumented mothers to free prenatal services in an interesting victory by pro-life and pro-immigrant advocates over immigration opponents.¹¹⁰ The state legislature found that because “unborn children do not have immigration status,” they should extend medical care to pregnant women who are income-eligible regardless of immigration status. The law took effect after the legislature overrode the veto of Republican Gov. Dave Heineman.¹¹¹

Additionally, many major cities have enacted policies that serve as models for state governments to guarantee that all public services will be provided to any resident regardless of immigration status. In New York City, executive orders 34 and 41 ensure that all New Yorkers regardless of immigration status can access all city services.¹¹² According to the executive orders, city workers must also protect the confidentiality of a person’s immigration status.

In 2009 Philadelphia Mayor Michael Nutter signed Executive Order 8-09, which bans city employees from asking about a resident’s immigration status unless required by law or to determine program eligibility, and protects the confidentiality of immigration status—unless disclosure is required by law, occurs with the permission of the individual, or the individual is suspected of criminal activity.¹¹³ The order also prohibits law enforcement officers from stopping, questioning, arresting, or detaining someone solely because of ethnicity, national origin, or perceived immigration status. Police are prohibited from asking about immigration status unless the status is directly related to a crime for which the person is being investigated or relevant to the identification of a suspect; asking about status for the purpose of enforcing immigration laws; or asking about the immigration status of victims, witnesses, or others who call or approach the police seeking help.¹¹⁴

Chicago has also had a longstanding policy prohibiting city officials from asking about the immigration status of individuals seeking city services since Mayor Harold Washington’s administration in the 1980s.¹¹⁵ That policy was recently reconfirmed in September 2012, when the Chicago City Council approved a

Welcoming City ordinance proposed by Mayor Rahm Emanuel.¹¹⁶ One component of that ordinance also requires “the development of public marketing materials that outline the services that law abiding immigrants can safely access in the city of Chicago.”¹¹⁷

Provide translation services

State legislatures should ensure that all state residents can access government services by requiring government agencies to provide translation services. In addition, state leaders can help uphold high standards in private industries that employ significant numbers of non-English-speaking immigrants by requiring such companies to provide translation services to their workers in order to uphold safety standards.

States should follow the lead of New York City, where the mayor’s executive order 120 requires city agencies to provide translation services to every city resident.¹¹⁸ The objective, according to Mayor Michael Bloomberg, is that all residents “should have the same access to the same services and the same opportunities.”¹¹⁹ Under the executive order, city agencies must provide telephonic interpretation, oral and written translation services, and translation of essential documents in the six most commonly spoken languages in the city: Spanish, Chinese, Russian, Korean, Italian, and French Creole.

Mayor Bloomberg’s executive order follows by five years the passage of New York City’s Local Law 73, the Equal Access to Services law, which requires agencies and contractors to provide language access, document translation, and assistance to fulfill the legislative intent of ensuring “that persons eligible for social services receive them and to avoid the possibility that a person who attempts to access services will face discrimination based upon the language s/he speaks.”¹²⁰

In Nebraska, former Gov. Mike Johanns (R) signed into law the Non-English-Speaking Workers Protection Act in 2003, which requires translation services to be available in the workplace.¹²¹ The law—which came out of efforts to improve work conditions in the meatpacking industry—requires employers with significant numbers of workers not fluent in English to ensure that translators are available to employees in the workplace and to provide statements written in the employees’ own language of terms and conditions of employment, including potential health and safety risks. Iowa has a similar law that requires employers

with a workforce that is more than 10 percent non-English-speaking to provide an interpreter available at the worksite for each shift during which non-English-speaking employees are present and employ a person whose primary responsibility is to serve as a referral agent to community services.¹²²

Invest in proven criminal justice methods and provide pathways out of the criminal justice system

Background

Too often crime-reduction policies of state governments are extremely costly and do little to make our communities safer or help provide offenders a pathway out of crime. Incarceration spending is growing at unsustainable rates and directly contributing to state budget shortfalls; state prisons and local jails are filled over capacity, often confining individuals who pose little threat to public safety; and too many communities are plagued by a seemingly unending cycle of violence and drug abuse.

A total of 2.2 million American adults are currently incarcerated in state and local prisons and jails, nearly 1 out of every 100 adults.¹²³ State spending on corrections has quadrupled from \$12.6 billion in 1988 to \$52 billion in 2008—outpacing the growth of nearly every other state budget item.¹²⁴ Jail populations also have increased significantly from 2000 to 2008, as have the number of individuals on probation and parole, which now approaches 1 in every 45 adults.¹²⁵

The prison population has outpaced capacity to such an extent in California that the U.S. Supreme Court has ordered the state's prison system to discharge 37,000 prisoners of its total of 156,000 inmates in 33 prisons. The High Court found that the effects of overcrowding—including inadequate medical and mental health care—caused “needless suffering and death” and constituted cruel and unusual punishment in violation of the Eighth Amendment.¹²⁶

Policing and corrections strategies that focus on locking more people up are not making communities safer. People convicted of nonviolent offenses comprise 60 percent of the prison and jail population today.¹²⁷ This allows whole generations of young people in some poor communities to cycle in and out of the corrections system and encourages the development of a permanent underclass, which impedes the economic development of everyone living in those communities.¹²⁸

Research shows that well-designed drug treatment, community corrections, and crime prevention programs cost far less and are far more effective than incarceration at reducing crime and providing offenders a pathway to a productive future. The Rand Corporation, for example, found that one dollar spent on drug treatment reduces crime related to cocaine use by as much as \$15.¹²⁹

Increasingly, bipartisan coalitions in state governments across the country are adopting sensible reforms that significantly cut state corrections spending while making communities safer and giving individuals convicted of nonviolent crimes the resources they need to reintegrate into society.

Adopt criminal justice reinvestment strategies

At least 16 states have implemented criminal justice reinvestment strategies to ensure that comprehensive data analysis drives state correction and prevention programs, and that these programs are targeted to the specific public safety needs of the state. By adopting these strategies, states have increased public safety, reduced crime, held offenders accountable, and controlled spending on corrections.¹³⁰

The Council of State Governments, a nonprofit nonpartisan organization serving state governments, outlines six lessons from those states that have initiated criminal justice reinvestment programs in its report, “Lessons from the States: Reducing Recidivism and Curbing Corrections Costs Through Justice Reinvestment.” The lessons detailed in the report include: conducting comprehensive data analysis; engaging all stakeholders from the outset; focusing resources on those most likely to reoffend; reinvesting in high-performing programs; strengthening community supervision; and incenting municipal and county governments to improve performance by restructuring funding.¹³¹

Kentucky, for example, is one of the most recent states to adopt a justice reinvestment program, which promises to save millions of dollars in corrections spending and reduce recidivism rates. Before implementation of the program, Kentucky’s prison population climbed by 45 percent between 1999 and 2009, and corrections spending rose 272 percent in the prior two decades. Yet despite increased spending and higher rates of incarceration, the recidivism rates remained high.¹³²

Kentucky’s 2011 justice reinvestment law—the result of a bipartisan task force convened by the state General Assembly—uses data to prioritize the most costly

prison space for the most violent offenders and establishes tracking mechanisms to reduce recidivism.¹³³ It also requires that 75 percent of state spending on supervision and intervention programs for pretrial defendants, inmates, and individuals on parole and probation is directed to programs that are evidence-based.¹³⁴ Kentucky's state budget director predicts that the law will generate state savings of \$422 million over 10 years, 25 percent of which will be dedicated to local corrections programs. The additional funds will be dedicated to substance abuse treatment, mental health programs, and efforts to address recidivism.¹³⁵

These predicted results are similar to those of other states that have adopted criminal justice reinvestment strategies. Texas was the first state to attempt justice reinvestment in 2007, resulting in \$443 million in immediate savings and a significant drop in crime rates.¹³⁶ North Carolina officials predict \$560 million in savings through the implementation of their program, such that the state's prison population is now expected to be 5,000 people less than previously projected for 2017.¹³⁷

Repeal mandatory minimum sentencing laws

States should repeal mandatory minimum sentencing laws, which have significantly contributed to prison overcrowding and driven up costs by requiring unnecessarily long prison sentences for nonviolent drug users. This portion of the incarcerated population poses little threat to public safety and, by being locked up in prison, misses out on treatment opportunities that are more effective at reducing crime. Eliminating mandatory minimum sentencing laws empowers prosecutors, judges, and defense attorneys, who know the facts of the case, to apply the appropriate discretion to determine sentencing.

Since 2009 several states, including New York, South Carolina, New Jersey, Massachusetts, Rhode Island, and Ohio have begun to reform their mandatory minimum sentencing laws.¹³⁸ South Carolina, for example, almost unanimously passed a sentencing reform law in 2010 in order to tackle the state's serious prison growth problem. The law there includes provisions to eliminate mandatory minimum sentences for simple drug possession and to give judges the discretion to impose nonprison alternatives on some types of drug crimes.¹³⁹ South Carolina's prison population had grown by 270 percent over the 25 years prior to passage of the law, its corrections expenses by 500 percent, and nearly half of its prisoners were incarcerated for nonviolent offenses.¹⁴⁰ With the adoption of the law, South Carolina is expected to reduce prison growth by 7.3 percent by 2014—saving the state \$241 million.¹⁴¹

Ohio too was facing similar problems: Its state prisons were at 133-percent capacity, and half of the incarcerated population was serving sentences of less than one year when Ohio passed its sentencing reform law in 2011.¹⁴² Its bipartisan reform law—which includes provisions to reduce mandatory minimum sentences for some drug crimes, requires nonprison alternatives for misdemeanors and low-level felonies, and expands parole eligibility—is projected to reduce prison growth by 13.8 percent by 2015 and save the state \$1 billion.¹⁴³

Leverage police intelligence and community involvement to improve safety

Cities across the country have significantly reduced violent crime, shut down open-air drug markets, reduced incarceration, and rebuilt relations between law enforcement and distressed communities through programs termed “intelligence-led policing.” States can encourage cities suffering from high rates of violent crime to adopt these cost-effective programs by providing technical expertise, funding assistance and coordination with states’ attorney generals’ offices.

Jeremy Travis and David Kennedy at the John Jay College of Criminal Justice of the City University of New York—who lead the National Network for Safe Communities, which is an alliance of cities dedicated to advancing strategies to combat crime, reduce incarceration, and rebuild relations between law enforcement and distressed communities—are pioneers in using intelligence-led policing to reduce violent crime and shut down drug markets.¹⁴⁴ Their strategy requires law enforcement to collect sophisticated intelligence on local gangs and drug dealers in order to understand how the networks operate and to build cases against offenders. But instead of simply prosecuting the worst offenders, law enforcement partners with social service providers and community organizations to engage in a sustained relationship with offenders. At “call-in meetings”—a key component of the strategy—offenders are presented with the legal consequences of further violence but are also given credible offers of support and assistance from their family, community leaders, and government social services to find work and end their involvement in illegal activities that harm the community.¹⁴⁵ The “Cure Violence/Chicago Ceasefire” model—an epidemiological crime prevention strategy, which also relies heavily on community involvement and intelligence—has met with similarly positive results.¹⁴⁶

Communities across the country, including Boston, Chicago, Cincinnati, and Indianapolis, saw significant reductions in gun homicides (from 25 percent to

more than 60 percent) after adoption of such policies.¹⁴⁷ In California, cities across the state are being encouraged to adopt this strategy in order to reduce gang violence. Under the leadership of the Governor's Office of Gang and Youth Violence Policy, the state has partnered with four private foundations to create "Safe Community Partnership Grants," which not only provide communities funding to adopt these strategies but also for intensive training and technical assistance.¹⁴⁸ Initial results demonstrate programmatic success: Gang related shootings, for example, were cut in half in Salinas, California, and homicides dropped in that city by 80 percent in the first six months of 2010, as compared to the same period one year previous before the law was adopted.¹⁴⁹

Strengthening indigent defense so that everyone gets a fair trial

States can reduce jail overcrowding, improve programmatic efficiency, and help ensure that everyone—regardless of their economic status—is able to exercise his or her constitutional right to a fair and expedient trial by reforming the indigent defense systems. State indigent defense programs are often plagued by severe underfunding, inexperienced legal counsel burdened with excessive caseloads, and inadequate payment systems that together contribute to severe jail overcrowding and create perverse incentives that encourage lawyers to spend as little time as possible on the defense of each individual client. In Texas, for example, more than half of jail inmates are pretrial defendants, and 20 percent of these pretrial defendants are being held for misdemeanor offenses—costing Texas taxpayers a total of more than \$471,000 per day.¹⁵⁰

While local governments generally provide the majority of indigent defense funding, the problem of jail overcrowding and low-quality counsel is so widespread that several states—Nevada, Idaho, Michigan, and Pennsylvania—have established special commissions to examine the issue.¹⁵¹

States must increase funding to counties and local governments for indigent defense programs, which could be generated by redirecting a portion of the savings associated with the repeal of minimum mandatory sentencing laws and other criminal justice reinvestment strategies to these programs. Additionally, states must institute systematic reforms to improve legal defense quality and efficiency. Best practices include creating an independent task force on indigent defense to monitor programmatic quality and advocate for reform; creating funding incentives for successful programs; expanding the use of public defenders at the local

and regional level; improving training and management of the private defense bar; and ensuring that indigent defense contracts adequately reimburse for the full cost of an investigation and trial.¹⁵²

The District of Columbia's Public Defender Services, a national leader in providing high-quality services, is funded at a level more than four times higher than the top-funded state. While the federal government spent about \$136 per capita on indigent defense services in the District of Columbia in 2008, funding for indigent defense in the states (which includes state and local funding) during that same period ranged from a high of about \$42 per capita in Alaska to a low of just barely more than \$5 per capita in Mississippi, with 15 states spending less than \$10 per capita.¹⁵³ The Michigan state legislature also passed a law this session that will normalize per capita expenditures for indigent defense counsel across the state and create a permanent and autonomous Indigent Defense Commission to implement and enforce minimum standards across the state.¹⁵⁴

Strengthen democracy by encouraging full participation

Background

In order to strengthen our democracy, state leaders should focus on encouraging all eligible citizens to vote. Americans take pride in the fact every citizen's vote is counted equally, no matter their age, race, economic background or social status. And we know elections work best when the electorate closely mirrors society. If young people and the poor turned out to vote at higher rates, it would be more difficult for politicians to ignore issues important to them. State-level voting laws should reflect this fundamental belief, making the ballot box equally accessible for all.

Yet more than a dozen states, including Pennsylvania, Wisconsin, Florida, and Texas, passed legislation making it more difficult for voters to cast a ballot since 2010.¹⁵⁵ These laws disenfranchise voters by increasing registration restrictions, limiting early voting, and requiring photo identification to vote.

Supporters of voting rights have spent considerable energy trying to fight these efforts and progressive coalitions in a number of states—including states as geographically and politically diverse as New York, Utah, California, and New Hampshire—are coming together to pass legislation to help increase voter

registration and access to the polls. Progressive leaders in other states have an opportunity to focus on laws to encourage all eligible citizens to vote in the 2013 legislative session.

Allow eligible citizens to register to vote online

State governments can increase participation by allowing eligible citizens to register online.

Most government forms can now be filed online. The IRS allows you to e-file your taxes. Many states permit you to register your vehicle on the Internet. Seniors can even apply for Social Security and Medicare online. And all of it is done safely and securely. Yet the vast majority of states still don't allow their citizens to register to vote on the web. Modernizing the process and allowing people to register online would significantly increase access to the right to vote.

Allowing online registration would be particularly helpful in increasing the youth vote. According to Project Vote, less than 63 percent of Americans ages 18 to 34 were registered to vote in 2009, yet a Nielsen survey found that these young citizens were by far the most electronically connected, with 88 percent having an Internet connection at home.¹⁵⁶

A handful of states are bringing voting rights into the 21st century. Sixteen states have passed bills permitting their citizens to register online,¹⁵⁷ and lawmakers in other states have already announced plans to introduce online voter registration legislation next year as well.¹⁵⁸

But online registration isn't just good for voters—it's good for state budgets as well. In Maricopa County, Arizona, for instance, processing a paper application costs taxpayers approximately 83 cents, while an electronic application will set them back just 3 cents. And in Washington, overall data entry time in some counties fell by 80 percent since the program was implemented in 2008.¹⁵⁹

One final benefit of registering online is that it prevents many clerical errors that often result in voters being disenfranchised. In Arizona, the number of human and data entry errors fell significantly since the programs started in 2002 because voters could enter and double-check their own information electronically.¹⁶⁰

Allow eligible citizens to register on Election Day

State governments can significantly increase access to the polls by enacting laws to allow citizens to register on Election Day.

Because voting in the United States is usually a two-step process—you must register to vote often weeks in advance before you can actually vote—many citizens lose their right to vote because they miss the registration deadline. Studies find that Election Day registration boosts turnout on average by 7 to 14 percentage points.¹⁶¹ And though less than two-thirds of eligible Americans typically vote in our presidential elections, the turnout rate among those who have registered to vote is typically between 75 percent and 90 percent.

It's not difficult to see why this is the case. Most states bar residents from registering to vote in the weeks just before an election—at a time when news coverage is at a fever pitch and many citizens are just starting to tune in. Some states such as Pennsylvania stop allowing people to register 30 days before an election.

Ten states and the District of Columbia enable residents to avoid such deadlines by allowing citizens to register to vote on Election Day. The group includes states as diverse as Wyoming to Wisconsin and New Hampshire to Iowa. In 2008 alone more than 1 million individuals registered on Election Day in these states.¹⁶²

Recent momentum has been building for Election Day registration. In 2012 both California and Connecticut passed Election Day registration legislation, coming on the heels of Iowa in 2007 and Montana in 2005.¹⁶³ Still, challenges remain. In 2011 Maine legislators tried to eliminate the state's 38 year-old Election Day registration law.¹⁶⁴ A petition drive forced the matter to a statewide referendum where voters overwhelmingly rebuked the move and reinstated Election Day registration.

Encourage young people to vote

Young Americans continue to vote at far lower rates than the rest of the citizenry. This year, for instance, half of the voting-eligible population between the ages of 18 and 24 cast a ballot, compared to more than two-thirds of senior citizens.¹⁶⁵

One simple way to ease the burden for young people and encourage them to

vote is for states to require public schools to facilitate registration on campus. Currently, at least 10 states either require public high schools and colleges to facilitate registration drives or to provide voter registration forms and accept completed applications.¹⁶⁶

Another way to help register younger voters is to allow for preregistration before the age of 18. These laws would allow teenagers to preregister when they are age 16 or 17 at their state registry of motor vehicles so they will be automatically added to the voting rolls once they turn 18. Currently, five states allow for preregistration at age 16, including Florida and Maryland, and two states, California and Oregon, allow for registration at age 17.¹⁶⁷ According to a study from George Mason University, preregistration programs are extremely effective at increasing voter registration.¹⁶⁸

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Reform the tax code so that it raises sufficient revenue fairly and efficiently

The Great Recession left state budgets in tatters. The recession resulted in huge budget deficits as states saw their revenues from taxes and other sources plummet. Even after the official end of the recession in June 2009, state revenue levels are still below prerecession levels. According to the Center on Budget and Policy Priorities, revenues were 5.5 percent below their prerecession level as of the first quarter of 2012.¹

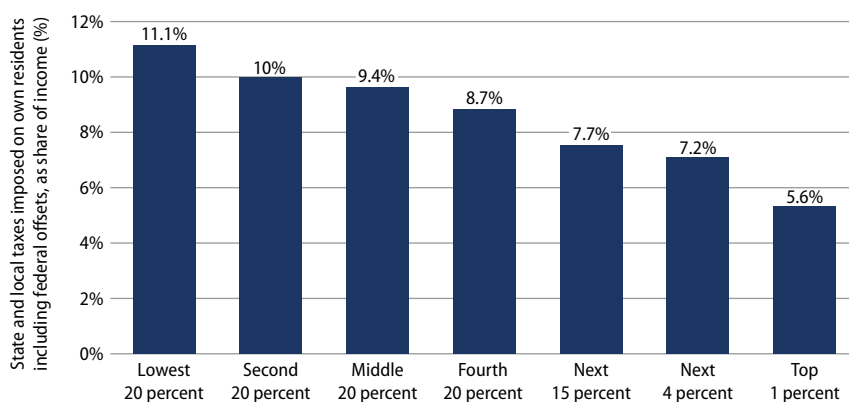
These persistently low levels of revenue resulted in state governments slashing government spending, reducing the provision of important services, and laying off thousands of government employees. Important investments in the future, such as education, suffered as state governments worsened the unemployment situation. Thirty-five states are now funding education at levels below spending levels in 2008.² Yet these types of forward-looking investments not only help state economies in the long term but also help prevent layoffs and even create jobs in the short term.

Additionally, as extensively documented by the Center for Budget and Policy Priorities, problems of insufficient revenue collection are further exacerbated by outdated state tax systems that fail to tax a multitude of services; budgeting processes that do not scrutinize all forms of spending—including programmatic expenditures made in the form of tax breaks; and insufficient state “rainy day” funds.³

FIGURE 3

The regressive nature of state taxes

State and local taxes hit poor and middle-class families hardest



Source: Institute on Taxation and Economic Policy, “Who Pays?: A Distributional Analysis of the Tax Systems in All Fifty States” (2013).

Beyond these collection problems, state revenues also come from regressive tax systems. In contrast to the federal tax system, where the wealthy generally pay a greater proportion of their incomes than do the middle class and the poor, state tax systems force those at the middle and the bottom to pay a greater share of their incomes than those at the top. According to the Institute on Taxation and Economic Policy, “even the least regressive states generally fail to meet what most people would consider minimal standards of tax fairness.”⁴ The regressive nature of state tax systems is largely due to a heavy reliance on sales taxes. Furthermore, the corporate income tax is raising less money than it did in the past. Corporate income taxes raised 10.2 percent of total state revenue in 1979, but that figure declined to 6.5 percent by 2005.⁵ This decline has taken place as corporate profits have risen by almost 80 percent over the same timeframe.⁶

State governments must reform their tax codes to ensure that everyone—including the wealthy and corporations—pays their share and that middle-class and poor families are not unfairly burdened.

Ensure that individual income tax systems are fair and produce adequate revenue

Background

Supermajorities of Americans believe that the U.S. tax structure favors the wealthy,⁷ and unfortunately the public is right. In states across the country, outdated tax structures and exemptions that favor the rich have allowed low- and middle-income families to shoulder an unfair tax burden and weaken the tax base of states.

The state income tax is the primary revenue generator available to state governments through which it's possible to tax wealthy residents at a rate higher than that of low- and middle-income residents. Sales and excise taxes and tolls and user fees all require low- and middle-income residents to pay a higher share of their income in taxes than those who are better off. And while state estate taxes are very progressive, they raise far less revenue. To achieve greater fairness in a state's tax code, it is critical that individual income taxes be more progressive to help balance the cumulative regressive effect of other state taxes and fees.⁸ But most state income taxes are not implemented in a way that makes the overall tax burden progressive.

In addition, updating the personal income tax is not only popular but it is also mathematically necessary for states to raise the revenue they need. For several decades America has witnessed a historic increase in income inequality. From 1979 to 2007 the wealthiest 1 percent of Americans saw their average real after-tax household income increase 275 percent, and the rest of the top 20 percent saw their income grow by 65 percent. The 60 percent in the middle experienced income growth of only 40 percent, while the income of the poorest 20 percent grew only 18 percent over those 28 years.⁹

Tax brackets and rates must reflect the fact that incomes are growing faster at the top.

Critics will claim that state policymakers will harm the economy and put their state at a competitive disadvantage by making income tax policies fairer. But analysis from the Institute on Taxation and Economic Policy discredits the idea that states can boost their economies by reducing or eliminating state income taxes, and demonstrates that in terms of the economic conditions of state residents, high-income-tax states are doing at least as well—if not better—than states without an income tax.¹⁰

Fortunately, states have many tools available to them to modernize their tax codes and to make them fairer and more effective at raising the revenue they need.

Set progressive income tax brackets

Many state individual income tax brackets were set many years ago at a time with far less income inequality, and are significantly out of sync with current income distribution. Today these states collect too much revenue from low- and middle-income taxpayers and too little from their highest-income households.

And although many states use graduated tax brackets, their systems do not achieve significant progressivity because the difference in the tax rate of the poorest and the most wealthy is quite small. States should achieve the greatest degree of fairness by having tax brackets with a wide margin between the lowest and the highest rates that reflect today's increasingly unequal incomes.¹¹

Maryland, for example, retained the same graduated bracket system—established in 1967—for 40 years. The state operated with three income tax brackets drawn to capture income above \$1,000, \$2,000, and \$3,000. But because the brackets were

bunched so narrowly, the state had an effective flat tax: Every resident who earned more than \$3,000 in taxable income was paying the same rate as Maryland's millionaires. In 2007 Gov. Martin O'Malley (D) proposed and the General Assembly approved three new brackets set at \$150,000 (\$200,000 for joint filers), \$300,000 (\$350,000 for joint filers), and \$500,000 to make the tax code more progressive.¹²

But given the degree to which states and localities depend on regressive forms of taxation, having progressive income tax brackets alone is not sufficient to achieve a tax system that is progressive overall.

California¹³ and Vermont,¹⁴ for example, have highly progressive income taxes but achieve a basically flat tax system overall when other taxes levied by the state are taken into consideration.¹⁵ For this reason, even states with fairly distributed income tax brackets should also consider adopting the reforms discussed below.

Create a millionaires' or high-income tax bracket

At the federal level the average tax rate paid by the very highest-income Americans is at near 50 year lows. The wealthiest one-tenth of 1 percent pay about a quarter of their income in federal income and payroll taxes today—according to a 2012 report from the National Economic Council—half of what they would have contributed in 1960.¹⁶ And at the state and local level, the top 1 percent spend approximately 8 percent of their income on state and local taxes while the bottom 99 percent spend nearly 11 percent.¹⁷ At the same time the incomes of the super rich have skyrocketed.

State legislatures should institute millionaires' tax brackets to ensure the richest residents pay their fair share.

Several states have updated their tax systems to reflect the fact that the wealthiest residents have captured an outsized amount of overall income gains. New Jersey, for example, taxes income of more than \$500,000 at 8.97 percent.¹⁸ And despite hyper-reluctance to raise taxes during a weak economy, a few states took some action on high-income taxes in 2012.¹⁹ In Maryland a special session of the legislature in May 2012 resulted in raising taxes on individuals with adjusted gross incomes of more than \$100,000 and couples with incomes of more than \$150,000—the top 14 percent of earners.²⁰ And in California voters approved a referendum to increase taxes on high-income taxpayers in the November 2012

elections.²¹ Income tax will increase 1 percent on households making \$500,000 or more a year, 2 percent on households making \$600,000 or more a year, and 3 percent on households making \$1 million or more a year.²²

Opponents often repeat unproven claims that passing high-income tax brackets will result in millionaires leaving the state. The Center on Budget and Policy Priorities demonstrated in a recent paper, “Tax Flight is a Myth,”²³ that household moves are rare, involving only 1.7 percent of Americans each year, and are usually attributable to other reasons like housing prices, job changes, climate, or age, rather than tax policy.

And the San Jose Mercury News recently found that the greatest number of millionaires per capita live in states with high-income tax rates for the wealthy, including California, New York, and New Jersey, while two-thirds of states with no income tax have fewer millionaires per capita than average.²⁴ Also, California retained its share of the super rich after passing its first millionaires’ tax in 2004, according to the same report.

Retain or restore a state estate tax or inheritance tax

State governments should use estate taxes—which are paid by taxable estates upon death—and inheritance taxes—which are paid by those individuals who receive gifts from estates—to help offset the regressive effects of the state property and sales tax. While estate and inheritance taxes make up only a small portion of state revenue collections and are paid by the wealthiest of state residents, they are one of the most progressive taxes and help reduce the transmission of concentrated wealth between generations.²⁵

Since 2001, however, many states that previously levied an estate tax are losing out on this source of revenue as a result of federal estate tax cuts. The tax cuts phased out a federal dollar-for-dollar tax credit against the estate taxes levied by states. The credit gave states an incentive to levy an estate “pick-up tax,” which was calculated to be exactly equal to the maximum federal tax credit.²⁶

Most states lost billions of dollars in “pick-up” revenue they had been receiving as a result of the phase out of the federal credit. To avoid losing that revenue, states are “decoupling” from the federal estate tax so that they can continue to collect taxes on estates or inheritances despite the lack of a federal credit.

According to Elizabeth McNichol, senior fellow at the Center on Budget and Policy Priorities, 22 states levy an estate or inheritance tax, including:

Fifteen states that levied pick-up taxes prior to 2001 retained estate taxes. Of these, twelve states— Delaware, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, North Carolina, Rhode Island, and Vermont — and the District of Columbia, decoupled from the federal estate tax law and continue to levy an estate tax that is the same or very similar to the earlier pick-up tax. Three states — Connecticut, Oregon, and Washington — replaced their pick-up taxes with estate taxes that are not tied to the federal tax.²⁷

States that have not already done so should restore their estate taxes by “decoupling” from the federal law or by enacting estate taxes that are similar in structure to the pick-up tax. In a few states, however, there are legal barriers to reinstating the tax. The constitutions of Alabama, Florida, and Nevada contain provisions restricting the amount of estate tax levied, and in California decoupling would require a referendum.²⁸

Tax capital gains at the same rate as wages

One of the most unfair features of the U.S. tax system is the fact that capital gains are often taxed at a much lower rate than wages. This often means that a wealthy person living off investments can pay a significantly lower income tax rate than low- and middle-income wage earners.

Tax-favored capital gains are heavily concentrated at the top. According to the Tax Policy Center, 47 percent of capital gains accrue to just the top one-tenth of 1 percent of the population.²⁹ And according to the IRS, in 2008, 12 percent of all capital gains went to just 400 of the highest-earning taxpayers, each of whom had an average adjusted gross income of \$202 million that year.³⁰

Unfortunately, a growing number of states have exacerbated the inequity in the federal tax code— which taxes capital gains at a lower rate than ordinary income—by passing their own tax cuts for capital gains income. According to the Institute for Taxation and Economic Policy, at least six states provide tax breaks for all long-term capital gains income—and many others provide tax breaks for gains from assets located within state boundaries.³¹ South Carolina’s 44 percent exclusion for all long-term capital gains income—the Institute on Tax and

Economic Policy found— cost the state \$115 million in 2010 and almost exclusively benefited the wealthiest fifth of state residents. Adding insult to injury, lower tax rates for capital gains do nothing to help a state's economy.³²

States should repeal these tax breaks and tax capital gains and dividends the same as ordinary income. Indeed, several states are beginning to reconsider tax preferences for capital gains. Rhode Island recently eliminated its preferential tax rates on capital gains, while Vermont and Wisconsin each reduced their capital gains exclusions.³³

Establish or improve a state earned income tax credit

States can help pull working families and children out of poverty, provide a valuable incentive for people to leave welfare for work, and ensure that low-income families receive fair tax treatment by establishing or strengthening a state-level earned income tax credit, or EITC.

The earned income tax credit—widely considered an effective poverty-fighting tax policy—provides low-income workers with targeted tax reductions.³⁴ The federal earned income tax credit lifted about 5.7 million people out of poverty, including about 3.1 million children in 2010.³⁵ The value of the federal credit varies with family income as well as with the number of dependents.

Yet in too many states, the working poor have significant state tax liability even if they have no federal liability.³⁶ States can help ensure that low-income families receive fair tax treatment by establishing a state-level earned income tax credit. Since taxpayers have calculated their federal earned income tax credit by the time they complete their state taxes, the state earned income tax credit is simple for eligible recipients to claim and easy for state tax administrators to track.

To date, 24 states and the District of Columbia have established such laws, according to the Center on Budget and Policy Priorities.³⁷

States that have an earned income tax credit should consider increasing the percentage of the federal credit that state taxpayers can claim. Vermont allows a taxpayer to claim 32 percent of the federal credit, Minnesota allows 33 percent on average, Wisconsin allows 34 percent for families with three or more children, and the District of Columbia allows 40 percent.³⁸

It is also critical that state earned income tax credits be refundable. This will strengthen the policy's ability to reduce poverty by giving families an income boost and ensuring that low-wage workers can afford to stay working. All but four of the states—Delaware, Maine, Rhode Island, and Virginia—that currently offer the earned income tax credit have made it fully refundable.³⁹

Reform the dependent care tax credit

The child and dependent care tax credit can be a key support for working families with children, since low- and middle-income families often spend an enormous portion of their budgets on child care. The federal government allows single, working parents and two-earner married couples to claim a nonrefundable credit to partially offset up to \$6,000 of child care expenses. Low-income families can claim up to 35 percent of the cost, and the credit percentage drops for higher-income earners.⁴⁰

Twenty-two states and the District of Columbia have a child care credit, and most model theirs on the federal program. Eleven states and the District of Columbia have nonrefundable credits, seven states have refundable credits, and four states have nonrefundable deductions.

States should make the dependent care tax credit fully refundable and use a sliding scale in order to target benefits to low-income families. Nebraska targets its tax relief very efficiently—the state allows low-income parents to claim 100 percent of their federal credit as a refundable Nebraska child care tax credit, and has a sliding scale that allows higher-income parents to claim 25 percent.⁴¹

Create a circuit breaker for homeowners and renters

State governments should create and expand “property tax circuit breakers” in order to provide relief to families whose property taxes are high relative to their incomes.

Property tax circuit breakers—which provide refunds from the state to residents whose property tax payments are deemed to be too great—are another effective, targeted tax break for low-income families.⁴² When a property tax bill exceeds a certain percentage of a taxpayer's income, circuit breakers provide rebate for all or a portion of the property taxes in excess of this level. This is often structured as an

income tax rebate or a rebate check, and one state, Maryland, structures its circuit breaker so that it is applied as a property tax credit against future property bills.⁴³

The Institute on Taxation and Economic Policy profiled state property tax circuit breaker best practices in its 2011 report “State Tax Codes as Poverty Fighting Tools.”⁴⁴ The best circuit breakers give homeowners and renters a credit equal to the amount by which their property tax bill exceeds a certain percentage of their income. Also, programs should be made available to all low-income taxpayers with a relatively high property tax burden—although many programs are targeted to senior citizens and the disabled.

Many states also extend their circuit breaker credit to renters since they pay property taxes indirectly through higher rents. Renters calculate their eligibility by assuming that their property tax bill is equal to a certain percentage of their rent—for example renters in Michigan may assume that 20 percent of their rent goes to property taxes for the purposes of calculating their circuit breaker eligibility.

Finally, the Institute on Taxation and Economic Policy recommends that circuit breaker programs must be paired with a successful outreach programs, so that eligible families take advantage of the credits.

Enact other targeted low-income tax credits

Because the earned income tax credit is targeted at families with children, it is much less helpful to older adults or families without children. States without a targeted low-income credit or no-tax floor as a complement to their earned income tax credit should pass such a policy, and states that already have one should consider expanding it or making it refundable.

New Mexico has enacted the Low-Income Comprehensive Tax Rebate, a refundable tax credit for households with a maximum income of \$22,000.⁴⁵ Ohio has enacted a nonrefundable credit that ensures that families with incomes of less than \$10,000 are not subject to state taxes.⁴⁶ Likewise, Kentucky has a similar nonrefundable credit to prevent families who live below the poverty line from paying state taxes.⁴⁷ Like the earned income tax credit, such credits are more effective if made refundable.⁴⁸

Other targeted tax credits include sales tax credits on groceries, which can help offset the regressive effects of sales taxes on low-income residents. They are usually administered as refundable state income tax credits available to taxpayers below a certain income threshold.⁴⁹ Idaho, for example, offers a \$90 refundable grocery credit for each qualifying resident and their dependents, and residents over age 65 receive an additional \$20 credit.⁵⁰

Reform the corporate income tax to prevent tax avoidance

Background

The corporate income tax is used to provide a sustainable, reliable revenue stream for the more than 40 state governments that have such a tax. Numerous research reports, however, suggest that this tax base has eroded as corporations have come up with an impressive array of strategies to minimize state income tax payments.⁵¹ In 1979 state corporate income taxes made up 10.2 percent of total state tax revenue. By 2005, however, that revenue source dropped to just 6.5 percent,⁵² although corporate profits rose by nearly 80 percent during that period.⁵³

Tax minimization strategies are used most frequently by large and multinational corporations and much less so by in-state, small- and medium-sized businesses.⁵⁴ Businesses operating in a single state, by definition, cannot use multistate tax avoidance strategies. And most small businesses have limited resources to invest into tax avoidance.

The effect of this tax avoidance means that state governments miss out on billions of dollars in lost revenue, and it forces states to either cut government services or raise personal income taxes, corporate income tax rates, or find other revenue streams to make up for the uncollected revenue.⁵⁵

The problem of tax avoidance is underscored by a 2011 report by Citizens for Tax Justice and the Institute on Taxation and Economic Policy that looked at 265 Fortune 500 companies. According to the report, if these companies had paid the 6.2 percent average state corporate tax rate on the \$1.33 trillion in U.S. profits that they reported to their shareholders from 2008 through 2010, they would have paid \$82.6 billion in state corporate income taxes. Instead they paid only \$39.9 billion, avoiding a total of \$42.7 billion in state corporate income taxes over just three

years⁵⁶—more than \$16 million per corporation with some of this difference due to corporate tax-shifting strategies and only some of it due to state tax incentives.

And a study by the Citizens for Tax Justice and Change to Win estimated that tax minimization by one large big box retailer alone cost states \$2.3 billion between 1999 and 2005.⁵⁷ Over those seven years, the retailer reported \$77.4 billion in pretax U.S. profits but reported a total state income tax bill of only \$2.4 billion, or 3.16 percent of its profits. The report found that if the company paid taxes at the statutory state corporate tax rates for the same period, it would have paid almost twice as much—\$4.7 billion.

States must aggressively crack down on tax avoidance strategies and update their state tax codes to keep pace with new tax avoidance approaches. They also need to increase enforcement of their corporate tax laws.

Pass combined reporting

Most multistate corporations are comprised of a parent company and any number of subsidiaries. These corporations commonly use accounting methods to shift income generated by a subsidiary in one state to a subsidiary in a state with no corporate income tax. Even more perverse is the existence of so-called “nowhere income,” which because of the interaction of poorly designed state tax codes with federal restrictions on what income states can tax, is income that’s allocated to “nowhere” and hence goes untaxed by any jurisdiction. The goal is to minimize the profits reported by subsidiaries in states with a corporate income tax.⁵⁸

Of the more than 40 states that have a corporate income tax, 23 states have now enacted combined reporting to end this corporate accounting shell game.⁵⁹ With combined reporting, corporations are required to report to the state their combined income, including parent companies and subsidiaries. The state then uses a formula to determine what percentage of the company’s overall profits will be taxed there, with that percentage based on the amount of real business activity in that state compared to other states.⁶⁰

Two states that have recently passed combined reporting laws are Vermont⁶¹ in 2004 and West Virginia⁶² in 2007. The AFL-CIO also has drafted model combined reporting legislation,⁶³ as has the Multistate Tax Commission, the intergovernmental state tax agency.⁶⁴

State corporate income tax laws should also include “throwback” rules to recapture for the state where goods are produced any taxes on the profits that cannot be collected by the recipient states.⁶⁵ To date, 25 states have enacted this rule.⁶⁶ The other states with a corporate income tax would gain revenue and improve fairness by enacting a throwback rule.⁶⁷

Increase disclosure of corporate taxes

A debate exists about the causes of the sharp drop in state collection of the corporate income tax over the last 30 years. Corporations frequently claim that they are simply taking advantage of incentives and other economic development strategies that state lawmakers have intentionally inserted into state tax codes to encourage business investment. Taxpayer advocates often argue that corporations are exploiting weaknesses and loopholes in state statutes.⁶⁸

One way to sort this out is for states to require company-specific corporate tax disclosure to give lawmakers the information they need to assess the effectiveness of their tax codes and their economic development incentives. The Center on Budget and Policy Priorities offers model language for corporate tax disclosure statutes.⁶⁹

Tighten rules on silent partners for S-corporations and LLCs

Certain business entities, including S-corporations, partnerships, and limited liability corporations, are not taxed because income flows directly to their partners, who are required to pay tax on the income. But often out-of-state partners do not report their earnings to all the states in which the partnerships earned profits, and states do not adequately check on whether each of these “silent” partners reported income to the state.

States should adopt rules to ensure that these out-of-state partners pay their fair share. Ohio, New Jersey, and New York have all tightened their rules on pass-through entities in recent years.⁷⁰

Reform the alternative minimum tax

Too often, large profitable corporations use tax avoidance to pay no state taxes at

all.⁷¹ At least 20 states and the District of Columbia address this problem by having a corporate alternative minimum tax, or AMT, though some set the minimum tax far too low.⁷²

Twelve states impose a minimum tax at a fixed amount,⁷³ ranging from \$20 in Idaho to up to \$100,000 in Oregon for companies with more than \$100 million in sales.⁷⁴ Other states, such as New Hampshire with its “Business Enterprise Tax,” take an alternative approach by requiring businesses to pay the higher of a tax calculated as a percentage of profit or a tax calculated on some other basis.

Decouple from the federal bonus depreciation tax break

A federal tax deduction, called bonus depreciation, allows businesses to claim 50 percent depreciation for certain business machinery newly placed in service.⁷⁵ President Obama recently signed an extension that revived this tax break for two additional years to help provide a temporary incentive to boost business investment. While this policy may benefit the national economy, as the Center on Budget and Policy Priorities argues: “there are no benefits to states from following suit.”⁷⁶

But since most states follow federal depreciation rules, those states stand to lose billions of dollars in revenue unless they decouple from the federal code regarding this rule.

As of April 2011, 18 states were on track to lose a combined \$4.6 billion over three state fiscal years unless they decouple. And according to the Center on Budget and Policy Priorities, states should decouple in such a way that the decoupling applies to any future change in federal depreciation rules beyond 2012.⁷⁷

Moreover, another 24 states and the District of Columbia could lose a combined \$10.8 billion⁷⁸ during the same timeframe if they altered their tax codes to conform to such federal changes. These states should ignore this federal rule change and remain decoupled.⁷⁹

Increase sales tax revenues and fairness

Background

Forty-five states and the District of Columbia levy a sales tax, and nearly all of them count on the sales tax to supply a major portion of their state budgets. State general sales taxes generated \$234.5 billion in 2007, making up an average of 31 percent of state revenue.⁸⁰

States began adopting sales tax policies 75 years ago when the American economy was dominated by manufacturing and the service sector was far smaller. Mississippi enacted the first state sales tax in 1930 with 23 others joining them by World War II. At that time, consumption of services was below two-fifths of all economic activity.⁸¹

Today, however, the consumption of services makes up a full two-thirds of the nation's economic activity.⁸² But state sales tax policy has not kept pace with the economic transition and most states raise far less revenue through the sales tax than they could because it is applied to the sale of tangible goods but not to the sale of most services.

A majority of states apply their sales tax to less than one-third of 168 potentially taxable services, according to the Federation of Tax Administrators.⁸³ Five of the 45 states with sales taxes impose them on fewer than 20 services.⁸⁴ This narrow application of sales tax to only a few services creates a tax structure that is overly complex, vulnerable to fluctuations as spending rises and falls, and is difficult to explain and understand. Moreover, the ability of states to raise sufficient revenues from the taxation of tangible goods has been further eroded by the increasing use of the Internet as a virtual marketplace.

As a result, many states are looking for ways to modernize their sales tax policies to tax more sales of services.⁸⁵

Pass a luxury tax

Although the sales tax is a regressive tax—since low- and middle-income taxpayers pay the same rate as the wealthy and spend more of their income—current exemptions of high-end services provide far more benefit to the rich than to the

rest of state residents. To counter this regressivity, policymakers should create a luxury tax for particularly high-end goods and services levied either as a surtax above a fixed amount—for example, \$50,000—or applied to specific high-end items such as yachts, furs, fine jewelry, or country club memberships.

The Connecticut General Assembly—as part of its larger sales tax reform effort—created a 7 percent luxury tax in 2011, which applies to cars that cost more than \$50,000, jewelry that costs more than \$5,000, vessels that cost more than \$100,000, and clothing items that cost more than \$1,000.⁸⁶

Crack down on Internet retailers that do not collect sales taxes

States should collect the sales tax they are owed and ensure a level playing field for local businesses by amending their laws to make online large retailers pay what they owe.

According to data from the National Conference of State Legislatures, states lost an estimated \$23.3 billion in sales tax revenue due to their inability to collect sales taxes from online retailers.⁸⁷ The Supreme Court ruled that states can only collect sales taxes from retailers with property, employees, or independent sales representatives in the state.⁸⁸

For years this meant state governments were not collecting sales taxes from most Internet retailers. Moreover, this loophole gives an advantage to online merchants whose goods appear to have a lower price than goods from local brick-and-mortar retailers.

Several states, however, have found a way to get these companies to collect sales taxes. New York passed an innovative law in 2008 that has become a model for other states. Many online retailers have “affiliate programs” where independent individuals or organizations post links on their websites to the retailer in exchange for some of the proceeds from the sale. The New York law states that these affiliates are third parties helping to “establish and maintain” a market for the retailer in the state.⁸⁹ Therefore, the retailer is subject to the state’s sales tax.

Several states have followed in New York’s steps, including Pennsylvania, Texas, and California.⁹⁰ These laws do not totally solve the problem of collecting sales taxes from online retailers—federal action is required for that—but they are an important first step.

Raise tobacco taxes and fund cessation programs

Background

Tobacco use is the leading cause of preventable death in the United States and is associated with 400,000 deaths of smokers annually—more than AIDS, alcohol, car accidents, illegal drugs, murders, and suicides combined. And another 50,000 people die annually due to illness attributable to secondhand smoke.⁹¹

In addition to the staggering human costs, tobacco use imposes a tremendous health care burden on state governments as well. Approximately 8.6 million Americans currently suffer from smoking-related illnesses. The Medicaid payments alone due to tobacco use cost \$30.9 billion annually—\$13.3 billion of which is borne by state governments.⁹²

Smoking is also estimated to cost the American economy \$97 billion in lost productivity from the reduction in work lives shortened by tobacco alone—and not including lost time to disability, sick days, or productivity declines while on the job.⁹³

States can save lives and reduce government costs by raising taxes on cigarettes and investing a significant portion of the revenue generated by these taxes into tobacco cessation programs.

Raise tobacco taxes

States should significantly hike tobacco taxes to save lives and reduce over time the massive economic and health care costs they incur from tobacco use.

Raising taxes on tobacco reduces smoking, especially among children. Economic studies have shown that cigarette taxes or price increases reduce both adult and underage smoking. In fact, the single-most reliable method for reducing consumption is to increase the price of tobacco products.⁹⁴ In general, for every 10 percent increase in the price of cigarettes, overall cigarette consumption drops by approximately 3 percent to 5 percent, the number of young-adult smokers drops by 3.5 percent, and the number of kids who smoke drops by 6 percent or 7 percent, according to research compiled by the Campaign for Tobacco Free Kids.⁹⁵

Moreover, states realize significant multiyear revenue increases following tobacco tax increases because the increase in per-pack revenue dramatically exceeds any decrease from reduced sales. Further, any drop-off in revenues from reduced use is dwarfed by savings from tobacco-related health care costs.⁹⁶

Also, Americans overwhelmingly support raising tobacco taxes according to public opinion polls. And in order to balance state budgets, voters prefer raising tobacco taxes to other tax increases or cutting government programs, such as education, health care, and public safety.⁹⁷

States should raise their per-pack tobacco tax as high as possible. Modest increases, such as less than 10 percent of the price of a pack, do not produce the deterrent effect, especially since cigarette companies can counter the impact of the tax increase with discounts, coupons, or other promotional strategies to maintain sales.⁹⁸ Also, states should raise the tax on all tobacco products—smokeless tobacco, roll-your-own tobacco, and little cigars—at the same time to prevent diminished outcomes due to cigarette smokers switching to other consumption methods.⁹⁹

As of October 2012, New York has the highest tobacco tax in the nation—\$4.35 per pack.¹⁰⁰ Research shows that the rate has helped New York cut adult and youth smoking by more than twice the rate of the rest of the nation between 2003 and 2010.¹⁰¹ New York's high cigarette tax, in combination with a comprehensive smoke-free air law and effective tobacco prevention and cessation programs, has reduced the number of adult smokers by 664,000, prevented 305,000 kids from becoming smokers, and prevented 265,000 smoking-related deaths. New York's smoking decline has also saved the state's budget \$11.6 billion in long-term tobacco-related health care costs.¹⁰²

Policymakers should consider when raising tobacco taxes that these taxes, like other sales taxes, are regressive. So while there is good evidence that higher taxes on tobacco discourage use and create other policy benefits, the majority of smokers will continue to use tobacco despite higher taxes, and research shows that low-income people will bear the brunt of the tax.¹⁰³ While we recommend that a significant portion of taxes be reinvested in state tobacco prevention and cessation programs, legislators could also consider using a portion of funds to fund or expand tax rebate programs for low-income families, as has been recommended by the Center on Budget and Policy Priorities.¹⁰⁴

Maximize revenue for prevention and cessation programs

States can realize even greater health benefits and multiyear cost savings by allocating a significant portion of any new tobacco tax revenue and more of their tobacco settlement funds to programs that prevent children from smoking and help smokers quit.¹⁰⁵

Antismoking education and cessation programs have been dramatically cut by states to fund other priorities—marking a major missed opportunity for states to save lives and lower health care costs. States promised in the 1998 Multistate Tobacco Settlement to allocate a significant portion of their settlement funds—\$246 billion over 25 years—for antismoking efforts. But in every state, those funds have been spent in other areas. Only 2 percent of those funds are now spent on antismoking efforts on average.¹⁰⁶

In some states the cuts are so severe that the Centers for Disease Control and Prevention has expressed concern that the states' antismoking programs are facing elimination.¹⁰⁷

States can reduce smoking and generate significant health care savings by dedicating more of their settlement funds and tobacco and cigarette tax revenues to antismoking programs.

States with the best-funded tobacco prevention programs during the 1990s—including Arizona, California, Massachusetts and Oregon—reduced cigarette sales by more than twice as much as the country as a whole, according to a 2003 study published in the *Journal of Health Economics*.¹⁰⁸ California—with the longest running prevention program in the United States—saw a reduction in adult smoking from almost 24 percent in 1988 when the California Tobacco Control Program was established to less than 12 percent in 2010.¹⁰⁹

The Centers for Disease Control offers best practice guidelines to states, including a community-based model to reduce youth smoking.¹¹⁰ They also offer recommended per capita funding levels for all 50 states,¹¹¹ which range from \$9.23 to \$18.02. Those levels represent the agency's estimate of what an effective, state-specific, and evidence-based tobacco control program would cost.¹¹² Only two states—Alaska¹¹³ and North Dakota¹¹⁴—currently fund antitobacco programs at or near Centers for Disease Control-recommended levels.¹¹⁵

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Stabilize the housing market, ensure affordable rental housing, and help rebuild communities affected by the foreclosure crisis

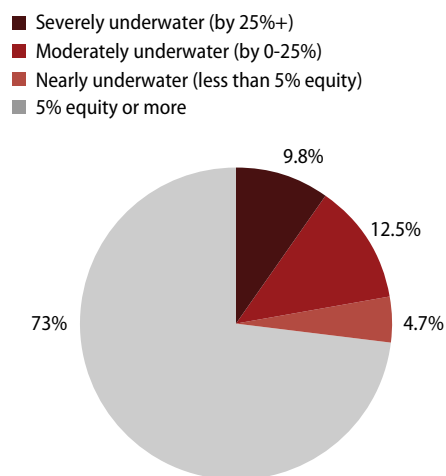
While the American housing market is starting to recover from the bursting of the housing bubble, the housing market is in a significant hole. The housing crash resulted in approximately \$7 trillion in lost household wealth—causing deep harm to families, as housing has long been the largest source of wealth for the middle class.¹ In addition to almost 4 million completed foreclosures, the crash in housing prices has also resulted in millions of households owing more on their mortgage than the value of their home. These “underwater” homeowners have seen their largest source of wealth evaporate and are left struggling with the aftermath.

Homeowners aren’t the only Americans being squeezed by the housing market. Renters are paying an increasingly larger share of their income toward housing as rental prices have skyrocketed and earnings have stagnated. Fully 18 percent of all American households are severely burdened—paying more than 50 percent of their income—but 27 percent of renters are severely cost-burdened, which is more than twice the rate for homeowners.²

Policies are needed to deal not only with the aftermath of the housing bubble but also with long-term problems in the housing market, both for homeowners and renters. Reforming the housing market will require action at the federal level but state governments can help address current housing problems while building the foundation for a more sustainable housing market and rebuilding communities.

FIGURE 4
Nearly one in four U.S. homeowners is “underwater”

Percent of mortgages by equity level, second quarter 2012



Source: CoreLogic, Second Quarter 2012

Prevent unnecessary foreclosures

Background

The foreclosure crisis has hit American homeowners hard: As of November 2012, banks and other financial institutions had completed approximately 4 million foreclosures since the financial crisis began in September 2008, with another 1.2 million home mortgage loans still in the foreclosure process.³ Earlier this year, Wall Street analysts predicted as many as 7.4 million to 9.3 million at-risk borrowers were yet to face foreclosure or liquidation.⁴

Moreover, the severe drop in home prices has placed between 22 percent⁵ and 28 percent⁶ of homeowners “underwater,” meaning they owe more on their homes than the homes are worth. These homeowners together owe approximately \$700 billion more than their homes are worth.⁷

Foreclosures are typically the least efficient economic outcome for homeowners and investors. The Department of Housing and Urban Development has estimated that median foreclosure “severities,” which is how much an investor loses, are more than \$75,000.⁸ Likewise, the typical foreclosure reduces the value of a house by 27 percent and costs borrowers up to \$7,000 in administrative costs alone.⁹ The costs of foreclosure also spill over into the local and state economies, reducing the value of neighboring houses, destroying consumer credit and purchasing power, and costing local governments billions of dollars in lost property taxes and increased expenses to fight crime and health hazards.¹⁰

For this reason, the prevention of unnecessary foreclosures—situations where the homeowner would like to stay in the home and has the capacity and willingness to continue to pay—is a critical goal for states.

Enact strong servicing standards

Mortgage servicers—companies that manage mortgages for the investors that own most loans in America and that process payments, handle modifications and foreclosures, and provide customer service to borrowers—have become notorious during the crisis for their incompetence and inability to handle the massive onslaught of delinquent borrowers. Servicers have not only failed to competently

serve borrowers but have also routinely falsified documentation about conducting reviews of the information used in foreclosure proceedings.¹¹ What's more, a misalignment of financial incentives means that when servicers act in their own interest, they are often working against the best interest of investors and homeowners. These problems and others have meant that servicers have failed to prevent a very large proportion of unnecessary foreclosures.¹²

New York state has passed exemplary rules requiring all servicers to engage in loss mitigation prior to foreclosure.¹³ Additionally, all servicers are required to have adequate staffing, methods to make sure homeowners only need to submit one copy of documents, and procedures for handling homeowner complaints and inquiries. Servicers may not move toward foreclosure if a homeowner is being considered for, or participating in, a trial or permanent modification, and they must act in good faith and communicate clearly and accurately with homeowners. The state also prevents servicers from placing insurance on a property without informing the homeowner.¹⁴

States should also consider other means to create strong servicing standards. States, for example, can require servicers to have a “single point of contact” for all customer communications so that customers are not shuffled from employee to employee when they have questions or concerns. States can also require servicers to disclose the test used to decide whether to let a homeowner fall into foreclosure—the net present value test—and require that all denied loan modifications receive independent review. Likewise, states can classify a servicer's failure to act in good faith as a defense against foreclosure.

Assist local entities in purchasing nonperforming loans and keeping homes occupied through Hardest Hit Funds or other programs

State policymakers should create or fund programs that purchase distressed or nonperforming loans and aim to keep homes occupied. These programs will prevent stakeholders from incurring the large costs of foreclosure, prevent homes from becoming vacant and contributing to blight, and help homeowners who can be saved remain in their homes.

To do this, states can help fund local entities that purchase mortgages from financial institutions with the explicit intention of avoiding foreclosure and keeping these homes occupied. The local entities would purchase loans at the prevailing

market price for distressed notes. These local entities would use principal reduction and refinancing to make mortgages more affordable, keeping the homeowner in their home when possible. Alternatively, when homeowners cannot keep their homes, the entities would use alternative foreclosure prevention techniques such as short sales or deed-in-lieu of foreclosure and then keep the home occupied.

A good source of initial funding is the Hardest Hit Funds awarded to states by the federal government.¹⁵ Additionally, other Housing Finance Agency funding could be used. These initial funds will continue to have an impact because as assisted homeowners continue to make payments and these loans are sold into the secondary market for mortgages, funds can be recycled to make successive rounds of mortgage purchases.

This type of program is already operating in the Chicago area in the context of a partnership called the Mortgage Resolution Fund.¹⁶ Enabled by an initial infusion of \$100 million from Illinois's Hardest Hit Fund, the Mortgage Resolution Fund purchases distressed or nonperforming mortgages with the intention of reducing principal and performing other modifications to keep homeowners in their homes whenever possible.¹⁷

The Mortgage Resolution Fund targets homeowners who are earning documentable income, are still living in their homes, and want to remain in them.¹⁸ Homeowners who have their mortgage purchased not only receive a chance to reduce their monthly payments and stay in their homes but also receive comprehensive credit counseling that teaches them about developing a sustainable, long-term household budget.¹⁹ Once homeowners have successfully completed counseling and made payments on their modified mortgage for 9 to 10 months, the modification is made permanent and sold on the secondary market; the recycled funds are then used to purchase more distressed or nonperforming mortgages.²⁰ For mortgages that cannot be successfully modified to keep homeowners in their homes, the fund works with community nonprofits to place other occupants in the homes and educates current occupants about foreclosure alternatives and transitioning to more affordable housing.²¹

Besides aiming to keep homeowners in homes whenever possible, the Mortgage Resolution Fund also aims to stabilize neighborhoods by targeting its purchases. The fund purchases only within communities that are low income, have low vacancy rates, have received neighborhood stabilization funds, and are in need of stabilization efforts.²² Initial estimates suggest the Mortgage Resolution Fund is effective: It

expects to be able to modify 60 percent of mortgages purchased—a much higher rate than private equity funds that have made similar purchasing efforts and have kept only about 20 percent to 25 percent of homeowners in their homes.²³

Require servicers to enter into mediation with borrowers before foreclosure

Experience has shown that there are few opportunities for homeowners and mortgage servicers to communicate during the foreclosure process—as a result, servicers often proceed to foreclosure with little or no contact with the borrower. What’s more, these foreclosures are occurring despite the fact that they are economically inefficient, suggesting that both homeowners and those who own mortgages have an interest in preventing foreclosure. In order to combat this problem, state policymakers should require servicers to enter into mediation with borrowers before foreclosure.

In foreclosure mediation, a neutral third-party mediator assists servicers and borrowers to reach a voluntary settlement in their foreclosure proceedings.²⁴ Mediation creates an opportunity for the parties to negotiate an outcome that is superior to foreclosure. It also provides a clear venue for borrowers and servicers to interact—a key step to combating the failings of many servicers in dealing with borrower requests.

Voluntary settlements can take the form of short sales, deed-in-lieu of foreclosures, cash for keys, negotiated departure date, or, commonly, loan modification. Not all voluntary settlements lead to borrowers staying in their homes but these settlements allow the parties to avoid evictions and lengthy foreclosure proceedings.

It is particularly important that states make foreclosure mediation mandatory, meaning that foreclosure mediations are automatically scheduled by a program administrator when the foreclosure process is initiated. The benefits of mandatory mediation are illustrated by Connecticut’s foreclosure mediation program. The Connecticut program initially required homeowners to opt in. Under this policy, approximately 20 percent of homeowners facing foreclosure participated. Since the end of 2009, however, participation has been automatic—homeowners now have to opt out if they do not want to participate. As a result of the change, nearly 75 percent of troubled homeowners have participated.²⁵

Furthermore, the mandatory program has proven remarkably successful at keeping homeowners in their homes. In the opt-in program, 12 percent of all home-

owners facing foreclosure were able to stay in their homes.²⁶ In contrast, with the mandatory program, 67 percent of mediations resulted in the homeowner staying in their homes, meaning about half of homeowners facing foreclosure were able to stay in their homes.²⁷

Expand the supply of affordable and sustainable housing

Background

Middle-class and low-income Americans face an affordability crisis when it comes to housing their families. According to the latest American Community Survey, 42 million households (37 percent of Americans) pay more than 30 percent of income for housing (moderate cost burden), while 20.2 million (18 percent) pay more than half (severe cost burden).²⁸ This problem is only getting worse: Between 2001 and 2010 the number of severely cost-burdened households climbed by 6.4 million.²⁹

The problem is even more severe for low- and moderate-income families who rent. Twenty-seven percent of renters are severely cost-burdened—more than twice the rate for homeowners—and only about a quarter of cost-burdened renters receive federal housing assistance.³⁰ Today there are 5.1 million more low-income renters than there are affordable rental units—more than double the shortfall observed in 2001. Of the affordable units that are available, more than 40 percent are occupied by higher-income renters.³¹ Nor are we creating more affordable housing: Nearly 3 of 10 units renting for less than \$400 in 1999 were lost from the stock a decade later.³² The problem has gotten so severe that in no state can a minimum-wage worker working a standard 40-hour work week afford a two-bedroom unit at fair market rent.³³

The crisis also has implications beyond the housing market. Unaffordable rents are depressing demand for goods and services. Lower-income families in unaffordable housing units spend 50 percent less on clothes and health care, 40 percent less on food, and 30 percent less on insurance and pensions compared to families in affordable units.³⁴

At the same time, there is an urgent need to increase the energy efficiency of our affordable housing stock, much of which was built in the late 1960s and early 1980s with only limited energy efficiency considerations in mind. Not only will

this benefit the planet but lower energy costs will also help lower-income tenants make ends meet or make owners of affordable housing more likely to preserve the units as affordable.

Given these challenges, state policymakers have an opportunity to create a housing market that works for low- and middle-income Americans by expanding our supply of affordable and sustainable housing.

Encourage the rehabilitation of vacant homes and land through land banking

Vacant and foreclosed properties have disastrous effects on neighborhoods, not only depressing property values but also fostering crime and creating health hazards. Moreover, leaving land and homes vacant misses an opportunity to collect property taxes and to put these resources to more productive use, such as in creating affordable housing.

In order to combat neighborhood blight and create more affordable, sustainable communities, states should pass laws to enable land banking and then fund land-banking projects.

Land banks are nonprofits or public authorities that acquire, manage, and develop vacant land and homes. Land banks are enabled by state laws that typically prescribe the forms that land banks take and the means through which land banks are funded and can acquire properties. Land banks typically focus on short-term ownership of land and homes, aiming to demolish homes or remediate these properties before they are sold to private developers for redevelopment.

States should focus on passing or modifying land bank legislation that enables flexible financing of land banks, and enables land banks to acquire properties in innovative ways.

To finance these efforts, state law should give land banks a stable source of financing, permit land banks to raise money on their own, and allow land banks to accept fees from banks and other entities to contribute to costs such as demolition and for upkeep and maintenance on properties the land banks do not formally own.

To facilitate acquisitions, state law should enable land banks to acquire properties through purchase; through transfers from banks, nonprofits, and other govern-

ment agencies; and through an expedited foreclosure process through which land banks can receive properties without sheriff's auctions.

Whenever possible, land banks should cooperate and coordinate with partners in the private sector and at all levels of government. Land banks should also have clear goals, including, whenever possible, a requirement that land be dedicated to affordable housing and in line with other planning priorities, such as sustainable urban planning and economic development.

Policymakers looking for an example of innovation in land banking can turn to Ohio and the experience of the Cuyahoga County Land Reutilization Corporation, or CCLRC. In 2009 Ohio updated its previous laws on land banks. The bill tasked land banks to work on a regional scale, gave land banks the ability to acquire foreclosed properties without appraisal or sale, and enabled land banks to fund themselves in the innovative ways mentioned above.³⁵

The Cuyahoga County Land Reutilization Corporation was able to take advantage of two rounds of federal Neighborhood Stabilization Funds and issue a \$9 million bond.³⁶ Likewise, the organization signed memoranda of understanding with municipalities within its jurisdiction to spell out the land bank's powers and priorities. Finally, the Cuyahoga County Land Reutilization Corporation entered into innovative partnerships with Fannie Mae, which sold low-value foreclosed properties to the organization and worked with banks, which not only donated foreclosed properties but also contributed to demolition costs.

Encourage affordable housing through inclusionary municipal zoning laws

States should pass laws that encourage municipalities and localities to zone a certain percentage of their residential units for affordable housing.

Today there are 5.1 million more low-income renters than there are affordable rental units—more than double the shortfall observed in 2001. And of the affordable units that are available, more than 40 percent are occupied by higher-income renters.³⁷

Given the high and rising cost of housing in many parts of the United States, governments have an interest in promoting affordable housing for working families who can't afford housing at the market rate. Many localities have implemented successful "inclusive zoning" laws that require a certain percentage of new housing

units to be rented or sold at an affordable rate or price. The vast majority of communities, however, have zoning laws that exclude or greatly inhibit the creation of rental housing affordable to the great majority of average working families.

State governments should encourage and even require inclusionary zoning in local communities. Massachusetts has been a leader in this area. Under chapter 40B of Massachusetts state statutes, local communities are required to have at least 10 percent of their housing stock meet affordability standards.³⁸ If communities do not meet this requirement, affordable housing developers can obtain a permit to build affordable housing through an override of local zoning laws, with an appeal before the state zoning board.³⁹ This provision allows developers to build affordable housing in areas previously zoned off limits by local governments. New Jersey also requires municipalities to provide a certain percentage of affordable housing, but the localities only have to submit a plan and the enforcement mechanism has weakened over time.⁴⁰

States should enact legislation similar to the Massachusetts model requiring communities to set aside, or allow, a certain portion of housing units for affordable housing. Under this model localities can adopt local zoning that encourages rental development in areas the municipality has determined are best suited. If a municipality continues to have exclusionary zoning, then the requirement would be enforced by developers who can override local zoning barriers, with appeals to a state-run zoning board.

Provide tax incentives to encourage the development of affordable housing units

States should target tax incentives to increase the development of affordable housing units.

Governments have an interest in encouraging the private sector to supply and operate affordable housing. Experience over decades has demonstrated that in many communities, without some sort of assistance from the public sector, private developers are unlikely to produce enough rental housing to meet demand.⁴¹ In order to be affordable to working families, rents need to be at levels generally below the rates charged by private, for-profit developers given the cost of producing and financing housing.

Property tax abatements are one way to potentially help alleviate these problems. While state governments should be careful to ensure that property tax abatements are not allowed to undermine the tax base, state leaders should consider allowing cities to use property tax abatements to reward developers that provide affordable housing—either by improving the targeting of existing tax incentives or by creating new ones.

Several states have programs that reduce tax burdens for affordable housing developments. Illinois, for example, provides for a reduction in property taxes depending upon the number of renters who use federal Section 8 housing vouchers. The program reduces the assessed value of the units leased to voucher holders by 19 percent therefore decreasing the landlord's taxes.⁴²

And New York state's 421a property tax abatement program—originally designed to spur all housing development—has recently been adjusted to encourage affordable housing development in high-cost areas as well. The program identifies high-cost zones in which private developers must construct at least 20 percent of new units as affordable to low-income households in order to qualify for the property tax abatement.⁴³ Reforms to the 421a program also added several requirements to the program including provisions requiring that affordable housing be built on-site and a prevailing wage be paid to workers who provide care or maintenance for buildings receiving benefits.⁴⁴ These tax abatements can last between 10 years and 25 years depending upon the location of the building and the number of affordable units.⁴⁵

Finance energy-efficient retrofits of multifamily properties

Roughly 6 million apartments, representing approximately 17 percent of the nation's stock of rental housing, are subsidized to serve low-income families. Most of this affordable rental housing was built with only limited energy efficiency considerations in mind. Energy retrofits of existing apartments can increase energy efficiency by 25 percent to 40 percent, leading to substantial savings in the affordable housing system—and in those cases where tenants are paying energy costs, more disposable income for lower-income families.⁴⁶ Moreover, these retrofits cost just \$2,000 to \$5,000 per unit.⁴⁷

There are, however, multiple barriers to such retrofits, particularly in the lack of targeted, efficient capital through loans, grants, or rebates that work with existing subsidized finance.⁴⁸ Consequently, some states are addressing the need for such financing with innovative programs such as Pennsylvania's Smart Rehab, which

has combined federal weatherization program funds with other grant and loan sources to retrofit multifamily housing developments that house lower-income individuals and families.⁴⁹ The Smart Rehab program has taken other innovative steps, such as securing foundation funding to train energy auditors. Current estimates suggest that the program will achieve an average reduction in energy costs of 25 percent to 30 percent and preserve 10,000 units of affordable housing over the next three years.⁵⁰

Help families access homeownership

Background

The foreclosure crisis and resulting credit crunch has hit middle-class and low-income homeowners hard. With so many families losing their homes, the U.S. homeownership rate has fallen from 69.2 percent in 2004 to 65.4 percent in the first quarter of 2012—the lowest level in 15 years.⁵¹ Creditworthy borrowers who want to buy a home face a difficult environment due to the lack of availability of credit: Lenders originated about \$505 billion in home purchase loans in 2011, compared to a peak of \$1.5 trillion in 2005.⁵²

Moreover, credit standards have gotten much tighter since the crisis began. In 2007 the average Fannie Mae-backed loan covered 75 percent of the home's value—meaning the borrower covered the other 25 percent through down payments and mortgage insurance—and went to a household with a credit score of 716. Last year's average loan covered just 69 percent of the home's value and the average borrower had a credit score of 762.⁵³

Expand down-payment and closing-cost assistance programs

Lack of savings for down payment has long been recognized as a key barrier to homeownership for lower-wealth families.⁵⁴ Similarly, a lack of savings makes it difficult to pay the costs of closing on a house—costs that can run from 3 percent to 6 percent of the home purchase price.⁵⁵

Fortunately, state policymakers can rely on a proven method for helping families achieve homeownership: down-payment and closing-cost assistance programs.

These programs assist borrowers with down payment and closing costs either through grants or loans. Typically, borrowers do not need to repay unless they rent or sell their home within a relatively short period of time or stop using it as their principal residence. Additionally, borrowers may be required to attend housing counseling classes to ensure they are educated about the responsibilities and risks of homeownership.

When designing or expanding down-payment and closing-cost assistance programs, policymakers should ensure the programs can only be used to offer safe mortgage products and explicitly forbid predatory loan features such as negative amortization, balloon payments, and seller-financed down payment assistance.⁵⁶ Additionally, in order to use public funds most efficiently, these programs should be targeted to low- and moderate-income borrowers.

Studies and experience have shown that down-payment assistance is an effective and safe tool to encourage low- and moderate-income borrowers to become sustainable homeowners. Research by the Federal Reserve Bank of Cleveland, for example, has shown that down-payment assistance is more cost effective at creating new homeowners than interest-rate subsidies.⁵⁷ Moreover, state policymakers have a model of an especially effective down-payment and closing-cost assistance program in Massachusetts' SecondSoft Program.⁵⁸

In the SecondSoft Program, borrowers receive financing for up to 97 percent of the first home's price; a 3 percent down payment is required, but only half must come from the borrower.⁵⁹ The home is paid for with two loans: The first loan is a conventional, 30-year, fixed-rate, fully amortizing loan. The second loan, which finances 20 percent of the price, is a fixed loan and carries a fixed rate but only requires interest payments for the first 10 years, keeping the costs to the borrower down while the borrower builds equity in the home through the first mortgage. Borrowers must have low or moderate income and must also complete a pre-purchase education class.

In its two decades of existence, the SecondSoft program has used a small public subsidy to finance \$2.5 billion in lending and help more than 15,000 borrowers buy their first home—between 10 percent to 20 percent of all eligible households statewide.⁶⁰ Furthermore, the SecondSoft program has done nothing to increase the likelihood of default: SecondSoft loans have a serious delinquency rate (90-plus days delinquent or in foreclosure) below that of prime loans in Massachusetts, and as of fiscal year 2010, the program had a default rate of just 3.4 percent since its inception.⁶¹

Protect tenants during foreclosure

Background

The foreclosure crisis has not exclusively affected homeowners: Tenants living in rental properties also face eviction when their building goes through foreclosure. In an effort to protect the rights of tenants, Congress passed the Protecting Tenants at Foreclosure Act of 2009. The act states that new owners of a property cannot require tenants to vacate until the conclusion of their prior lease, or for at least 90 days after they are notified—whichever is later.⁶²

While the Protecting Tenants at Foreclosure Act is an important step toward safeguarding tenants during foreclosures, numerous problems remain:

- The tenant protection act has no regulatory mechanism at the federal level, and enforcement at the state level has not been consistent.⁶³
- Despite the fact that renters have very different rights in a foreclosure than homeowners, few advocates are aware of local laws in these situations.⁶⁴
- The act will expire on December 31, 2014, and few states have enshrined the protections in the act in their state law.⁶⁵
- The act fails to address many abuses tenants face during foreclosure—for example, it does not prohibit eviction of some or all tenants without “good cause” or require that tenants be notified about their rights before foreclosure occurs.

By taking proactive steps detailed below, however, states can address these problems.

Enforcement of the protections in the Protecting Tenants at Foreclosure Act has not been consistent or strong. Many “notices to vacate” violate the law; tenants are sometimes given misleading “cash for keys” offers, in which tenants accept a payment to vacate quickly without being told they have the right to stay; and some owners make no effort to communicate with tenants or determine whether the properties are occupied.⁶⁶

Enforce, strengthen, and make permanent the Protecting Tenants at Foreclosure Act

Because the Protecting Tenants at Foreclosure Act expires in 2014, states should adopt its protections into state law. Maryland has incorporated these tenant protections into state law without a sunset date.⁶⁷ If necessary, a state should include provisions permitting enforcement by state agencies. Maryland's other efforts worth replicating include requiring that tenants be notified before foreclosure occurs about their rights, and that their property may fall into foreclosure.⁶⁸ Additionally, Maryland requires that tenants receive timely notice of who owns their rental property after foreclosure and how to pay rent.⁶⁹

Another exemplary state when it comes to tenant protection is Connecticut. Its Office of the Attorney General worked with legal service attorneys to send “cease and desist” letters to more than 30 violators of the law’s protections.⁷⁰ Connecticut also prohibits eviction of elderly or disabled tenants living in multifamily properties without “good cause” such as failure to pay rent or violation of rent terms, meaning that foreclosure is not sufficient cause for eviction.⁷¹

Finally, states should pursue public education and outreach efforts to ensure that tenants understand their rights.

Use National Mortgage Settlement Funds to support housing

Background

In February 2012 federal prosecutors and 49 state attorneys general finalized the National Mortgage Settlement with the nation’s five largest mortgage servicers. In addition to other payments, \$2.5 billion of the settlement involves direct payments to states, which states can decide how to spend.⁷² The settlement agreement specifies that this portion of the settlement (\$2.5 billion) is intended to “compensate the States for costs resulting from the alleged unlawful conduct of the Defendants”⁷³ by giving them funds for “purposes intended to avoid preventable foreclosures, to ameliorate the effects of the foreclosure crisis, (and) to enhance law enforcement efforts to prevent and prosecute financial fraud.”⁷⁴

Yet many states are using their settlement money to fill their budget gaps rather than to revive ailing communities and support the housing recovery. So far, only 23 states are using substantially all of the money on housing-related initiatives, while five are using none of their award on housing. States have announced plans to spend \$977 million on activities related to housing and foreclosure prevention. They will divert \$989 million to states' general funds for nonhousing initiatives,⁷⁵ and \$588 million of settlement money is still uncommitted.⁷⁶

State policymakers should use as much of the settlement money as possible on housing-related issues. And while it may not be possible to recover the money that has been diverted for other uses, states should at a minimum use the remainder of the state's uncommitted money to revive the housing market, prevent unnecessary foreclosures, and help struggling communities. Below are some suggestions for how states can use the settlement money.

Provide housing counseling

Housing counselors provide education, training, and technical assistance to prospective and current homeowners and renters. Research shows that housing counseling benefits both homeowners and lenders. Prepurchase housing counseling can reduce delinquency by 19 percent up to 50 percent,⁷⁷ and postpurchase counseling not only doubles the likelihood that homeowners will get a loan modification but also improves the terms they get on that modification.⁷⁸ Given its effects in reducing defaults and preventing foreclosures, housing counseling is important both for our economy's recovery and for a future sustainable housing market.

Typically, the cost of housing counseling ranges from \$500 to \$1,500.⁷⁹ Given the magnitude of funds from the settlement, states have an opportunity to provide counseling to many prospective homeowners.

Fund legal aid

Nonprofit legal aid groups are increasingly strapped for cash at a time when they are needed most. The Brennan Center for Justice reports that fewer than 15 percent of borrowers in foreclosure in some communities had any legal counsel.⁸⁰ Legal aid is an often underfunded and ignored piece of the housing puzzle that is essential for helping underprivileged communities deal with the housing crisis.

While the services offered are often similar to housing counseling, legal aid advocates see a different community of clients, and they can also help clients pay for their mortgages by ensuring that the homeowner is paid wages appropriately and can access any public benefits for which they are eligible.

Encourage principal reduction

State policymakers have an opportunity to devote settlement funds to a proven technique to reduce defaults and prevent unnecessary foreclosures: principal reduction. Principal reduction lowers the amount of the loan in exchange for a greatly increased chance of repayment.⁸¹ Recent research suggests that loan modifications that include principal reduction not only maximize value for lenders⁸² but also lead to far lower rates of default.⁸³

Two good examples of using state funds for principal reduction are the Nevada and California Hardest Hit Fund programs. In California the Housing Finance Agency is using those funds to target delinquent homeowners. The program reduces principal on Fannie Mae and Freddie Mac loans, after which the borrower's loan is recast at the lower principal balance, making the monthly payments much more affordable and restoring homeowner equity.⁸⁴ Nevada's Housing Division is using those funds to assist deeply underwater homeowners who have remained current on their mortgage payments. In that program the state's housing division reduces principal balances for homeowners with Fannie and Freddie loans who qualify for the Home Affordable Refinance Program, or HARP, thereby enabling them to refinance into a loan that has both a lower interest rate and a lower principal balance.⁸⁵

Principal reduction, as one of the most effective ways to prevent default and right-size underwater mortgages, should be a centerpiece of any housing plan for National Mortgage Settlement funds. Unfortunately, only four states have reported plans to use settlement money for loan modification programs.⁸⁶

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Improve the quality of education for all students

An educated workforce has long been at the heart of American economic success. The American public school system was one of the first to focus on providing a high school education to all children and programs such as the G.I. Bill and Pell Grants have helped expand access to college. These policies helped build the greatest middle class the world has ever seen.

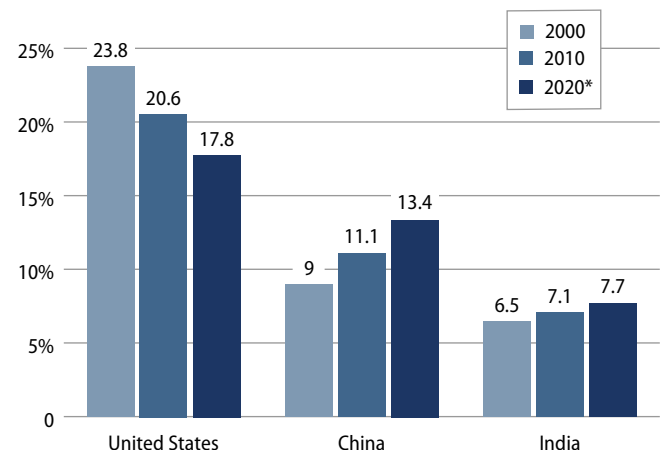
The United States, however, is no longer a world leader in terms of education, as our high school students score poorly compared to other countries and our college graduation lead has evaporated. Unlike many other advanced economies, the United States does not offer universal preschool. This gap in education means that many young children do not have access to organized learning activities before age 4, although 85 percent of core brain development happens before this age.¹ Our K-12 education system is also failing students due to inequitable funding and teachers who lack support and adequate training while students have too little time in the classroom. Likewise, our higher education is in need of reform as the price of tuition continues to rise, completion rates for bachelor's degrees stagnate, and student debt reaches troubling levels.

States can't reform the educational system top to bottom by themselves but they can take significant steps at all stages of the education system.

FIGURE 5

Share of the world's college graduates

Comparing the United States, China and India, 2000 to 2020



Source: Donna Cooper, Adam Hersh, and Ann O'Leary, "The Competition that Really Matters: Comparing U.S., Chinese, and Indian Investments in the Next-Generation Workforce" (Washington: Center for American Progress and Center for the Next Generation, 2012)

Establish high-quality child care and preschool for all

Background

High-quality early care and education is essential for all American children, without which children can suffer learning deficits that can last a lifetime.

Eighty-five percent of core brain development happens before age 4, establishing the foundation for a child's future health, education, and well-being.² Numerous studies show that children who have access to high-quality early education are more likely to have greater cognitive development³ and develop foundational social skills—including persistence, dealing with frustration, paying attention, and working well with others—that are the basis for later learning.⁴

Early care and education can also overcome the disadvantages associated with poverty. Research shows that an at-risk child with no access to early education is 25 percent more likely to drop out of school; 40 percent more likely to become a teenage parent; 50 percent more likely to be placed in special education; 60 percent more likely to never attend college; and 70 percent more likely to be arrested for a violent crime.⁵

For those reasons, high-quality early care and preschool is a highly efficient economic investment for federal and state governments. The economic return on investment in early education routinely exceeds the payoff for remedial investments aimed at older children. As Nobel laureate James Heckman explains, “The returns to human capital investments are greatest for the young for two reasons: a) younger persons have a longer horizon over which to recoup the fruits of their investments, and b) skill begets skills.”⁶

Improving early education is one key strategy for the United States to maintain its economic leadership. By 2020 China will provide 70 percent of its children with three years of preschool. India also plans to increase the number of children entering school ready to learn from 26 percent to 60 percent by 2018.⁷

During the last decade, states poured significantly more resources into early childhood education. States doubled their investment in pre-kindergarten from \$2.4 billion in fiscal year 2002 to \$5.4 billion between 2001 and 2010,⁸ and nationwide enrollment passed 1 million children.⁹

Yet too few American 3- and 4-year-olds have access to early education and in too many states, the programs that are available do not reach adequate educational quality. In 2011 only 4 percent of 3-year-olds and 28 percent of 4-year-olds nationwide were enrolled in early education programs,¹⁰ and many states facing budget deficits cut funding for pre-K programs in 2011.¹¹

And state investment in early care and education for infants and toddlers lags even further behind spending on preschoolers, resulting in a serious shortage of affordable, quality infant and toddler programs in most states.¹² Young, working families often find it near impossible to obtain reliable, high-quality and affordable infant and child care. Families are often forced to pay far more than what is affordable in order to provide care for their children and in 2012, 23 states either turned away or placed working families eligible for government assistance to pay for child care on waiting lists.¹³

It is critical that states return to the growing investments of the previous decade as state budgets continue to recover from the recession. And it is equally important that they apply the lessons learned from the states that are operating the most successful child care and pre-K programs.

Convert states to an integrated birth-through-12th-grade education model

Although the majority of brain development occurs before age 4, for decades our dominant school model has begun teaching children only after age 5. States, with support from the federal government, should move from a K-12 school model to a pre-K-12 school model, and work to make voluntary pre-K available to all 3- and 4-year-olds. States should also ensure that their pre-K programs are smoothly integrated with the broader early care and education system for children from birth through age 5.

Thirty-nine states have established state pre-K programs, but enrollment varies substantially. Florida (76 percent), Oklahoma (74 percent), and Vermont (67 percent) had the largest percentages of 4-year-olds enrolled in state pre-K programs in 2011.¹⁴ And New Jersey, Connecticut, and Oregon top the list in terms of state spending per child, all spending more than \$8,000 per student.¹⁵

Moving to a universal and integrated pre-K model will require new investments in public school systems to create preschool programs, but it will also require better coordination of early childhood education programs to build on the early learning gains for children enrolled in high quality child care. Administration of local

Head Start programs, for example, should move to the state level. States should prioritize an integrated approach to early care and education for children from birth to age 5, which recognizes the needs of working families for full-day, full-year services, and which improves early experiences for children of all ages.

To ensure that the early gains that children make in preschool are supported and enhanced as children transition to kindergarten and the early grades, states' expanded pre-K programs should be operated by school districts, or by community providers in partnership with school districts, where districts have a comprehensive plan and system of continuity. Research, for example, attributes the Head Start “fade out” effects—that is, how the cognitive benefits disadvantaged students gain from attending preschool often “fade out” within the first years of elementary school—documented among black children to the poor quality of schools that they disproportionately attend.¹⁶ The coordination between pre-school and K-12 school systems, therefore, is critical.

Boost the accessibility and affordability of quality infant and child care

Too often working families with young children struggle to find high-quality and affordable child care. Child care assistance can help working families with the cost of child care. But in 2012, 23 states either turned away eligible children or placed them on child care waiting lists.¹⁷ Less than one out of every five children potentially eligible for child care assistance received support.¹⁸ And although the U.S. Department of Health and Human Services recommends that parents spend no more than 10 percent of their family income on child care,¹⁹ the cost of center-based care for an infant exceeds 10 percent of state median income for a married couple in 40 states and the District of Columbia.²⁰

Meanwhile, the child-care and early-learning workforce—which remains a key career opportunity for many women—is among one of the lowest-paying fields.²¹ This not only hurts the early care workforce, but when worker turnover rates are high due to very low wage rates, access for working families is reduced. And most early care and early learning providers do not have access to one of the primary means available to moving into the middle class—meaningful access to union representation.

In order to build a more accessible and affordable early care and learning system, child care assistance should be expanded to serve all needy children—not the less

than 20 percent of potentially eligible children who are currently served²²—and early care and learning teachers should earn family-sustaining wages.

Even in tough economic times, states are experimenting in a number of ways to expand access to child care and raise the quality of early care and learning positions. State governments should pursue strategies to create incentives for teachers to pursue further education, as well as supplementing pay and strengthening workers' voice on the job.

North Carolina's TEACH Early Childhood Project, for example, was created in 1990 to improve the training, compensation, and turnover of their early childhood educator workforce. The program, which has now spread to 21 other states and the District of Columbia, offers scholarships to early education teachers who want to get an associate or a bachelor's degree in early childhood development.²³

In Washington the state government partnered with child care centers to establish the Washington State Early Childhood Education Career and Wage Ladder in 2000. Under the program, participating centers agree to a career and wage ladder where teachers are compensated based on education and experience and the state supplements these wages.²⁴ Research by Washington State University finds that the program has improved quality of care, encouraged additional teacher training, reduced teacher turnover among newly hired staff, and increased teacher morale.²⁵ Other wage supplementation strategies employed by states include North Carolina's Child Care WAGE\$ project, which provides salary supplements directly to low-wage teachers, directors, and family child care providers working with children from birth to age 5.²⁶

States can also support the early childhood workforce by giving child care providers and teachers a voice at work. Research shows that where providers have reached collective bargaining agreements with the state, they have gained many benefits that stabilize the workforce and improve the quality of services.²⁷ Such an investment will not only serve to recruit and retain the best providers but will also provide children with quality services.

Establish consistent learning standards

Learning standards are fundamental to every educational program. In early education these standards establish what each child can and should be learning, including academic, social, and emotional skills.²⁸ All 50 states and the District of Columbia have standards for pre-K, but they differ widely.²⁹

States should align their pre-K standards with the Common Core State Standards, which are state-developed standards for reading and math in grades K-12 that 45 states have voluntarily chosen to adopt.³⁰

A handful of states are working toward this goal. The Maryland State Department of Education, for example, brought together educators from across the state to develop pre-K benchmarks in reading and math that used the K-12 Common Core State Standards as a reference point.³¹

Close the gaps in universal developmental screening

Early developmental screening that leads to assessment and effective intervention is inconsistently used by early childhood education and care programs. Delayed or absent screening means children with developmental disabilities are identified much later than they should be, making it more difficult to address their conditions.³² The Centers for Disease Control and Prevention estimates that 1 in 6 children suffer from developmental disabilities—and that number is rising—yet only a fraction of these children receive early intervention services.³³

States should close the gaps in universal developmental screening across all state-supported early learning or care programs. They need to be especially attentive during the screening of children whose first language is not English, and use uniform home language assessments, both to identify actual developmental disabilities and to guard against the overidentification of disabilities among dual-language learners.³⁴

Washington state is implementing a program that aims at universal development screening with the goal of supporting each child's development and helping to reduce the kindergarten readiness gap. Through a partnership between the state's department of early learning, department of health, and private companies, Washington is instituting a program that would initially focus on providing universal development screenings for children from birth to age 3.³⁵ The screenings will be accessible through many venues and the program will work to break down cultural barriers so that all children can receive necessary screenings.³⁶

Strengthen K-12 education

Background

Few issues are more important to strengthening America's middle class than our ability to strengthen our K-12 education system. In order to make it into the middle class, American students must graduate with the knowledge and skills to get a good job and move on to postsecondary training. Also, the nation's economy depends on our schools to create a skilled workforce that can compete for jobs in a global economy. Yet too many public schools are failing their students.

Students should be able to succeed no matter where they go to school. Yet public school quality varies tremendously within states and school districts. Too many public schools are not succeeding due to inequitable funding, teaching staff with insufficient training and support, and the lack of time spent on high-quality instruction. As a result, student performance suffers, teachers churn through schools, and dropout rates climb—and too many children leave high school unprepared.

Too often it is African Americans, Latinos, Native Americans, English language learners, students with disabilities, and low-income students who attend these failing schools. Many of these students scored about two grade levels behind their more advantaged peers on national reading and math assessments in 2011.³⁷

And American students are falling behind our global competition.³⁸ A 2009 study found U.S. teens ranked 25th out of 34 nations in math, while Shanghai's (China) teenagers topped the list.³⁹ And just 6 percent of U.S. students performed at an advanced level on an international exam administered by 56 nations in 2006, lower than students from 30 other nations.⁴⁰ While U.S. schools have seen some improvements in recent years, many other nations are making gains at a much faster rate. A recent study by Harvard University's Program on Education Program and Governance found that Brazil, Latvia, and Chile are making gains three times faster than American students, while many other countries were gaining twice as rapidly.⁴¹

While school reform debates often divide progressives, reform-minded policymakers, administrators, and teachers' unions are collaborating across the country to improve educational outcomes for all students.

Ensure equitable funding to poor jurisdictions

States must put an end to persistent school funding inequity that often leaves students from high-poverty districts without the resources they need to succeed in school. Too often, state and local funding of public schools entrench rather than alleviate existing disadvantages.

Local funding—generated primarily through property taxes—allows property-rich districts to raise far more support for their schools than property-poor areas. About 40 percent of school funding is generated at the local level across the country,⁴² but in states such as Illinois and Nevada, this number is about 60 percent.⁴³

And although state tax revenue is supposed to ameliorate this inequality and provide increased funding for high-need districts, too often states fail to target state funding based on need, causing funding gaps to remain. In some cases state funding distribution methods may even exacerbate inequity in resources by providing state funding to the communities with the least need, according to a recent Center for American Progress report by Rutgers University’s Bruce D. Baker and New York University’s Sean P. Corcoran.⁴⁴ As a result, in 39 states, differences in per-pupil funding across districts still range by more than \$1,000.⁴⁵ To be sure, funding inequality cannot be blamed for all the problems of struggling schools, but failing to provide schools with the resources they need means that low-performing schools, which are often high poverty, may find it challenging to adopt necessary reforms.

In order to provide equal opportunity to students in high-poverty schools, state legislatures should adopt a state-centralized system of financing that allocates funding based on student need that all but eliminates local funding of schools, as Cynthia Brown, Vice President for Education Policy at the Center for American Progress, advocates for in an upcoming book.⁴⁶ School districts would be prohibited from raising more than 10 percent in additional funds. Admittedly, this would be costly and politically difficult and would require significant commitment by the state government to provide sufficient aid to back-fill local contributions. Yet some states have already undertaken this approach. Local revenues generate only 3 percent of public school funding in Hawaii, which has a state centralized system, and 8 percent in Vermont.⁴⁷

At a minimum, states should implement progressive funding formulas that allocate resources through a weighted student funding system that takes into account

student needs and the local district's capacity to meet those needs. Such systems ensure the districts that spend the most are those with the greatest student needs.

States that have adopted more equitable systems of public school funding have seen results in the classroom. In New Jersey, for example, after lawmakers adopted a more equitable funding system, test scores improved and the achievement gap narrowed. Between 2003 and 2007 all New Jersey students improved their fourth-grade reading scores, and the gap between African American and white students continued to narrow through 2011. On eighth-grade math, all students in New Jersey improved between 2003 and 2011 and achievement gaps were narrowed for African American (but not Latino) students versus white students.⁴⁸

Build teacher capacity

To improve teacher quality there are a number of strategies states should pursue including:

- Strengthening professional development
- Mentoring opportunities and evaluation of teachers
- Encouraging school districts to collaborate with teachers and their representative unions when developing and implementing performance pay programs and incorporating these pay systems into comprehensive strategies to improve teacher effectiveness

Oklahoma, Nebraska, Ohio, and Indiana have passed new laws to encourage school districts to engage in various forms of compensation reform.⁴⁹ And at least 19 states have some type of performance-pay law on the books.⁵⁰

But too often these programs are treated as simply a bonus for increasing test scores rather than being incorporated into comprehensive efforts to build teacher efficacy and don't involve teachers in the development of performance metrics or programmatic design. This inhibits teacher support for these programs and reduces the likelihood that these pay programs will improve school performance.

The federal government has offered a model—the competitive Teacher Incentive Fund Program—to incentivize districts to develop performance-based compensation reforms that are linked to improvements in classroom instruction and student achievement, and are tied to high-quality educator evaluation and support

systems. Some states are using the experiences of their Teacher Incentive Fund grantees to pilot various components of their statewide educator evaluation and support systems. States can expand the use of performance-based compensation through similar incentive grant efforts.

For these efforts to have any chance of success, however, they must be sited within comprehensive human resource management systems that consider district recruitment and program needs, are tied to educator effectiveness based on student achievement (not seniority and degrees), provide for greater differentiation of teacher roles, and recognize additional responsibilities as well as service in high-need schools and subjects. These incentive grants to districts would require collaboration with teachers and their unions to create, implement, and sustain these new systems. State laws that do not align educator performance based on student outcomes and compensation policies should be revised.

Several individual school districts—including districts in Colorado, Maryland, Pennsylvania, and Ohio—have collaborated with unions to develop and implement more comprehensive performance-pay partnerships. In these districts teachers are being rewarded for improving student performance, taking on additional master/mentor responsibilities, and teaching in schools that are especially difficult to staff.

In a report for the Center for American Progress, “Partnering for Compensation Reform: Collaborations Between Union and District Leadership in Four School Systems,” journalist Meg Sommerfield profiles four school systems that have created successful differential-pay systems through collaboration with teachers unions, especially the American Federation of Teachers, finding that these programs shared several common elements, including:

- A history of trust between administrators and union leaders
- A focus on joint problem solving
- A significant amount of teacher input
- A complete approach to building teacher capacity with accompanying efforts to change the way teachers are recruited, trained, developed, and evaluated
- Voluntary teacher participation
- Flexibility in program design⁵¹

Also at the local level, school districts in California, Florida, New York, Minnesota, and Ohio are partnering with local unions to enhance the level of detail in teacher evaluations, and ensuring that teachers have a role in determin-

ing review criteria and evaluating their peers.⁵² A Center for American Progress report, “Reforming Public School Systems through Sustained Union-Management Collaboration,” by Saul A. Rubinstein and John E. McCarthy at the Rutgers University School of Management and Labor Relations, finds that these collaborative efforts have allowed school administrators and teachers’ unions to find collaborative solutions to improve student achievement and teacher quality.⁵³

To receive flexibility through the waivers provided by the U.S. Department of Education from certain provisions of the No Child Left Behind Act, states are required to engage diverse stakeholders, including educator unions, in the planning, development, and implementation of new systems of educator evaluation and support.⁵⁴ In response, most states have included union representatives on statewide advisory committees, councils, and taskforces. In many states, new reform legislation has been the culmination of thoughtful discussion between state leaders and the leaders of state teachers’ unions and other key stakeholders. In some cases, for example in Michigan, this is a requirement of state law.⁵⁵ And at the local level, teachers and school administrators and school districts have worked with local unions to develop teacher evaluations that are aligned with the state evaluation framework. Recently, this reform was enacted in New Haven, Connecticut.⁵⁶ And in New York, school districts must bargain with their unions over the selection of student achievement measures for the evaluation systems.⁵⁷

Begin improving teacher recruitment and retention by obtaining firsthand feedback

Improving educational outcomes requires recruiting and retaining strong teachers. Yet approximately one-third of new teachers leave the classroom within the first three years, and as many as half leave after just five years, according to Richard Ingersoll, a professor at the University of Pennsylvania.⁵⁸ National surveys uncover that unsatisfied teachers often report too little preparation time, heavy teaching load, poor salary and benefits, and a lack of input into factors that affect teaching and student achievement.⁵⁹

States can improve teacher satisfaction, better understand how to recruit new teachers, and retain existing ones by surveying educators about workplace conditions and responding to their concerns. Research shows that when teachers’ needs are met, they are more likely to stay on the job and student achievement increases.⁶⁰

In 2002 North Carolina became the first state to survey its teachers on their experiences and working conditions. By 2008, 87 percent of teachers were completing this online survey, which was providing to lawmakers invaluable firsthand data at a school-specific level.⁶¹ At least nine other states have developed teacher surveys since then—including Alabama, Illinois, Kansas, Maine, Massachusetts, and West Virginia, which developed their surveys through a partnership with the National Education Association and the New Teacher Center in 2008.⁶²

States adopting these surveys report that policymakers and activists are using the results to support the right set of education policy reforms, improve current programs, and facilitate collaboration between state and local policymakers.⁶³

Improve teacher preparation programs

Nationwide, many state teacher preparation programs are weak, the methods to evaluate them are ineffective, and too often the regulations to hold them publicly accountable are toothless. Federal law requires states to hold preparation programs accountable, but few to none use actual performance to do so. A 2010 Center for American Progress report⁶⁴ called for a stronger accountability system for teacher education programs and recommended five measures:

- A teacher effectiveness measure that reports on whether program graduates help their K-12 students to learn
- Measures of classroom teaching performance of program graduates built on reliable and valid classroom observation instruments
- Persistence rates in teaching for all program graduates, disclosed to the public for up to five years post-completion
- Feedback surveys from program graduates and from their employers
- A new system of teacher licensure testing, with the number of current tests cut by more than 90 percent, and with every state adopting the same tests and the same pass rate policies

The Obama administration's signature Race to the Top program, among its other priorities, provided support for states to improve their teacher preparation

programs, to use enhanced data to better evaluate their effectiveness, and to make those programs more transparent and accountable by releasing that data publicly. In January 2012 the Center for American Progress released a report, “Getting Better at Teacher Preparation and State Accountability: Strategies, Innovations, and Challenges Under the Federal Race to the Top Program,” that details the progress of the 2010 winners of the Race to the Top grants. The report outlines how each state is attempting to meet its commitments to improve teacher education and to strengthen public disclosure and accountability of program performance.

Policy recommendations aimed at maximizing the potential for change through the Race to the Top program, and also applicable for other states, included the need to:

- Develop high-quality state data reporting systems
- Pilot stronger measures of preparation program accountability
- Monitor state performance
- Work to close the gaps in a fragmented accountability system⁶⁵

Extend school day and year

Lengthening the school day, school week, or school year for all students in a given school can help close the academic and enrichment gap between the haves and the have-nots. Many students from low-performing, high-poverty schools have likely suffered a series of missed opportunities in the educational pipeline, including lack of high-quality preschool opportunities and highly effective teachers. They also lack access to traditional afterschool activities such as arts, service, and athletics, which enhance and enrich student learning.

To help level the playing field and capitalize on underutilized afterschool time, state governments can expand school learning time to focus on rigorous academic work and formally incorporate enrichment activities into the school day. Schools that lengthen the school year can help combat summer learning loss—a problem that disproportionately affects impoverished students⁶⁶—and address the challenge of finding child care for working families during the long summer break.⁶⁷

Research suggests that redesigning and expanding the school calendar to use learning time more wisely can close the achievement gap between low- and high-performing students. A recent analysis of charter schools in New York showed that students are more likely to outperform their peers in traditional and other

charter schools if their schools stayed open even 10 days longer.⁶⁸ A study by the American Institutes for Research of the large student achievement gains at Boston's charter schools concluded that additional learning time was essential to the success of charter schools.⁶⁹ Charter schools in the study operated for an equivalent of approximately 62 additional days of school over the course of a traditional school year.⁷⁰ In addition to improving student achievement and adding more time for enrichment activities, expanding the school calendar can provide teachers with more time for planning, preparation, and professional development, as is the case for school participating in Massachusetts's Expanded Learning Time, or ELT, Initiative.⁷¹

Lengthening the amount of time students spend in school can increase costs. Schools participating in Massachusetts's Expanded Learning Time Initiative generally add up to two hours to their school day, while also implementing comprehensive reforms to the entire school day, at a cost of \$1,300 per student, or about \$4.33 per extra student hour. But more schools are experimenting with creative staffing models, including staggering teacher schedules, and new uses of technology to expand learning time at a minimal cost. States can also make the most of their investment by prioritizing high-poverty schools, whose students are most likely to benefit from the additional time.

Make higher education and continuing education available to all

Background

Today's economy places unprecedented demands on America's higher education system. The dizzying pace of technological change requires not only the most highly educated workers in the nation's history, but a workforce that is continually adding to and diversifying its skills. Our future economic competitiveness will largely depend on whether we increase the education and skill levels of the American workforce.

Yet as demand for postsecondary education grows, the skyrocketing cost of colleges and universities puts college out of reach for millions of Americans and poses a severe threat to America's ability to meet the competitive challenge of a global economy. In 1979 a person earning the minimum wage could pay a year's tuition at a public four-year college after working about 250 hours, but today it would take

a minimum-wage worker four times as long—nearly 1,000 hours or more than six months working full time.⁷² And after adjusting for inflation, the cost of tuition, room, and board at a public university has risen 42 percent in just 10 years.⁷³

And even when students are able to access postsecondary education, too often universities and colleges do not provide sufficient support to ensure that they are successful and receive the training they need to find a good job. Yet state governments do too little to encourage in-state colleges and universities with abysmal graduation rates to improve or to match training to the high-growth industries.

As a result, the United States will soon be unable to produce the graduates we need to fill jobs in growing sectors or compete in the global economy. About 63 percent of job openings between 2008 and 2018 will require some amount of postsecondary education or skill training, but our higher education system will fall short by 3 million associate and bachelor's degrees and nearly 5 million postsecondary credentials.⁷⁴ Also, by 2030 China will have 200 million college graduates—more than the entire U.S. workforce—and by 2020 India will be graduating four times as many college graduates annually as the United States.⁷⁵

It's critical that state governments maximize opportunities for every high school student to attend and succeed in college or receive some sort of postsecondary training. And it's equally important that states optimize the choices adult workers have to continue their education to diversify the skills they will need to compete in a dynamic economy.

Ease transfers across postsecondary institutions and give credit for prior learning

According to the Department of Education, only 34 percent of college students will attend only one college while pursuing their degrees.⁷⁶ The majority will move on to a second or third institution, and consequently will need to transfer credit between institutions.⁷⁷ Also, many students returning to school after beginning their working lives have gained experience that is directly relevant to their degree programs. Too often colleges and universities do not recognize learning obtained from other institutions or in students' working lives. This needlessly drives up costs, wastes time and effort, and discourages students from continuing with their educations.

Elsewhere, fortunately, other institutions are lowering barriers that prevent students from completing college. Two strategies stand out.

First, articulation agreements between community colleges and four-year institutions allow students a simple process to transfer credits among institutions and can establish common course requirements within popular majors across institutions.⁷⁸ Establishing articulation agreements is not expensive, and federal aid is available through programs such as the College Access Challenge Grant.⁷⁹

States should require all public colleges and universities receiving public appropriations to participate in a common statewide articulation agreement. Statewide articulation agreements should:

- Provide for a common core curriculum across all public institutions within the state, with common course numbering for core classes. This will facilitate easier transfer between schools and reduce the unnecessary waste of time, effort, and money.
- Guarantee that an associate's degree fulfills the first two years of core studies at public four-year institutions within the state. This common articulation agreement will enable students to save thousands of dollars if they choose to spend their first two years of study at a community college.

States should also be encouraged to negotiate articulation agreements with other states, which would facilitate interstate transfer.

Second, prior learning assessments allow students to save valuable time and money by earning college credit for subject matter they've already mastered through workplace experience.⁸⁰ The Council for Adult and Experiential Learning found that 56 percent of adult students using these prior learning assessments earned a postsecondary degree within seven years, compared to only 21 percent of adult students without this opportunity.⁸¹

Each state should facilitate greater use of prior learning assessments credit by creating their own statewide agency to assess prior learning and allowing students to transfer prior learning credit earned through the statewide agency to any school in the system. Vermont, for example, has successfully adopted such a system.⁸² Also, Pennsylvania has taken a step in the right direction by establishing the Pennsylvania Prior Learning Assessment Consortium, a group of commonwealth

institutions that offer various assessment opportunities and have agreed to abide by state recommended guidelines for prior learning assessments.⁸³

In addition, states should work with the federal government to ensure that federal student aid—such as Pell Grants, Stafford Loans, or Post-9/11 G.I. Bill benefits—is eligible to pay for prior learning assessment portfolio evaluation courses through their statewide system of prior learning assessment, as long as subsequent credits are accepted at all public colleges and universities in the system.

Ensure students have the technical skills they need to succeed in the workplace

States can help provide good jobs and strengthen regional economies by helping to build training partnerships between community colleges and industry.

High-growth industries such as health care, biotech, nanotech, clean energy, and advanced manufacturing provide the promise of good paying, middle-skill careers for millions of American workers. Yet these positions too often go unfilled today due to lack of qualified workers, and we are on pace to encounter a shortage of nearly 5 million of these sorts of middle-skill workers by 2018.⁸⁴

In order to access these jobs, workers need to acquire technical skills through an associate degree or industry-recognized postsecondary credential.⁸⁵ Community college systems have the ability to train workers to fill these positions, but too often lack the funding or key industry relationships.

States should provide funding and help build partnerships between industry and community colleges to align business needs with community college curricula, so industry knows that community college graduates will be trained to meet their needs, and so students will know that they will have a job available to them upon graduation or certification. States should use a portion of their federal workforce training funds—while also requiring 50 percent matching funds from the private sector—to develop these alternative postsecondary education and training programs that are tightly linked to local or regional economic development.

After the United Parcel Service, Kentucky's largest employer, for example, threatened to relocate in 1996, the state partnered with the company and a local community college to help upgrade workforce skills. Through collaboration these groups created Metropolitan College, which allows UPS workers to work

part time and obtain a postsecondary degree tuition free—tuition costs are split between UPS, the state, and local government. In the first decade of Metropolitan College operations, the number of UPS workers with a postsecondary degree grew from 8 percent to 45 percent, and annual turnover rates fell from 100 percent for new hires at the company in 1998 to just 20 percent in 2009.⁸⁶

Also, more than 15 states have purchased licenses for analytic tools to study the needs expressed by industry in online job ads, to uncover mismatches between labor market demand and college skills training, and to make programmatic decisions based on that data.⁸⁷

Require colleges to provide consumer information via college “nutrition labels”

Average student debt loads at colleges can range from \$950 to \$55,250 and graduation rates range from 6 percent to 92 percent.⁸⁸ Yet many students are unaware of these differences in part because colleges are free to determine the information they provide to students, which means they are likely to exclude embarrassing information that may reflect poorly on the school.

State governments should require public colleges and universities to provide pertinent information to prospective students concerning their likelihood of graduating, finding employment, and paying off student debt. And states should encourage in-state private schools—both nonprofit and for-profit—to provide this information by making compliance a condition of the authorization process to operate in the state or tying compliance to receipt of student financial assistance payments.

Just like with nutrition labels on food, this information should be provided through a standardized college fact card that is used by all colleges and universities.⁸⁹ Schools should be required to place this standardized college fact card on all promotional materials and on the front page of school websites to allow students to easily compare schools. An adequate college fact card should include a standard format to communicate easy-to-understand information on:

- Graduation rates
- Average out-of-pocket costs net of grant aid
- Average student debt and average monthly payments to pay off student debt in 10 years

- Employment rates and average salary one year after graduation for recent graduates

The effectiveness of the college nutrition label relies upon it being accessible and easy to find. Requiring the college label to be posted on college websites, enrollment forms, financial aid paperwork, offer letters, and other promotional materials will make it visible enough to grab the attention of applicants.

Protect students from failing colleges and universities

State governments should protect students from poorly performing schools by preventing failing public, nonprofit, and for-profit colleges and universities from receiving state-level student aid and upholding strong oversight in the state authorization process.

This problem has been particularly acute among for-profit colleges and universities in recent years. An increasing number of American students are choosing for-profit colleges and universities, as enrollment in these institutions grew by 225 percent between 1998 and 2008.⁹⁰ Yet too often, high-cost private, for-profit colleges fail to deliver positive outcomes for students.

For-profit schools, for example, graduated 22 percent of their first-time, full-time students from their bachelor's degree programs on average in 2008, compared to 55 percent of such students at public institutions, and 65 percent at private nonprofit schools, according to a 2010 report by The Education Trust.⁹¹ And graduates at for-profit schools paid a much higher price for their degrees. The median debt load of bachelor's degree recipients from for-profit schools was \$31,190—nearly two times that of graduates of private nonprofit institutions (\$17,040) and more than three and a half times that of graduates of public colleges (\$7,960).⁹²

Yet many of the problems associated with for-profit universities are due to lax state and federal regulation of all colleges and universities. By raising standards for all public, nonprofit, and for-profit universities that the universities must meet in order to receive state support and operate within the state, state governments can go a long way toward ensuring students choosing for-profit schools receive good value for their investment.

California has moved in the right direction—its 2012–2013 state budget ties

eligibility to the state's Cal Grant loan program to student loan default and graduation rates.⁹³ In order to qualify, the new law requires colleges to have a graduation rate of at least 30 percent and a maximum default rate of 15.5 percent. California's Legislative Analyst's Office expects that for-profits that will be excluded from receiving grants due to poor performance will account for more than 80 percent of the sector's total enrollment in the state.⁹⁴

State governments can also uphold high standards through university and college authorization requirements. In order to operate within a state, all institutions must receive the state's authorization. This includes online universities that should be authorized in every state in which their students reside. Yet many states have turned a blind eye to online universities that are out of compliance with this requirement in recent years.

In order to encourage compliance, the federal government recently enacted regulations tying an institution's receipt of state authorization and compliance with any "State requirements for it to be legally offering distance or correspondence education in that State" to the ability of students from that state to be eligible for federal financial aid to attend the school.⁹⁵ While this regulation is currently being litigated, states should use this opportunity to uphold high standards in their authorization standards.

In order to do so, several states are joining together in a State Authorization Reciprocity Agreement, being convened by the National Center for Interstate Compacts (a policy program developed by Council of State Governments to assist states in developing interstate compacts), The Presidents Forum (an organization that promotes online colleges and universities), and the Lumina Foundation (the nation's largest foundation dedicated exclusively to increasing students' access to and success in postsecondary education). The agreement will allow states to recognize online universities' and colleges' authorization from states that uphold similarly high standards and ease the administrative burden on online schools of meeting compliance requirements in every state in which they operate.⁹⁶ Concurrent with these efforts, state governments should also aggressively seek out schools operating without authorization.

Develop public online higher education options

Students are increasingly relying on online universities in order to fit postsecondary training into their working lives. For-profit universities were the pioneers in providing flexible, online education options, but a number of states have introduced innovative online options that provide high-quality, low-cost options for students.

States should establish an exploratory committee or fund state university governing boards to consider how to facilitate the formation of an online public university that would provide a high-quality and affordable option for in-state students. These committees should investigate how student and industry needs could be met by a public online option, how best to situate an online university within the existing state system, and regulatory and legal changes—including changes to the state’s accreditation and financial aid requirements—to facilitate program formation. In addition, state governments should identify open courses that are equivalent to existing college courses and develop a process for students to use these online programs and courses to earn college credit.

Western Governors University is an online, nonprofit university supported by 19 state governors that now serves more than 19,000 students.⁹⁷ Supporters of the private nonprofit university laud it both for its affordability—tuition is \$5,800 annually—and its innovative performance-based model, which allows students to earn credit based on demonstrated competencies. In 2012 Indiana Gov. Mitch Daniels signed an executive order to partner with the school to create WGU Indiana, which will offer fully accredited bachelor’s and master’s degree programs.⁹⁸ WGU Indiana will operate without direct state funding and be self-sustaining on tuition.

Similarly, Maricopa County, Arizona, has created the primarily online Rio Salado College, which offers associate degrees and delivers course offerings to nearly 63,000 students. Rio Salado College has partnered with corporations, government agencies, and other educational institutions to offer more than 600 online courses and 60 certificate and degree programs as well as in-person and hybrid classes throughout the region.⁹⁹

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Ensure affordable, quality health care for all

The reform of the U.S. health system took a huge step forward in the spring of 2010 with the passage of the Patient Protection and Affordable Care Act. The law, which is still being implemented, will address some of the biggest problems in our health care system, such as high costs and the millions of Americans who lack health insurance.

States play a key role in ensuring health care reform is properly implemented and they can take additional steps to bring costs down and improve the quality of care.

The United States continues to pay much more for health care than any other developed country—\$7,960 per person compared to \$3,182 per person for the average developed country—while only getting similar results at best.¹ In short, the health care system is incredibly inefficient and in dire need of more payment and delivery reform.

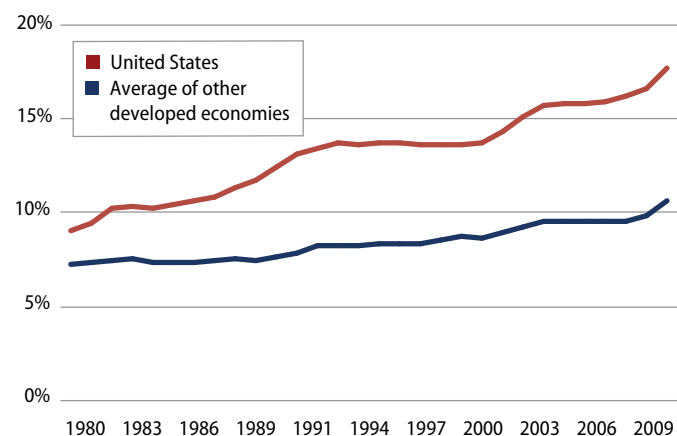
The extremely high costs of health care are harmful to the budgets of middle-class families and employers, as well as governments that bear a significant portion of overall health care expenses. As a result, reducing health care costs would be good for families, businesses, and taxpayers.

The Affordable Care Act addresses critical problems by expanding coverage to millions of Americans while taking steps to reform the health insurance industry and how we pay for health care. The implementation of these reforms will require considerable work from state governments over the next few years. Not only should

FIGURE 6

The United States spends much more on health care than other developed countries

Total expenditure on health as percent of GDP, 1980–2010



Source: OECD Health Data 2012 - Frequently Requested Data, available at <http://www.oecd.org/health/healthpoliciesanddata/oecdhealthdata2012-frequentlyrequesteddata.htm>

Note: "Other developed countries" are Australia, Canada, Denmark, France, Germany, Japan, Netherlands, New Zealand, Norway, Sweden, Switzerland, and the United Kingdom.

states fully implement the Affordable Care Act reforms, but they should also improve upon these reforms and address other challenges in the health care system.

Optimize the implementation of the Affordable Care Act

Background

While the federal government dominates media coverage of health care reform, much of our health care system is regulated at the state level.

By far the most significant recent legislation affecting health care delivery is the Patient Protection and Affordable Care Act of 2010. This historic legislation sets the United States on a path to provide access to health care for all Americans. Major provisions of the law prevent insurance companies from discriminating against patients based on pre-existing conditions, allow young adults to stay on their parents' insurance until age 26, significantly expand Medicaid coverage for low-income individuals and families, and provide assistance to ensure that middle-income Americans who currently do not have health insurance can afford to purchase it.

States play a major role in implementing two provisions of the Affordable Care Act:

- The creation of health care exchanges for uninsured individuals and small businesses to shop for health insurance products
- The expansion their state Medicaid programs so that low-income state residents will gain needed coverage through Medicaid

Despite strong opposition to the law by some state leaders, all states have taken some action to begin to implement the Affordable Care Act.² Already, 44 states have taken advantage of the new premium rate review system under which insurers must justify double-digit increases in health care premiums.³ But at this point, state approaches to Affordable Care Act implementation vary considerably.

Design and run a state health insurance exchange

State governments are extremely knowledgeable when it comes to local health insurance markets and should therefore design and run their own state health insurance exchanges. Effective implementation of the exchanges—whether they are run by the state or by the federal government—can reduce costs, improve quality, and enhance the consumer experience.

State insurance markets vary considerably due to differences in legal requirements, demographics, and geography. Due to these differences, the Affordable Care Act gives states the opportunity to run their own exchanges and grants states wide latitude in designing the programs. The first deadline for submitting health care exchange blueprint applications to the federal government was December 14, 2012. If a state elects not to implement an exchange or will not have one ready by 2014, the federal government will run the exchange on the state's behalf.

As of December 2012, 18 states and the District of Columbia had either passed legislation or been given an executive order to implement Affordable Insurance Exchanges.⁴ States running their own exchanges, however, will continue to refine their programs and states that are not yet ready to run their own exchange will have opportunities to do so in the future.

States implementing insurance exchanges can use this marketplace to reduce costs, improve quality, and enhance the consumer experience.⁵ In order to do so, state exchanges should:

- Use competitive bidding to secure the best premium rates and to promote payment and delivery reform
- Reward high-performing plans with bonus payments
- Create manageable choice for individuals and businesses and steer customers toward low-cost, high-value plans
- Structure exchange websites and customer-assistance programs to help customers make informed choices
- Design small-business options to protect older employees and minimize adverse selection

Massachusetts' Commonwealth Health Insurance Connector—the exchange established by the state's health care reform law of 2006—provides a powerful example of how well-functioning exchanges can improve the consumer experience. The Massachusetts state exchange uses competitive bidding to select plans based on quality and value, and as a result the premiums of plans offered by the exchange have increased at rates much lower than those of the outside market.⁶ And as a result of consumer feedback, the Massachusetts exchange now offers a limited number of standardized plans in order to increase consumer satisfaction.⁷

Expand Medicaid coverage

States should opt-in to the Affordable Care Act's Medicaid expansion, which if fully implemented would result in 17 million Americans gaining health care coverage without significantly increasing state program costs.⁸

The Medicaid expansion would provide coverage to all people with incomes up to 138 percent of the federal poverty line—which is approximately \$15,000 for an individual and \$31,000 for a family of four.⁹ Under the Affordable Care Act, the federal government would provide 100 percent of the needed funding for the expansion initially, and transition between 2017 and 2020 to requiring states to provide 10 percent of funding.

Initially, the Affordable Care Act conditioned the receipt of the states' existing federal Medicaid funds on that state's participation in the expansion program. The United States Supreme Court, however, rejected this provision of the law and now states can reject the expansion without losing any current funding.

As of December 2012 the governors of Alabama, Georgia, Iowa, Louisiana, Maine, Mississippi, Nebraska, Oklahoma, South Carolina, South Dakota, and Texas have rejected the deal expansion, often calling it too expensive.¹⁰

This is a penny-wise and pound-foolish stance. The expansion of Medicaid would allow states to increase the number of insured people by an average of 25 percent, with an increased state cost of less than 3 percent.¹¹ What's more, these increases are offset by savings on uncompensated care for the uninsured residents who are treated in their hospitals.¹² Michigan, for example, could save almost \$1 billion over 10 years if it expands Medicaid eligibility.¹³ Overall, the Affordable Care Act

would cut state spending on uncompensated care by \$18 billion if the Medicaid expansion is fully implemented.¹⁴

Lower health care costs

Background

The huge and rapidly increasing cost of health care is a significant threat not only to the health care system, but also to our ability to invest in other priorities. In 2012 spending on health care in the United States is expected to reach \$2.8 trillion, or about 18 percent of total spending on all goods and services.¹⁵ This amounts to more than \$8,000 per person on health care, more than double the average of \$3,400 per person in other developed nations.¹⁶ The Center for American Progress, together with other health care experts, outlined its plan of how to “bend the health care cost curve” in an article in the September 2012 edition of the *New England Journal of Medicine* entitled “A Systemic Approach to Containing Health Care Spending,” which we will detail shortly.¹⁷

All this spending, however, does not make a difference when it comes to health care outcomes. Health care spending varies significantly in different areas of the country. Yet looking within the United States, there is no correlation between spending and better outcomes.¹⁸

State governments oversee the purchase of billions of dollars of health care services every year both through state Medicaid programs, Children’s Health Insurance Programs, other state-only health programs, and through state employee health care plans. As such, states across the country are exploring new and creative ways to use their purchasing power to drive down health care costs and improve health care outcomes.

The Center for American Progress has done a great deal of thinking about how to reduce spending and improve quality at both the federal and state level. A number of these approaches are applicable to state governments, including several that were highlighted in the *New England Journal of Medicine*¹⁹ and are outlined below.

Adopt payment rates within global targets

Under current health care payment systems, providers negotiate payment rates with multiple insurers. This fragmented system increases administrative costs and allows providers to shift costs from public to private payers and from large to small insurers.²⁰

States should adopt a model of self-regulation to streamline payment negotiations and reduce costs.²¹ Public and private payers would negotiate payment rates with providers. These rates would be a binding upper limit on all payers and providers in the state, but providers could offer rates below the negotiated rate.

These rates would also adhere to a global spending target for both public and private payers in the state. After a transition, this target should limit growth in health care spending per capita to the average growth of wages in the state. State governments could create an independent council composed of health care providers, payers, businesses, consumers, and economists charged with setting and enforcing the spending target.

Policymakers creating and implementing this policy should also ensure that the spending target is set at an appropriate level to provide quality care and access and require all health care segments to bear responsibility for cost containment. Additionally, the process for developing such limits and targets must be transparent and engage the broadest range of stakeholders.

In August 2012 Massachusetts Gov. Deval Patrick (D) signed a measure that will help his state contain health care costs through a similar mechanism. Massachusetts' new Health Policy Commission will set a state benchmark for health care spending each year and publish yearly recommendations about how to lower costs.²² The target is tied to the growth rate of the state's economy. Massachusetts is the first state to set statewide benchmarks to control health care costs, albeit with limited enforcement mechanisms.²³ The governor's office predicts the legislation will result in \$200 billion in savings, as well as \$10,000 in increased pay per worker, over 15 years.²⁴

Additionally, states could experiment with ways to meet global spending targets. For instance, states could look at Maryland's method of setting hospital payment rates. In Maryland the state's Health Services Cost Review Commission considers and sets the rates that hospitals can charge for each service. The state has received a waiver from Medicare to operate the program since 1971.²⁵

Encourage alternatives to fee-for-service payments

One leading driver of the high cost of health care is the prevalence of the fee-for-service payment system. Seventy-eight percent of employer-sponsored health care services were fee-for-service as of 2008.²⁶ Because a separate fee is paid for each item or procedure, fee-for-service payment systems often incentivize wasteful consumption of health care services—especially services with high profit margins for providers—and do not encourage care coordination across a patient’s providers. As a result, patients often receive treatments or tests that they don’t need or want, and which may cause the patient harm.²⁷

And by paying for the volume of health care delivery, rather than patient outcomes or health care quality, fee-for-service payments do not encourage low-cost, low-margin, yet valuable services such as preventive care or wellness programs.

A 2012 Center for American Progress report, “Alternatives to Fee-for-Service Payments in Health Care: Moving from Volume to Value,” profiles promising alternatives to fee for service, including:²⁸

- Bundled payments—which eliminate incentives for unnecessary services by paying health care providers a fixed amount for a bundle of services or all the care a patient is expected to need during a set time period
- Patient-centered medical homes—which are redesigned primary-care practices that reduce costs by focusing on preventative care, patient education, and care coordination between different health care providers
- Accountable Care Organizations—which are groups of health care providers who agree to share responsibility for coordinating lower-cost, higher-quality care for a group of patients

States are increasingly experimenting with these types of payment systems, but many Medicaid and state employee health plans use fee-for-service payments. States should continue to experiment with alternatives and scale up successful programs. Also, states can potentially do so by taking advantage of Affordable Care Act provisions to create a variety of Medicaid pilot and demonstration programs.

In Minnesota, for example, lawmakers in 2008 enacted a requirement to standardize definitions of seven “baskets of care,” including asthma, knee replacements, and

lower back pain. Hospitals and providers can then set rates for a bundle of care, and patients and other payers can compare rates for the bundle of care they choose.²⁹

Likewise, Oregon lawmakers passed legislation in 2011 to encourage the delivery of Medicaid health care services through coordinated-care contracts that use alternative payment methodologies to focus on prevention, improving health equity, and reducing health disparities. The program utilized patient-centered primary care homes, evidence-based practices, and health information technology. A third-party analysis found that implementing this program could save the state a large portion of its projected Medicaid costs in both the short and long term—potentially more than \$1 billion within three years and more than \$3.1 billion over the next five.³⁰

Finally, in Arkansas Gov. Mike Beebe (D) began moving away from fee-for-service in 2011 by developing global payments for certain conditions and “episodes of care”—all clinically related services for a patient for a condition from the onset of symptoms until treatment is complete—and identifying best practices for those episodes.³¹ The state is starting off with bundled payments for five diagnoses, but will be scaling up in the hopes of being 90 percent to 95 percent free of fee-for-service rates within three years. Significantly, the state’s two largest insurers, Blue Cross Blue Shield and QualChoice, will also use these episodes as the basis for their payments.³²

Expand the use of nonphysician providers

Many states have restrictive scope-of-practice laws that prevent nonphysician health care providers from offering the full range of care in which they have been trained. Case in point: advanced practice nurses, who are prohibited in 34 states from practicing without supervision by a physician.³³

The stated purpose of these laws is to protect patients by ensuring that health care workers are practicing in areas for which they are properly trained. But these laws are too often woefully outdated or have been used to protect the interest of one group of health care professionals by restricting other professionals from providing competent, affordable, and accessible care.³⁴

States should adopt scope-of-practice reforms that would expand the pool of health care providers, offer patients more options, expand competition, and lower costs.³⁵

Former Pennsylvania Gov. Ed Rendell (D) included scope-of-practice reform as a plank in his “Prescription for Pennsylvania” comprehensive health care reform package. The reforms, announced by the governor in 2007, removed unnecessary restrictions that prevented licensed health care providers—including advanced nurse practitioners, physician assistants, physical therapists, and public health dental hygiene practitioners—from offering the full range of care in which they have been trained.³⁶ And a number of states—including New Mexico, Iowa, Virginia, and Minnesota—have adopted scope-of-practice review processes and boards to rationalize and remove bias from these debates about who and who cannot provide care.³⁷

Improve integration of care for “dual-eligible” patients

More than 9 million Americans are eligible for both Medicare and Medicaid, including some of the sickest and poorest Americans who are in need of a range of primary, acute, long-term, and behavioral health services.³⁸ Medicare and Medicaid share responsibility for these patients—together spending approximately \$300 billion on dual eligible patients per year.³⁹ These patients face significant challenges navigating two systems with different eligibility, coverage, payment, appeals, and consumer-protection requirements.

Despite the hefty price tag, little has been done to reduce costs by coordinating and simplifying care across programs. Approximately 90 percent of spending on dual-eligible patients is fee-for-service.⁴⁰ And the dual-eligible structure creates a number of inefficiencies by splitting responsibility for these beneficiaries between Medicare and Medicaid. The Medicare Payment Advisory Commission—an independent congressional agency—has noted that the dual-eligibility structure creates incentives to shift costs between the two payers, hinders efforts to improve quality and coordination of care, leads to coverage conflicts that are difficult to resolve, and creates barriers to access.⁴¹

Currently, a number of state governments are experimenting with small pilot programs to improve quality of care and reduce government costs for dual-eligible patients. Massachusetts’ Senior Care Options program, which enrolls Medicaid-enrolled and dual-eligible seniors, is one example. Individuals who choose to participate in the program receive all of their Medicare- and Medicaid-covered services through participating special-needs plans, which are paid by the state. Data show that beneficiaries enrolled in the Senior Care Options program have

fewer hospital days and lower total monthly costs than the fee-for-service, dual-eligible population.⁴² And a survey of Senior Care Options beneficiaries also found high member satisfaction.⁴³

A similar program in Wisconsin also shows that the program helps to reduce hospitalizations, nursing home stays, and emergency room visits, and as in Massachusetts, survey results show high satisfaction among beneficiaries.⁴⁴ Also, the Medicare-Medicaid Coordination Office—created by the Affordable Care Act—is scheduled to begin a series of demonstration projects to be funded in 2013.

Because of the diversity within the dual-eligible program and differing state health care infrastructure capacity, there is no one-size-fits-all approach to improving coordination of care for this group. States should continue to fund and experiment with these programs with the goal of designing programs that maintain program quality and fit the needs of their dual-eligible population. Demonstration programs should be evaluated and show evidence of positive outcomes before being expanded. Further, as these programs ramp up, they should remain “opt-in” programs in order to preserve patient choice.

Lower prescription drug costs

Background

Prescription drugs make up a large share of total health care spending in the United States. Retail prescription drugs accounted for 10 percent—or \$259 billion—of aggregate national health expenditures in 2010, according to the Centers for Medicare & Medicaid Services.⁴⁵

Health insurance often masks the pain of these costs due to fairly reasonable co-pay costs. And thanks to the passage of the Affordable Care Act, far fewer Americans will be forced to pay the full price of prescription drugs. The new health care law, however, does not entirely resolve the problem of high out-of-pocket spending on prescriptions for consumers. As a consequence, state governments will continue to shoulder a significant portion of the costs of providing prescription drug benefits to state employees, Medicaid enrollees, and beneficiaries of other prescription drug assistance programs.

In order to drive down these costs, state governments have adopted innovative reforms to produce cost savings to government. States use multiple methods of negotiating lower prescription drug prices with pharmaceutical companies and encourage the use of safe and effective generics whenever possible. As a result, Medicaid uses generic drugs—when there is an equivalent—89 percent of the time.⁴⁶

Still, there is more that can be done to lower prescription drug prices. The Center for American Progress' analysis of American Enterprise Institute data finds that maximizing generic drug substitution could save Medicaid overall up to \$7.6 billion over 10 years—and that is just one example of savings.⁴⁷ States should continue experimenting with ways to negotiate lower prescription drug prices and increase the use of generics.

Negotiate lower prescription drug purchase prices

States engage in a number of strategies to reduce prescription drug prices negotiated with pharmaceutical companies. Federal law requires pharmaceutical companies to provide rebates to states for drugs dispensed to Medicaid patients in exchange for state Medicaid coverage, but states are permitted to negotiate even greater rebates and should consider if these supplemental rebates might lower costs.⁴⁸ States already have experience doing this and typically negotiate rebates and discounts for prescription drugs covered under state employee health plans and other prescription drug assistance programs.

Negotiation strategies to reduce prescription drug prices include:

- **Forming purchasing pools with other states to negotiate lower prices or rebates for prescription drugs:** ⁴⁹ Louisiana estimated their savings from participating in such a pool to be \$27 million in 2006, while Maryland expected to save \$19 million, and West Virginia \$16 million that year.⁵⁰
- **Negotiating directly with the pharmaceutical company:** States maximize their savings by negotiating directly with pharmaceutical manufacturers, rather than negotiating through a pharmacy-benefits manager—a third-party administrator of prescription drug programs.⁵¹
- **Using preferred drug lists:** Preferred drug lists include prescription drugs covered under a benefits plan and can thereby promote the use of effective,

but less expensive drugs. At least 48 states have some form of a preferred drug lists.⁵² Most state lists apply to Medicaid, and as of 2009, at least 17 states have expanded their lists to other programs, such as offering reduced-price drugs to the elderly or disabled.⁵³ And in 2009 Oregon enacted legislation to create a statewide drug list that will eventually include 850,000 residents.⁵⁴

There is no one single best approach to contain state spending for drugs. And some of these strategies are mutually exclusive. To the extent allowed under federal law, and ensuring that these discounts do not come out of dispensing fees paid to pharmacies, states should continue to experiment with new programs to find what methods for purchasing drugs work best.

Promote safe and generic alternatives

Moving from purchasing name-brand pharmaceuticals to safe generic alternatives offers enormous savings potential for states. On average, a generic drug is \$45 less than the brand-name equivalent.⁵⁵ Currently, the substitution rate for name-brand drugs when a generic is available is 89 percent in Medicaid—while this number is quite high, more can be done. The Center for American Progress’ analysis of American Enterprise Institute data finds that maximizing generic drug substitution could save Medicaid overall up to \$7.6 billion over 10 years and that is just one example of savings.⁵⁶

States should reexamine their policies governing generics in both Medicaid and state employee health plans in order to maximize their use.⁵⁷ To the extent allowable under federal law, legislatures should review both the requirements on doctors prescribing name-brand drugs and how much the state will reimburse for drugs with equivalent generics (ensuring that generic reimbursement rates are not artificially inflated by the inclusion of brand-name drug costs).⁵⁸ State governments should also be very wary of arbitrary “carve out” laws, which prohibit generic-substitution laws from including certain categories of drugs.

Finally, the Affordable Care Act provides an abbreviated licensure pathway for generics for biologics—medicinal preparations made from living organisms and their products, such as vaccines—called biosimilars.⁵⁹ As these products come to the market, state governments should consider how to encourage their use.

States that have increased their purchasing of generics are realizing significant cost savings. After Massachusetts' state Medicaid program instituted the requirement that doctors justify the need for name-brand pharmaceutical when a generic equivalent existed, state spending on brand-name drugs with generic equivalents dropped from between \$10 million and \$11 million per month to between \$200,000 and \$300,000 percent month.⁶⁰ Each 1 percent increase in generic prescriptions generated \$7.4 million in savings for the state.⁶¹ And Texas saved more than \$223 million a year simply by changing its prescription pads to make it easier for doctors to prescribe generics.⁶² The law requires physicians write "brand necessary" or "brand medically necessary" on the prescription pad when no substitutions were appropriate.⁶³

Create a prescriber education program

The pharmaceutical industry employs more than 90,000 "detailers"—representatives, armed with samples and marketing materials, who make personal calls to doctors' offices to recommend their products. Detailers are not required to have any clinical training, but rather are hired for their sales ability. The number of detailers has doubled in the last 10 years. In addition to pharmaceutical marketing, industry detailing also drives up costs by promoting the use of name brands over less expensive generic alternatives.⁶⁴

As a response, more states are considering "academic detailing"—employing objective representatives to share the latest credible, independent drug reviews with doctors. Programs are usually based in a public medical or pharmaceutical school, and employ highly trained medical professionals, including pharmacists, nurses, and other physicians. Rather than sorting through competing marketing materials and academic detailing, prescribers can access the most current clinical information about drug effects, interactions, and side effects.

Academic-detailing programs currently exist in Maine, Massachusetts, New York, Oregon, Pennsylvania, South Carolina, Vermont, and the District of Columbia with pilot programs also underway in Idaho and Oregon.⁶⁵

Address mental health coverage

Background

Mental health disorders are extremely common and affect an estimated 57.7 million Americans in a given year, according to the National Alliance on Mental Illness.⁶⁶ Suicide is the 10th most common cause of death in the United States,⁶⁷ and approximately 90 percent of adults who commit suicide are associated with mental or addictive disorders.⁶⁸ Most mental illness is highly treatable, yet only half of adults and less than one-third of children with a diagnosable mental health condition receive treatment.⁶⁹

Historic lack of attention, misunderstanding, and years of stigma has helped make mental illness a hugely neglected public health issue. And even though large numbers of Americans face a mental health disorder every year, longstanding stigmatization means that many individuals do not seek diagnosis. Adding to the urgency to address mental health treatment is the fact that troops returning home from Iraq and Afghanistan do so increasingly with serious mental illness.⁷⁰

State governments facing severe budget shortfalls have made the problem worse by significantly cutting funding of mental health services in recent years. States cut more than \$1.6 billion in general funds for mental health services between fiscal year 2009 and fiscal year 2012.⁷¹

State legislatures should work to restore funding for mental health services. In fact, the Medicaid expansion of the Affordable Care Act will help alleviate some of the burden on state programs, since many of the people currently using those services will be newly eligible for Medicaid. States should evaluate whether this savings should be reinvested into mental health services.

In addition, states should adopt high standards for private insurance mental health coverage, improve statewide data collection and outcomes measurement, and address the growing needs of veterans and youth.

Require insurance plans to provide complete mental health coverage

Advocates of people living with mental illness won a major victory with the passage of the Affordable Care Act. The law significantly expands mental health coverage by increasing access to Medicaid and providing assistance to those purchasing insurance through the new exchanges. All health insurance plans offered in the exchange and expanded Medicaid programs must cover mental health and substance-abuse services as an “essential health benefit.” New and modified private plans outside of the exchanges must follow this requirement as well. And no plan may impose annual or lifetime dollar limits on these services.

Insurance policies must cover these benefits in order to be certified and offered in the exchanges, and all Medicaid state plans must cover these services by 2014.⁷² States, however, have a lot of flexibility in determining the scope of services that must be offered.

States are required to select a “benchmark plan” that sets the minimum standards for essential health benefits levels that other insurers must provide. Mental illness coverage quality varies considerably among private insurers, however, so selection of a benchmark plan will have a large effect on coverage quality within the state. There are many gaps in coverage of eating disorders across the benchmark plans, for example. To date, 25 states have selected a benchmark plan.

States should set high standards to ensure that these plans provide an array of effective and evidence-based mental health services. State governments should also consider how to provide public education and outreach so that those who suffer from mental illness come forward to receive the care they need.⁷³

Improve data collection and outcomes measurement

States must collect accurate and thorough data on mental health treatment and outcomes in order to demonstrate service success, avoid negative health outcomes, inform policy decisions, and maximize return on investment. Yet, the accuracy of data and outcomes measurement in the mental health sector has long been inadequate according to a 2011 report from the National Alliance on Mental Illness, “State Mental Health Cuts: The Continuing Crisis.”

The National Committee for Quality Assurance is developing quality measures on schizophrenia, mental health treatment for children and adolescents, and integration of mental and behavior health care.⁷⁴

In Arkansas all community mental health centers use a standard data-collection tool to report uniform data to the state. Additionally, mental health centers are required to screen for substance-abuse disorders, and substance-abuse providers are required to screen for mental illness.⁷⁵

California used federal and state grants to improve their county-level data collection to report on evidence-based practices and to better track patients who are receiving integrated treatment for mental health and substance use disorders.⁷⁶

Address growing needs of veterans

The nation's veterans from Iraq and Afghanistan share characteristics that distinguish them from groups of veterans of previous wars. Their large numbers and recent demographic changes have challenged state and federal service delivery systems, according to the National Alliance for Mental Illness. Half are from the National Guard or are Reserve members of the regular forces.⁷⁷ Compared to veterans of previous wars, they tend to be older, and are more likely to have families.⁷⁸ More hail from rural America, and many have served multiple tours.⁷⁹ Nearly 19 percent of returning troops currently suffer from a post-traumatic stress disorder or depression.⁸⁰

As such, states must develop coordinated strategies to respond to veteran's needs.

Mental health agencies in 10 states have created thorough service delivery and referral initiatives, and another 13 were either beginning or planning to provide significant services to National Guard members as of 2009.⁸¹ States are also partnering across agencies, together with the federal government and with the private sector, to reduce barriers to access.⁸² Colorado, for example, is increasing mental health services at community centers in rural areas through cooperative agreements with the Veterans Health Administration and private funders.⁸³ New York state is also partnering with the Veterans Health Administration to offer mental health screening as part of its New York National Guard Yellow Ribbon Reintegration Program.⁸⁴

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Rebuild America's crumbling infrastructure

America's infrastructure is in a dire state. Bridges are crumbling, our highways need repair, and our power grids are out of date. Increasing our investments in infrastructure is critical for the short-term and long-term health of our economy and our middle class. In 2009 the American Society of Civil Engineers gave America's infrastructure a grade of "D," while analysis by the Center for American Progress estimates that we need to invest \$129.2 billion more per year over the next 10 years just to meet our country's infrastructure repair and improvement needs.¹

Boosting investments in infrastructure and facilitating the growth of the clean-energy and energy-efficiency industries are very effective ways of boosting economic growth and increasing job growth. In a report on the American Recovery and Reinvestment Act, the Congressional Budget Office wrote that spending on infrastructure created the second-most economic activity for each dollar spent.² This power comes from the fact that economic activity is created by the direct hiring of workers to build the infrastructure as well as the boost from the spending of those newly hired workers.

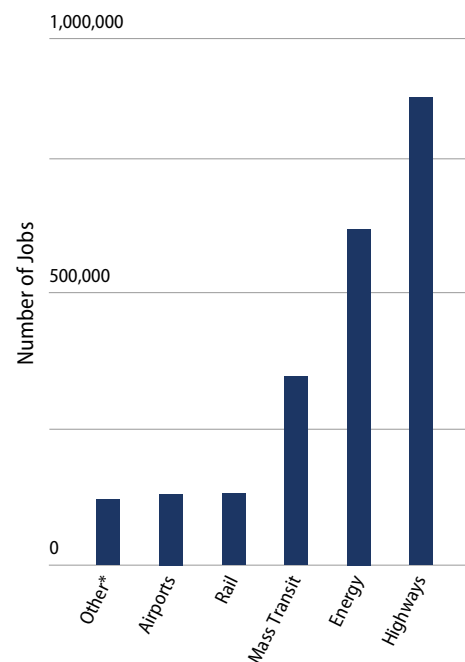
The long-term health of the economy is also helped by strong public infrastructure. Public infrastructure helps boost the productivity of workers and businesses in the private sector.

Well-maintained roads, for example, allow goods and people to move quickly between locations increasing productivity and reducing costs.³ The increased productivity results in stronger economic growth and rising wages for workers. Over the longer term, the entire economy would be wealthier and the middle class stronger.

FIGURE 7

The employment power of infrastructure investments

An estimated 2.4 million jobs created with \$129.2 billion more infrastructure spending, based on 2009 data



Source: Donna Cooper, "Meeting the Infrastructure Imperative: An Affordable Plan to Put Americans Back to Work Rebuilding Our Nation's Infrastructure" (Washington: Center for American Progress, 2012).

Rebuild infrastructure to create jobs and spur the economy

Background

Our nation's infrastructure is crumbling. Aging schools, roads, bridges, and water and sewer systems put the public's health and safety at risk. The problem is well documented and grows more severe with each passing year. Nearly one of every four U.S. bridges is structurally deficient or functionally obsolete;⁴ 4,000 of the country's dams are in need of repair;⁵ and insufficient freight rail infrastructure results in 39,000 additional truck trips to the Port of Los Angeles alone each day.⁶

Crumbling infrastructure endangers the physical and economic well being of all Americans. In 2007 the I-35W Mississippi River bridge in Minneapolis, which had been categorized as structurally deficient, collapsed, resulting in the death of 13 people and 145 injured.⁷ Two years earlier, New Orleans' levees failed to hold back the flood waters of Hurricane Katrina, claiming the lives of more than 1,800 people, and causing at least \$125 billion in economic damage.⁸ Both disasters illustrate the cost of neglecting the country's infrastructure.

Moreover, infrastructure investment holds the promise of accelerating the sluggish economic recovery. Infrastructure spending pumps money into local economies by creating work for private-sector companies and good-paying construction jobs.

Mark Zandi, chief economist at Moody's Analytics, found in 2011 that new federal spending for infrastructure improvements to highways and public schools would generate \$1.44 of economic activity for each \$1 spent.⁹ In fact, the Congressional Budget Office found that infrastructure investments had one of the strongest economic impacts of all the policies included in the American Reinvestment and Recovery Act.¹⁰

Rebuilding our crumbling infrastructure is a daunting, but achievable, goal. The nation needs an additional \$129.2 billion per year investment to meet the current backlog of infrastructure repairs and improvements, according to a report by American Progress's Donna Cooper, "Meeting the Infrastructure Imperative: An Affordable Plan to Put Americans Back to Work Rebuilding Our Nation's Infrastructure."¹¹

This will require states to raise and spend much more on infrastructure. And although funding is scarce due to the Great Recession and the slow economic recovery,¹² states are using new and creative methods to fund infrastructure projects.

But some states lag behind. On average the federal government provides 20 percent of surface-transportation funding to state projects while state and local spending accounts for 50 percent and 30 percent, respectively.¹³ But in 17 states, federal funds were the primary source of transportation dollars, as of 2006.¹⁴

Even with a heavy reliance of federal dollars in some states and cities, a significant amount of federal money is going unused. Cooper's analysis for American Progress shows that based on the loan-matching requirements established by Congress, at least \$20 billion in private, state, local, or public authority capital could be drawn into U.S. infrastructure projects if the federal loan and loan-guarantee programs were fully tapped.¹⁵

This is an opportune time for state governments to catch up on our long backlog of infrastructure priorities. Interest rates available to states are historically low and policymakers who act now to finance their infrastructure can lock in inexpensive financing for many years into the future.

Plan for infrastructure needs

States should formalize their infrastructure planning and financing process and create pathways for public involvement. Moreover, infrastructure plans should identify and seek to achieve specific policy goals—such as increased equity, protection of environmental resources, and increased economic development.

The state of California, for example, through its Infrastructure Planning Act,¹⁶ requires the governor to create a comprehensive, five-year infrastructure-development plan.¹⁷ The plan, along with a proposal for its funding, is submitted to the legislature for review, enabling a public vetting process.¹⁸ Additionally, subsequent legislation required that state infrastructure projects adhere to three planning priorities:¹⁹

- Promote infill and equity so that infrastructure funds benefit disadvantaged communities and redevelopment of areas previously developed and served by transit, streets, water, sewer, and other essential services.
- Protect environmental and agricultural resources.
- Encourage efficient development patterns.

Maximize public investment

There are a number of ways states can raise revenue to finance infrastructure projects. States facing severe budget shortfalls but also containing equally important infrastructure-reinvestment needs could maximize public investment by pursuing the following strategies:

Raise the gas tax and other user fees: States not raising enough revenue to meet the construction and repair needs for their road and transit systems should increase their gas tax and other user fees to help make up the difference. States raise billions of dollars each year through the gas tax, yet the amount varies widely by state, ranging from 8 cents per gallon in Alaska to 49 cents per gallon in New York.²⁰ In the United States, a little more than 42 percent of state-level funding for roads comes from user-fee generated revenue. States asking less from those using their roads should increase user fees if they face infrastructure needs.

Massachusetts, for example, receives only 26.8 percent of its state highway funding from user fees²¹ and has a backlog of 1,060 structurally deficient or functionally obsolete bridges, more than half of all bridges in the state.²² With a state gas tax rate less than half the rate of neighboring New York, Massachusetts has ample room to increase its gas tax to help fund the improvement of its bridges.²³ And though only six states have indexed their gas tax to keep pace with inflation, every state should follow that approach.²⁴ While not every state with high user fees has low bridge-deficiency rates, and vice versa, if states are not raising revenues in other ways to accelerate the repair of their bridges, increasing the gas tax makes sense.

Policymakers should keep in mind that gas taxes—like other sales taxes—are regressive. While we recommend that a significant portion of taxes be reinvested back into infrastructure, legislators could also consider using a portion of funds to for tax-rebate programs for low-income families.

Use GARVEE bonds: All states use general obligation bonds to finance their infrastructure, and 33 states plus the District of Columbia and Puerto Rico use Grant Anticipation Revenue Vehicles, or GARVEE, bonds.²⁵ These bonds allow states to spend future federal highway grants funding now rather than wait when there is an acute need for both the infrastructure and jobs and interest rates are low. States that are not using these bonds should consider doing so.

Increase tolling and user fees: States should also consider increasing tolling and other user fees. Most states have some roads or bridges that are viable candidates for new or increased tolls. Doing so would enable states to attract private financing to help fund road and bridge improvements, by dedicating the new tolling revenues to pay off the debt. Credible estimates suggest governments could raise at least \$100 billion by taking advantage of existing tolling opportunities.²⁶ While the policy implications of increased tolling can be complicated and increase costs on the middle class, increased tolling is a necessary part of the comprehensive approach states should take toward raising essential revenues for infrastructure improvements.²⁷

Explore using pension investments to drive infrastructure improvements

States should look for creative ways to encourage safe investments of their pension funds into state infrastructure improvements. This will provide both added funds to finance infrastructure projects and provide a stable return on investments and broaden the portfolios of pension funds.

On September 29, 2012 California Gov. Jerry Brown (D) signed SB 955, authorizing CalPERS—the \$227 billion California Public Employees’ Retirement System—to prioritize California infrastructure projects with its investment dollars.²⁸ CalPERS opposed the original draft, which required public-employee pension funds to prioritize California projects, but removed their opposition once the amended bill clarified that the public retirement system boards—and not the legislature—retained investment decision-making powers. CalPERS has already begun to move \$4 billion into the market to finance infrastructure improvements, 20 percent of which will be in California.²⁹

Two years earlier the California State Teachers Retirement Systems made the decision to invest in infrastructure improvements and as of October 2012 has committed \$750 million to finance infrastructure projects nationwide.³⁰ And, finally, the New York City Employee Retirement System also recently passed a board resolution to invest in local infrastructure projects.³¹

Increase funding for water-system upgrades

The average American family of four uses 400 gallons of water per day.³² Accessing this water is becoming increasingly costly from both an economic and environmen-

tal standpoint as the aging water systems Americans rely on have reached the end of their useful lives. Every year thousands of aging water pipes burst, costing millions of dollars in repairs and untold economic losses. Every year the United States loses 25 percent of its treated water to leakage and more than 1.7 trillion gallons to 240,000 water main breaks.³³ At the same time, outdated wastewater systems dump billions of gallons of untreated sewage into our rivers, lakes, and streams.³⁴

State revolving loan funds are struggling to keep up with the massive demand to repair and improve water infrastructure. One reason revolving loan funds do not have enough assets is due to overly cautious investment practices, according to American Progress's 2012 report, "How to Upgrade and Maintain Our Nation's Wastewater and Drinking-Water Infrastructure." Many of these state entities currently invest unassigned grant funds and repaid loan funds in low-interest-bearing accounts and financial instruments that often yield a return of less than 1 percent a year, which is barely enough to keep pace with inflation.³⁵ If more funds maintained a balanced portfolio as state pension funds do, they would enjoy a much greater rate of return without taking on irresponsible risk.

New York and Connecticut have begun to take this approach. New York's investment portfolio, for example, consists primarily of highly rated taxable municipal securities, all of which are higher-yield investments. These practices along with a transition to a leveraged-lending model have already enabled New York to increase its loan capacity by an impressive 25 percent.

The Center for American Progress estimates that if these changes were adopted by all state funds in conjunction with transitioning remaining drinking-water and clean-water state loan funds to leveraged models, total funds available for project financing could increase by \$300 million per year.³⁶

Increase the use of renewable energy to help the middle class

Background

State governments have a tremendous opportunity to increase the use of renewable energy. After decades of state-level experimentation, state governments now can adopt proven strategies to conserve electricity and to grow their renewable-electricity industry by increasing wind, solar, and geothermal power. By doing so, states not only

reduce carbon pollution, clean their air, and protect public health but they also help grow their economies by creating thousands of reliable, permanent, high-wage jobs.

In large part because of the critical initial investments in renewable energy put in place by the federal government, and by many state and local governments as well, the renewable- and efficient-energy sectors have already become proven job creators.

The Department of Labor's Bureau of Labor Statistics finds that nearly 2 million people work in establishments where all of revenue comes from green goods and services, and more than 6 million additional people work in establishments where some revenue comes from green goods and services.³⁷ This includes a diverse group of occupations, including software engineers who help design smart-grid technologies, commercial construction workers, and even bus drivers.³⁸

And this job growth continues even amid the current sluggish economy. According to Environmental Entrepreneurs (a national organization of business leaders promoting environmental policies), in April, May, and June 2012 alone, 70 U.S. cities, organizations, and companies announced new clean energy projects in public transportation, manufacturing, power generation, and energy efficiency that were predicted to create 37,409 new jobs.³⁹ And over the past four years, the United States has doubled generation of wind and solar electricity.⁴⁰

Moreover, the future job-creation potential for renewable energy is even more promising. According to one study, Texas could add 123,000 new high-wage jobs to its economy by 2020 by actively moving toward solar power.⁴¹ Similarly, by 2023 Florida could save \$28 billion, offset the state's entire future growth in electric demand, and create more than 14,000 jobs by adopting energy-efficient strategies, according to a 2007 study by the American Council for an Energy-Efficient Economy.⁴² And a 2010 University of California, Berkeley study found that a variety of national renewable energy policies would create the equivalent of 4 million jobs by 2030.⁴³

Moving to a more sustainable, lower-carbon energy economy helps the middle class in numerous ways beyond job creation. A more diverse electricity sector, incorporating many different kinds of renewable power sources, would move the country away from its current dependence on large, centralized fossil fuel power plants—the kind of plants that are most vulnerable to going down in extreme weather events such as the recent Hurricane Sandy. A less carbon-intensive energy sector would also vastly improve public health, especially in urban areas. And

moving away from fossil fuels will help slow the process of climate change, which is ultimately the most serious economic issue facing the globe.

State governments are adopting a variety of strategies to speed the conversion to renewable energy, protect consumers, and create good jobs. In particular, states are focusing on the three key elements of this conversion:

- Helping create a market for clean energy products and processes
- Helping facilitate private-sector financing of these projects
- Investing in the infrastructure (including the skilled workforce) necessary to move clean electricity and fuels to market.

Below we profile some of the most promising of these strategies, which are detailed in more depth in a 2009 Center for American Progress Report, “The Clean-Energy Investment Agenda: A comprehensive approach to building the low-carbon economy.”⁴⁴

Establish a state renewable portfolio standard and take steps to meet it

As of April 2012, 29 states and the District of Columbia were helping drive investments in their renewable energy industries by establishing an enforceable renewable portfolio standard, and seven states had adopted voluntary renewable energy goals.⁴⁵ Renewable portfolio standard laws require public utilities to increase their use of renewable energy over time. Typically, these laws create a reliable market for renewable energy by requiring that renewable-energy usage be gradually increased until renewables account for a certain percentage of a state’s electricity generation. In addition to reducing pollution, renewable portfolio standard laws diversify a state’s energy mix, reducing the risk to consumers of relying on a single source of energy and decreasing reliance on fossil fuels according to American Progress’ 2012 report, “Renewable Energy Standards Deliver Affordable, Clean Power.”⁴⁶ The 21 states without a renewable portfolio standard should strongly consider adopting one.⁴⁷ Standards should encourage all forms of renewable energy, including solar photovoltaic, solar thermal, wind, biomass, new hydropower, and geothermal heat and cooling, among others. In some cases where a state has particularly strong resources in one specific area, the state may want to write a standard that favors this particular resource (for example, solar power in Arizona or wind power in South Dakota).

California's model renewable portfolio standard⁴⁸ requires the state's electric utilities to draw 33 percent of their retail electricity from renewable energy sources by 2020. The statute also established interim targets of 20 percent by the end of 2013, and 25 percent by the end of 2016.⁴⁹ And the aggressive standards have worked. In 2012 California's three large investor-owned utilities collectively generated 20 percent of their retail electricity sales that year with renewable power.⁵⁰

Texas has also achieved positive results by enacting a Renewable Portfolio Standard in 1999 that focuses primarily on wind energy.⁵¹ State wind-power corporations and utilities have invested \$1 billion in wind power, meeting their 10-year generation goals in just six years.⁵² And the Union of Concerned Scientists estimates that the state will create nearly 20,000 new jobs and gain an additional \$600 million in the Texas economy if the state meets its 2025 goals.⁵³

States should adopt similarly ambitious standards, including interim goals so utilities continue to invest in renewable sources. Steady growth in the renewables market reassures investors and provides predictability for renewable companies so they can manage growth.

Encourage CLEAN contracts

Across the world, the policy that has helped more than any other to bring more renewable electricity into the market is the Clean Local Energy Accessible Now, or CLEAN, contract, also known as a "feed-in tariff," according to the 2011 report, "CLEAN Contracts: Making Clean Local Energy Accessible Now," authored by the Center for American Progress and environmental advocacy groups, Groundswell and the Energy Action Coalition.⁵⁴ These policies allow owners of renewable electricity facilities to sell their power to utilities at a predictable, fixed price over a long period of time. Clean-energy growth requires substantial new investment, which requires a predictable market. Yet decades of policies favoring traditional fossil fuels, combined with an uncertain regulatory environment, create anxiety among clean-energy investors who are understandably hesitant about investing in promising technologies. These contract programs confront those challenges by providing clean-energy investors and owners with a stable market for clean energy at a reliable price. It makes it easier for consumers to buy and use clean energy and for business to move projects forward.⁵⁵ CLEAN contracts also provide an incentive for investment in nonutility-scale "distributed generation" of renewable energy, such as rooftop solar and community wind projects.

California’s CLEAN contract program,⁵⁶ for example, requires utilities with 75,000 or more customers to make a standard feed-in tariff available and allows customer-generators to enter into contracts of up to 20 years with utilities to sell the electricity produced by small renewable-energy systems at time-differentiated, market-based prices.⁵⁷ Under the program, utilities pay higher rates, for example, for electricity generated during standard business hours.

In 2009 the city of Gainesville, Florida replaced its existing solar-promotion programs with a feed-in tariff. The program there offers a 20-year contract at a constant rate with the city’s municipal utility, Gainesville Regional Utilities.⁵⁸ The plan has been deemed a success as Gainesville now ranks first in the state in renewable energy per capita and the strategic planning engineer for the utility has praised the program for its “impressive results” that have required no new staffers.⁵⁹

States should implement a CLEAN program at their municipally owned and cooperative utilities, and they should engage with the Federal Energy Regulatory Commission to clarify how they would view potential statewide CLEAN contracts.

Facilitate distributed generation

State governments should also focus on “distributed generation” in order to maximize the amount of renewable electricity they generate. This refers to smaller energy generators, such as homes and small- and medium-sized businesses that may generate renewable electricity via solar or other sources of clean power. CLEAN contracts can help to accomplish this effectively, but other strategies are available to states. This section will briefly describe four policies that states can adopt to further encourage distributed generation:

- Providing incentives to residential users and small businesses to install energy generators
- Adopting net-metering policies to allow small-scale producers to sell their power back to utility companies
- Establishing clear and uniform processes for connecting distributed-generation systems to the grid through comprehensive interconnection rules
- Encouraging broad-based public investment in small-scale projects

First, state governments should adopt programs that provide incentives to residential users and small businesses to install of energy generators. California’s

2006 Go Solar Plan,⁶⁰ for example, expanded existing efforts in the state to increase solar photovoltaic installation on homes and businesses. One program, the California Public Utility Commission's California Solar Initiative,⁶¹ is the largest solar rebate program in the world. This program incentivizes the installation of 1,940 megawatts of new solar capacity on existing homes by offering \$2.2 billion in rebates to residential customers of investor-owned utilities between 2007 and 2016. The initiative includes programs that target single-family, low-income homeowners⁶² and owners of multifamily affordable residential housing,⁶³ as well as funding continuing research and development.⁶⁴ In addition, the state's New Solar Homes Partnership⁶⁵ offers incentives for solar installation on new homes. By 2016 this \$400 million incentive program aims to install 360 megawatts of new solar capacity.

California has been a leader in distributed generation. As of the first quarter of 2012, California had brought on line 2,025 megawatts of solar energy capacity—roughly half of which are from small-scale installations, with the other half coming from utility-scale projects.⁶⁶

Second, states should adopt a net-metering policy to give distributed generation systems the ability to sell power back into the grid from small installations such as residential solar or wind units. More than 40 states now have some form of net-metering policy, and many states have passed recent legislation to improve their policies.⁶⁷

California and Utah have passed legislation to increase the amount of energy provided by net meters.⁶⁸ Others have clarified the ability of customers to sell excess capacity back to the utility at full value after the end of a billing period.⁶⁹

Colorado's net-metering policy⁷⁰ is considered to be one of the best, according to DSIRE Solar, a database of state incentives for renewables and efficiency funded by the U.S. Department of Energy.⁷¹ The state has no limit on the aggregate net-metering capacity, which means that any size renewable energy system can qualify, and the policy encourages utility customers to produce more energy than they will consume by allowing systems that produce up to 120 percent of a customer's average annual bill to qualify for the program.⁷² Also, customers receive credit for the energy they produce on their subsequent bill.

New Jersey's net-metering policy, established in 1999⁷³ and expanded in 2004⁷⁴ and again in 2012,⁷⁵ is also regarded by DSIRE Solar as one of the nation's strongest.⁷⁶ It has no individual system-capacity limit and no firm limit on aggregate net metering. Any net excess capacity is carried forward to the next bill at the full rate.

Third, state governments should establish clear and uniform processes and technical requirements for connecting distributed-generation systems to the electric utility grid through comprehensive interconnection rules. These rules reduce uncertainty for distributed-generation producers and protect energy end users by ensuring that interconnection costs are uniform throughout the state and commensurate with the size and scope of the project; allowing developers to predict the time and costs involved in connecting to the system; and ensuring that distributed-generation projects meet safety and reliability standards.⁷⁷

The Interstate Renewable Energy Council—a nonprofit organization committed to accelerating the sustainable utilization of renewable energy—has established model interconnection standards which incorporate a number of best practices, including requirements to ensure: all utilities are subject to the policy and all customers should be eligible; there are multiple levels of review to accommodate systems based on capacity, complexity, and level of certification; and application costs are kept to a minimum, especially for smaller systems.⁷⁸ To date, more than 30 states have adopted comprehensive interconnection rules that apply to both large- and small-distributed generation systems. States with some of the strongest policies include Virginia, Maine, and Utah.⁷⁹

Finally, one limitation on the broad-based expansion of solar energy is that many people have a hard time participating in its generation. Tenants in multifamily residential units commonly have no rooftops of their own to use to capture solar energy. And a huge number of single-family homeowners do not have rooftops with appropriate sun exposure.

Community-solar facilities—projects where community members pool investments and benefits into renewable energy development—solve this problem and maximize the potential of net metering. Colorado, for example, enacted the Community Solar Gardens Act in 2010, which allows for community solar gardens to be established. These facilities can be owned by a utility or by a for-profit or nonprofit organization with 10 or more subscribers, each of whom receive credits on their utility bills in proportion to the size of their subscription.⁸⁰

Ensure clean-energy and energy-efficiency jobs are good jobs and go to qualified workers

As state governments drive toward greater efficiency and renewable energy use, they should also focus on job quality. Without any preconditions on the qualifica-

tions of the workers, some utilities or their contractors and subcontractors may attempt to maximize profits by driving down wages or hiring workers without needed training. Some states have created programs to ensure that qualified workers are doing the renewable-energy and energy-efficiency work—including requiring workers to get proper certification, establishing a prequalification list of certified workers, and requiring that contractors hire workers from the list.

After the Center for Working Families and the Center for American Progress released the 2009 report “Green Jobs, Green Homes, New York,”⁸¹ challenging New York state to perform efficiency retrofits to 1 million homes over five years, the legislature passed the Green Jobs/Green New York Act.⁸² The program provides funding and support for training for jobs in the renewable-energy and energy-efficiency sectors, including jobs in the operations and maintenance of energy-efficient buildings. The program also helps create a market for this work by providing free and reduced-price energy audits and low-interest loans for residential and small-business owners to energy-efficiency improvements (as discussed in the next section on page 179).⁸³

The program requires that training institutions pursue accreditation by applicable independent organizations, such as the Institute for Sustainable Power, the Building Performance Institute, or the North American Board of Certified Energy Practitioners. And it provides for the recognition of existing state-funded training programs to train and place workers with green contractors. The program also conducts needs assessments to ensure that workers will continue to be well trained for existing jobs, especially as new competencies are required.⁸⁴

Use the state’s public power to leverage private funds for green investment

State legislatures should consider establishing state-level, green-financing instruments, which allow the government to combine scarce public resources with private-sector funding, and leverage these funds to invest in clean-energy projects that would likely otherwise not receive support.⁸⁵

Connecticut, for example, established the Clean Energy Finance and Investment Authority in 2011—making it the first state to create a green bank.⁸⁶ The bank combines different funding sources, including its public-benefit fund, to create an initial loan pool that is now being used to attract private-sector investment. Similarly, in 2010 Kentucky established a green bank that used Recovery Act funds to offer a revolving loan fund that finances energy-efficiency improvements of state agency buildings.⁸⁷

Alternatively, in states where setting up a new authority dedicated specifically to funding clean-energy projects is not feasible, legislatures should consider embedding a green-investment function in the state infrastructure bank.⁸⁸

Use energy-efficiency improvements to save money and drive job growth

Background

Americans use huge amounts of energy simply to heat, cool, and light indoor spaces. Buildings account for about 40 percent of total energy consumption in the United States, and about 70 percent of total electricity consumption; they are also responsible for 40 percent of carbon dioxide emissions.⁸⁹ For this reason, improving energy efficiency for existing buildings and new construction is critical to moving the United States toward a more sustainable energy economy.

In recent years, advocates for new green construction and existing structure retrofits have enjoyed success in the public and private sectors. High electricity prices have contributed to this, as building owners (especially in the manufacturing sector) struggle to contain costs. In addition, there is considerable interest in both sectors in constructing new buildings that are certified “green” by outside verifiers.

Indeed in the public sector, governments can reap many rewards in addition to reduced carbon emissions by making buildings energy efficient. More energy-efficient buildings would help reduce costs for the government. State and local governments spend more than \$40 billion each year on energy costs.⁹⁰ These costs have shot up over 50 percent in the last eight years, posing a growing threat to strained state budgets.⁹¹

Likewise, private-sector industries are investing in energy efficiency to reduce costs. U.S. manufacturing firms, for example, can significantly reduce costs by incorporating energy-efficiency improvements into their “lean-manufacturing” strategies.⁹²

States stand to enjoy huge fiscal savings by improving their energy efficiency through programs to ensure all new state facilities are built “green,” along with retrofitting existing buildings. And in the private sector, reducing energy costs can help significantly reduce costs for U.S. industries thereby increasing global competitiveness and

keeping jobs in the United States. These investments in energy improvements could generate thousands of new, high-wage jobs for workers retrofitting, constructing, and maintaining energy-efficient buildings. The upshot: States should not leave untapped the short-term and long-term benefits of improving energy efficiency.

Ensure that utility companies participate in the drive toward increasing energy efficiency

Investor-owned utility companies under a traditional payment structure make profits through an approved rate of return built into every unit of electricity they sell. That is to say, the more electricity utility companies sell, the more profits they generate. This creates a financial disincentive for utilities to encourage consumers to reduce energy consumption or invest in efficiency technologies.

State governments should ensure that utility companies participate in the drive toward increasing energy efficiency by enacting laws to decouple utility companies' profits from electricity sales combined with establishing strong Energy Efficiency Resource Standards.

Decoupling laws allow utility companies to raise rates temporarily to recover money it loses when electricity use drops. At least 30 states have approved some form of decoupling.⁹³

While decoupling laws neutralize the disincentive for efficiency, they do not create any positive incentive for utilities to invest in efficiency. Energy Efficiency Resource Standards—which have been adopted by at least 21 states⁹⁴—create this incentive by establishing long-term targets for energy savings that utilities must meet through customer energy efficiency programs.⁹⁵

Minnesota's state legislature passed the Next Generation Energy Act in 2007, which included decoupling for public utilities along with establishing Energy Efficiency Resource Standards.⁹⁶ The law requires utilities to reduce energy sales 1.5 percent below their "average sales" over three years and invest a portion of their revenues in energy-conservation improvements.⁹⁷ It also requires utilities to fund programs targeted at low-income customers, as well as programs to encourage all customers to use efficient lighting.⁹⁸

Under the Minnesota law, each utility must also develop a Conservation Improvement Plan every three years and file it with the Energy Division of the

state's Department of Commerce. They must report actual spending and energy savings on an annual basis. In 2009 and 2010, the most recent years for which data is available from the Minnesota Department of Commerce, utility companies invested more than \$391 million to conserve energy, achieving 1.6 million megawatt-hours of annual electricity savings and approximately 4.5 million thousand cubic feet of natural gas savings. This reduction in electricity use avoids an estimated 1.7 million tons of carbon pollution, according to the report.⁹⁹

Finally, when crafting decoupling language, policymakers should ensure that utility companies can only raise rates when utilization drops due to energy-efficiency improvements—and not for other occurrences that can cause use to drop such as economic downturns or power outages. Maryland's Public Service Commission amended its 2007 decoupling mechanism to disallow utilities from using bill stabilization adjustments following outages in January and October 2012.¹⁰⁰

Set high-performance building requirements

States should establish high-performance building requirements on new construction and major rehabilitation projects as well as building maintenance and operation with the broadest possible reach. This would require these projects to incorporate energy efficiency, durability, life-cycle performance, and occupant productivity into their design.¹⁰¹

In 2009 Washington's state legislature passed a law requiring that future updates to the state energy code incrementally increase efficiency standards for residential and nonresidential construction, so that the code will achieve a 70 percent reduction in annual net energy consumption by 2031.¹⁰² Washington's energy code largely adopts advanced energy-efficiency standards developed by ASHRAE, formerly the American Society of Heating, Refrigerating, and Air Conditioning Engineers.¹⁰³

Other states have adopted optional energy-efficiency codes. Oregon adopted an optional "Reach Code" for commercial construction—which is a set of optional construction standards designed to increase the energy efficiency of buildings above the mandatory statewide building code.¹⁰⁴ And in 2011 the Maryland legislature approved optional use of the International Green Construction Code for new private and public construction in the state.¹⁰⁵

In addition, states can begin by adding these requirements to state and local government buildings and other buildings receiving state financing, such as airports, ports,

schools, universities and colleges, medical institutions, and publicly financed college and professional stadiums. This is far from an insignificant place to start—researchers at the Center on Wisconsin Strategy estimate that this sector controls more than 16.5 billion square feet of office space, and uses \$40.7 billion of energy each year.¹⁰⁶

By using high-performance building standards, states set themselves up to enjoy long-term cost savings on energy usage. Tremendous gains have been made in energy-efficient construction over the last decade. As costs of normal construction have risen, the premium cost of high-performance construction has shrunk, and many estimates showing high-performance construction costs as only 2 percent to 5 percent more than traditional construction.¹⁰⁷ Any modest additional costs in building material will most likely be covered by energy savings in the years after the building goes into use.

In 2008 Maryland passed a requirement that new construction and substantial renovations of state buildings and new schools will meet the U.S. Green Building Council's Leadership in Energy and Environmental Design, or LEED, silver standard or a comparable level of an alternate standard approved by the state.¹⁰⁸ The requirement offered to pay to local governments 50 percent of the local share of any additional costs for achieving that standard. In 2012 the state expanded the requirement to the state's largest water and sewer utility.¹⁰⁹

In 2012 California Gov. Jerry Brown (D) ordered new and renovated state office buildings to meet the LEED Silver standard and, by 2025, be constructed as zero net energy facilities with an interim target for 50 percent of new facilities designed after 2020 to be zero net energy.¹¹⁰ State agencies must also try to achieve zero net energy for 50 percent of the square footage of existing state-owned buildings by 2025.¹¹¹

California is also requiring state-occupied buildings to reach set standards for operations and maintenance. The state's Department of General Services is leading efforts to ensure that all state-occupied buildings larger than 50,000 square feet attain LEED for existing buildings—operations and maintenance certification, which addresses building cleaning and maintenance issues (including chemical use), recycling programs, exterior maintenance programs, and systems upgrades.¹¹² As of 2012, 37 state office buildings have been certified under this standard.¹¹³

And in 2008 Florida passed a law requiring that new construction and the renovation of buildings owned by state and local governments, as well as state universities and community colleges, follow the guidelines of LEED or other green-building-rating systems, including Green Globes and the Florida Green

Building Coalition standards.¹¹⁴ The bill further requires that all new leases of state-occupied office space must meet Energy Star energy-conservation standards.

Finally, Oregon's legislature in 2011, unanimously approved their Cool Schools legislation, House Bill 2960, to create a high-performance school pilot program and a fund to help pay for energy-efficiency upgrades through grants and low-interest loans.¹¹⁵ Funding for the program includes sources such as federal Qualified Energy Conservation Bonds, the State Energy Loan Program, and private funds, and, in order to participate, school districts must hire only Oregon-based contractors.¹¹⁶ Similarly, Pennsylvania's Department of Education provides additional funding for certified green school construction projects.¹¹⁷

Improve energy efficiency of all K-12 schools

Thousands of older schools are enormously energy inefficient, filled with inefficient lighting along with wasteful appliances and heating and cooling systems. And their energy costs are further exacerbated if faculty and students are not focused on saving energy.

States should encourage local K-12 districts, even those without funding for updated equipment, to adopt Energy Star standards, an energy-conservation and management program developed by the U.S. Environmental Protection Agency and the Department of Energy.

This program uses automation systems as well as educational materials and rewards to teach students, teachers, and staff how to save energy. In St. Tammany Parish, Louisiana, officials began the program to help schools replace appliances and heating and cooling systems following Hurricane Katrina. For a \$300,000 investment, the school district saved more than \$1 million per year.¹¹⁸ Other elements of the program are aimed at improving indoor and outdoor air quality; enhancing lighting; and expanding recycling.¹¹⁹ States could improve on this program by adding a requirement for U.S.-manufactured appliances.

Expand residential energy improvements

States can increase residential energy efficiency by establishing a goal for home-energy retrofits.

In 2009 New York passed the landmark Green Jobs/Green New York Act ¹²⁰ to establish a program to retrofit 1 million homes over five years, which was estimated to create 14,250 jobs. The statute allocates \$112 million in revenue raised via the auction of greenhouse gas credits through the Regional Greenhouse Gas Initiative, and uses those funds to establish a revolving loan fund aimed at homeowners and businesses who want to make efficiency improvements.

The fund makes loans of up to \$13,000 to homeowners and \$26,000 to businesses, and also provides energy audits and a credit enhancement for critical private-sector capital investments. ¹²¹ The homeowner or business owner will pay the full cost of the retrofit over time, but they are estimated to enjoy savings of 30 percent to 40 percent. The program will create thousands of local jobs for contractors and the state estimated the program would save it up to \$1 billion. ¹²²

In 2011 the New York Assembly complemented the 2009 Green Jobs/Green New York Act with the New York Power Act. ¹²³ The power act, sponsored by State Sen. George Maziarz (R), authorized the nation's first statewide on-bill recovery program, which allows the costs of retrofitting a home or business to be included in a utility bill statement and paid in installments over time.

The law is critical because in New York, as in most states, the majority of residents cannot afford to pay the large upfront costs of retrofitting their homes. ¹²⁴ This “win-win” program allows manageable payments for homeowners while lenders are reassured by their inclusion on utility bills, which cash-strapped homeowners are more likely to pay than other bills if they have to choose. One especially smart feature is the calibration of monthly payments to the resultant energy savings so that the loan does not increase the ratepayer's monthly bill. ¹²⁵

And, as discussed in the previous section on page 173 the law provides funding for programs that train workers in the energy-efficiency sector—including retrofitting and the maintenance and operations of new energy-efficient systems. The program, operated by the New York State Energy Research and Development Authority, allows workers to gain valuable skills and credentials, which will help boost their wages. ¹²⁶

Many more states should follow New York's lead. The Center for American Progress has estimated that cutting energy use by 20 percent to 40 percent in just 40 percent of America's building stock would create 625,000 sustained jobs over

a decade and drive half a trillion dollars of new investment into the built environment, while saving ratepayers as much as \$64 billion every year on energy bills.¹²⁷

Help industries become more competitive by increasing energy efficiency

State governments can help industries become more competitive by incorporating energy-efficiency improvements into their “lean”-production strategies.

Lean-production strategies attempt to eliminate wasteful expenditures of resources that do not create value for the end customer. These strategies are highly focused on waste minimization and can—but do not always—produce environmental improvements.

Washington state is a leader in assisting in-state manufacturers “green” their production processes as they adopt lean production strategies. Industries use about 43 percent of total electricity and 36 percent of natural gas consumed in the state—producing 12.6 million metric tons of carbon dioxide equivalents and requiring companies to pay huge energy costs.¹²⁸

Washington’s Department of Ecology “Lean and Green Project” partners with Impact Washington—a nonprofit organization tasked with supporting in-state manufactures and improving competition—to help manufacturers integrate lean strategies and environmental methods in order to improve productivity, increase process efficiencies, reduce waste, and increase overall competitiveness.¹²⁹ The program provides both funding and technical expertise.

A 2008 review of the program pilot found that the three companies initially included saved a collective \$1.6 million in annual operational costs; saved 36,900 gallons of wastewater; reduced the use of hazardous substances by 68,700 pounds; and saved 146,700 therms of natural gas.¹³⁰ Additionally, the program helped improved manufacturer competitiveness by cutting production times, increasing flexibility, and allowing the companies to be more responsive to customer demands.¹³¹

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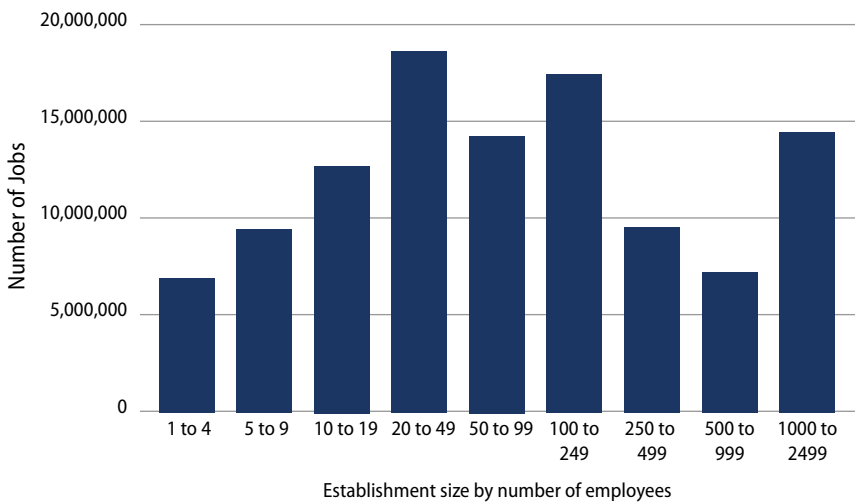
Strengthen local communities

While many communities have flourished in the past few decades, others have faced hard times and struggled to adapt to the realities of a new economy. Many local economies have not fully bounced back from the decline of employment in major industrial sectors like manufacturing. The well-paying, middle-income, middle-skill jobs have slowly faded away. The lack of jobs means less revenue for state and local governments, which in turn leads to cuts in important government sources, such as education. After these cuts, residents leave the state and the process repeats itself.

Instead of succumbing to their current situation, many states have taken proactive steps to help strengthen their communities and boost development in local economies. These programs help small business, spur innovation, boost local lending, improve the efficiency of community investments, and help low-income workers keep more of their money—all helping create the foundation of long-term economic growth. These programs, in conjunction with others detailed in this report can help many local communities get back on the way to economic prosperity.

FIGURE 8
Small and medium business employment

Small and medium businesses are important sources of jobs



Source: Business Dynamics Statistics, US Census Bureau

Background

All too often, states seek to boost economic development by offering ever-increasing tax breaks—but this strategy is unlikely to be a long-term winner for states. At best, this strategy simply encourages businesses to move from elsewhere, and its effectiveness at that is questionable.¹ More problematic: The strategy does not necessarily drive new innovation, which is important for long-run economic development that sustains high-quality jobs or attract the best kind of businesses—“high-road” business owners who obey the law, pay good wages and benefits, and know that their bottom line is better served by locating to areas with a skilled workforce and modern infrastructure, rather than the place that offers the biggest tax break. Moreover, these tax breaks are too often quite costly—eroding the state tax base for little public benefit.²

States are better served in the long run by investing in the human capital, infrastructure, partnerships, and culture that can help to catalyze the formation of innovation clusters. This means going beyond luring businesses to a state, but rather seeding the state’s economic soil with new businesses and forward-looking ideas with the potential to grow into new economic opportunities. And when governments do offer financial incentives to companies, they should ensure they offer a good return on their public investment, in the form of good paying jobs, a long-term commitment to remain in the community, and even a share of the profits.³

Increasingly, forward-thinking state governments are teaming up with the federal government, local institutions, and even other state governments—when regional economies spill across state lines—to invest in workforce development, economic development, and other programs to boost the competitive edge of our economy.⁴

These investments are being linked to “regional innovation clusters”—groups of diverse public- and private-sector stakeholders that together support innovation in states and regions. State governments are positioned to play a unique convening role in bringing together stakeholders—including existing companies, individual entrepreneurs, venture capitalists, new startup businesses, private and public universities, community colleges, regional economic development organizations, federal facilities, and job centers like ports and airports—to help innovation clusters form and grow.

When states bring together and encourage interaction among the building blocks of these clusters, innovation and economic growth result.⁵ Further, these public investments, according to many prominent economists, are linked to higher wages and higher rates of employment.⁶ While many states are investing in regional clusters, more can be done to grow local businesses and soften the ground for innovation.

Invest in technology incubators, accelerators, and regional innovation anchor institutions

State governments should support those who are already interested in innovation and entrepreneurship through direct financial support—direct grants or seed capital—as well as indirect supports such as counseling, office space, and entrepreneurship guidance.

Ohio, for example, has a public-private initiative called JumpStart, which provides a network of experienced entrepreneurs to provide one-on-one advice to first-timers.⁷ The most promising JumpStart clients compete for a limited pool of seed funding. And JumpStart acts as a hub for private-sector investors—connecting them to Ohio startup companies.

Pennsylvania's Innovation Works⁸ and Washington's Innovate Washington programs⁹ similarly provide a combination of counseling, networking, office space, and small pools of grant funding to bridge the gap between research and market, helping young technology companies get off the ground.

Other states invest directly in their own homegrown entrepreneurial talent. The Invest Maryland initiative, for example, is a \$70 million investment fund for early-stage technology companies in the state.¹⁰ Companies receiving the funds are required to pay back the state's investment and provide it with a share of the profits.¹¹

Pure Michigan Business Connect uses a network of different funds totaling \$2 billion to support small companies, startups, and technology commercialization within the state. And in Virginia the Commonwealth Research Commercialization Fund provides millions to seed-stage companies that are bridging the gap between university research and marketable product.

Connecticut Innovations operates essentially as state-run venture capital firms, but with an explicit focus on fostering high-technology entrepreneurship

activities in Connecticut.¹² And the state of Illinois Department of Treasury maintains a Technology Development Account, which invests in private-sector venture capital firms.¹³

Invest in innovation and commercialization on public university campuses

Universities are hubs of innovation, startup formation, and job creation. The research, science, and technology that flow from them are the major economic anchors of regions, but they are not being leveraged to their fullest potential to spin out new companies, new technologies, or new jobs in regional markets.¹⁴

State governments should increase the role their public-university systems play in local innovation. While there is no one right way to encourage university involvement in innovation, promising models are being adopted that:

- Increase investment in high-risk, large-scale, potentially transformative early-stage research (such as Nevada’s Knowledge Fund)
- Promote small-business spinouts and collaboration with cutting edge industries to bridge the gap between the lab and the marketplace (such as Michigan’s University Commercialization Initiative)
- Give faculty credit for patents and commercialization when they are being considered for tenure or promotion (such as the University System of Maryland)¹⁵
- Develop better infrastructure for measuring the impact of federally funded university research on human capital, jobs, and markets¹⁶

Many states are investing in the innovation that flows directly from university research. The University of Texas at Austin Technology Incubator, for example, provides office space and mentorship to startup companies that take root in university research or on the university campus.¹⁷ In Michigan, the Michigan University Commercialization Initiative provides seed funding for promising startups in the state working to commercialize the fruits of federally funded university research.¹⁸

Nevada also has two funds managed by the state’s Economic Development Authority that target universities: the Knowledge Fund and the Catalyst Fund

provide funding to universities and businesses, respectively, to develop and pursue business plans for the fruits of publicly funded research.¹⁹

Be more strategic about use of existing state funds to support innovation

Too often government programs supporting entrepreneurs by investing in human capital, workforce skills, infrastructure, and research lack a coordinated vision to work together to drive innovation.

Better coordination of existing programs to support small business—such as regional growth initiatives, research, technology, and workforce-development programs—can help make the most of each of those different efforts. Fortunately, many states have initiated reforms to help increase coordination among these different areas.

Colorado’s Gov. John Hickenlooper (D) signed an executive order asking each county to submit a summary of startup activity within its own borders to the state’s Office of Economic Development and International Trade, the findings of which will help guide statewide decision making about technology, talent, and economic development investments.²⁰

By assessing existing capabilities and developing a strategic innovation vision, states stand to improve their performance measures for job creation and innovation. Going even further, states could combine all statewide funding opportunities for technology, business development, economic development, and workforce training into a single common application, like standard college applications. This would help put decisions about aligning business, technology, and workforce programs in one place where they can better collaborate to promote innovation, while saving applicants time and money.²¹

Streamline and modernize government services for small businesses and start-ups

States can further help in-state small businesses and startups by streamlining and modernizing government services. Several states have redoubled their efforts to help small business by identifying outdated regulations and duplication, licensing and permitting hurdles, or needless regulatory duplication.

In 2010 Maryland Gov. Martin O'Malley (D) signed an executive order creating a small-business commission charged with identifying permitting, licensing, and regulatory barriers to business success. This led to the creation of Maryland Made Easy,²² a state effort to streamline application processes and simplify regulation, which has implemented three key policy initiatives:

- The Central Business Licensing Initiative: Created a one-stop shopping website to consolidate all state permits and licenses, and submit various applications
- Fast Track: A program to expedite state review of qualifying development projects, which will allow priority projects to receive increased state executive attention
- Access Permit Process: A new process from the State Highway Administration that will make it easier for businesses to obtain permits for development projects

And in 2010 Washington's Gov. Christine Gregoire (D) issued Executive Order 10-05, which includes a number of provisions to help small businesses compete on a fair playing field. The order consolidates small-business licensing, registration, and certification guides into one online resource and provides a plan to evaluate current regulatory steps and processes required of small business. It also identifies ways to streamline these processes and procedures without diminishing public health and safety.²³

Spur local lending

Background

In the wake of the Great Recession, small businesses are in a difficult situation. The economy is recovering, but finding a loan to start or grow a small business is difficult. The number of small-business loans has been on the decline since 2008, according to data from the Federal Deposit Insurance Corporation analyzed by the Small Business Administration.²⁴

And while small-business loans continue to shrink, loans to large business seem to be picking up, according to research by the Federal Reserve Bank of San Francisco, which also found that lending to small business has declined by more than \$47 billion since its peak in 2007.²⁵

While the Small Business Administration helps small businesses at the federal level, states can take action to improve credit access for local businesses. Unlike large businesses that can raise money in the stock or bond markets, small businesses are reliant upon bank loans.²⁶ Cheaper, more readily available bank loans would help entrepreneurs start new businesses as well as finance expansions of already existing small businesses. State governments can help increase the flow of capital to local businesses in several ways, including establishing a state bank and creating a “lend local” program.

Establish a state bank

State legislatures should consider establishing a publically owned state bank to spur local economic activity and facilitate small-business growth. The bank would primarily encourage lending indirectly through participation loans in conjunction with private-sector banks. By participating in these loans, the state bank would drive down the cost of the loan for both the participating bank and the customer and thereby allow for the loaning of more funds.

The main source of liquidity and funding for the bank would be deposits from the state government and all state agencies, which would be required to deposit funds in the state bank.²⁷ While the bank would eventually become self-sufficient, initial seed funding for the bank could come from the state general fund, general obligation bonds, or another dedicated funding source.²⁸

North Dakota has proven the value of such a system with their nearly century old model.²⁹ The Bank of North Dakota—the only state bank in existence in the United States—was created by the state legislature in 1919. The Bank of North Dakota routinely turns a profit and then returns those profits to the state’s general fund. Since 1945, when the bank started transferring profits to the state government, it has given more than \$555 million to the general fund.³⁰

Like the North Dakota model, state legislatures could enable the bank to take deposits from other organizations and individuals. The experience of North Dakota shows, however, that these deposits would not be a large portion of its deposits. Only 1.5 percent of the Bank of North Dakota’s total deposits are retail deposits.³¹ The small share of deposits from individuals should assuage concerns that a state bank would siphon deposits away from private retail banks.

Finally, legislatures should ensure that such a bank would be run by a professional, nonpolitical staff—such as other commercial banks—and be overseen by a board of directors appointed by the governor and chaired by the state treasurer.

According to the National Council of State Legislatures, there were 19 bills pending in 14 states as of May 2012 that would either call for study of the issue or create a state bank.³²

Create a banking partnership program for local businesses

States can also encourage private banks to lend to local, small businesses through “lend local” programs that provide dollar-for-dollar matches on all applicable loans with state funds deposited in the bank.³³ This reduces the risk of the loan to the bank because it knows an equal amount of funds are in its reserves. Participating banks would be required to pledge that the loans would go to local, small businesses, and the state would provide an oversight role to ensure that this happens.

In 2011 Massachusetts adopted this model through the creation of the Small Business Banking Partnership, which encourages loans to small businesses by moving state funds to community banks. Massachusetts originally intended to only deposit \$100 million, but the program was so popular that the initial amount was expanded and as of July 2012 the program had resulted in more than one-quarter billion dollars being moved to community banks.³⁴

In order to participate, banks must disclose their lending activity every quarter on their own website and the Massachusetts Treasury website.³⁵ Qualifying banks are also required to disclose their previous small-business lending practices to the state before entering the program, allowing the state to ascertain if the bank is seeking out new, higher-risk loans and prevent banks from receiving state assistance on loans they would have made anyway.³⁶

Maryland and Oregon adopted similar programs in 2012. The Maryland law³⁷—which is not yet been implemented—will require that the interest rate charged to the small business be two percentage points below the going rate. Oregon has taken a slightly different approach in which the state runs a fund that lends money to local banks, in addition to making loan guarantees for local and community banks.³⁸ Some activists have raised concerns that the fund will be too focused on

venture capital investments, which will be bought by out-of-state companies and neglect assistance to lending to local businesses.³⁹

Use social impact bonds to improve outcomes

Background

Social impact bonds are an innovative new form of funding social-service programs that pays for what actually works. The Center for American Progress has been a leader in exploring the policy implications of social impact bonds over the past several years.⁴⁰ State governments should begin to experiment with these programs while ensuring that they do not drive down government standards, including job standards for program workers.

Governments usually pay upfront for services to be completed, not for the actual outcome of the services. Too often, this method results in overly prescriptive guidelines that prevent the use or development of more effective delivery models over legacy programs. Furthermore, paying for outcomes allows the government to experiment with delivery models that have already proven successful in the philanthropic sector.

The social impact bond model instead pays depending upon the outcome of the service. More precisely, the government sets an outcome they want achieved relative to a specific population and contracts with an external organization that pledges to achieve that outcome. The external organization hires and supervises service providers who perform interventions intended to achieve the outcome. But the government only releases funds once the outcome has been achieved. For working capital, the external organization raises money from private investors to fund the interventions. If the programs are successful, the government releases an agreed-upon amount of money and the private investors receive a return on their investment. The model contains no direct relationship between the service provider and the government. Social impact bonds are an attractive investment for the private sector not only because they offer financial returns: Increasing interest in “impact investing” has many investors pursuing so-called “double bottom line” investments, which can result in both financial and social returns.

The model has been implemented in the United Kingdom and several state and local governments have started on the path to using social impact bonds. New York City has announced the first social impact bond in the United States to support a criminal justice program, while Massachusetts is negotiating two bond agreements and Connecticut and New York state are strongly considering the option.⁴¹ These financing instruments can help expand government services, particularly preventive services, as well as help develop best practices that can be incorporated into traditionally funded service provision.

Ensure state budgets can allow for proper use of social impact bonds

States should amend their budgets so they can allow multiyear payments for social impact bonds and ensure unspent funds will revert to a designated program instead of the state general fund.

The very structure of social impact bond agreements may not be compatible with current state budgeting practices. State budgets mostly operate on a one-year schedule, though several states have biannual budgets. Social impact bonds, however, require that payment for an ongoing service be delayed for several years, until the outcome is achieved. Governments are not used to making such delayed payments and should ensure that their budget rules allow for these sort of payments. States could alleviate this problem by allowing their budgets to delay payments and holding the funding in reserve until payment is due in accordance with social impact bond agreements.

Conversely, the external organization in a social impact bond agreement may not achieve the agreed-upon goals, meaning the government will not make a payment. This would result in the government having “leftover” funds. In many states, these unspent funds will revert directly to the state’s general fund instead of returning to the budget line for which the funds were originally intended.⁴² States can rectify this problem by writing into the statute that unspent funds return to a specific budget or by creating a trust fund to hold social impact bond outcome payments.⁴³

Guarantee that payments will actually be made upon success

States should assuage the concerns of external parties by extending the full faith and credit of the state to social impact bond outcome payments.

Due to concerns about politics and the short-term budgeting practices of state governments, external parties might be worried that they won't receive payment when a social impact bond project is complete. In a normal government-contracting situation, the provider would receive payment as the services transpired, not in a lump sum at the completion of the project. This deferred payment system creates uncertainty for external parties.

That uncertainty would be mitigated if the state guaranteed the payment, contingent upon completion of goals, with the full faith and credit of the state government. If the state reneged on the agreement, the state's government's credit rating and ability to raise funds would be impaired. Actual risk to the state, however, would be quite low for state governments that follow the state budgeting practices recommended above.

Massachusetts included this provision in appropriations legislation dealing with its social impact bond program.⁴⁴

Ensure state is not directly contracting with the service providers, while upholding high standards

States need to ensure that there is an arms-length relationship between the state government and the service provider while ensuring that they do not drive down government standards, including job standards for program workers.

One of the key aspects of the social impact bond's agreement is that service providers are chosen by external organization, not the state government. This allows the external organization to find the best possible service provider to achieve the outcome without being beholden to political considerations or legacy programs. But in order to ensure that social impact bonds do not drive down job standards, governments should consider how to apply high standards for government contracting (detailed on page 13) to service providers.

In the original social impact bond programs in the United Kingdom, which serves as the model for U.S. states, the external organization had considerable freedom to choose service providers.⁴⁵ Massachusetts conducted a procurement to select service providers for its social impact bond deals independently of its selection of external organizations.⁴⁶ States that use social impact bonds in the future should be cautious if they make this choice. If the state chooses the service providers an

external organization is to work with, the external organization may have grounds to claim that they are not responsible should the social impact bond agreement fail to achieve the specified outcome.

Protect residents from predatory lending and unfair financial practices

Background

Millions of working families across the United States struggle to pay bills and balance their family budget every month. And this struggle has been even more difficult during the economic downturn for large number of families with a wage-earner unemployed.

Short-term loans—such as those offered by payday lenders, auto-title loan companies, and rent-to-own contracts—promise struggling Americans access to the needed funds or assets to provide for their families. And for the unbanked, often the only way to access the money they earn is by paying high check-cashing fees.

The total cost of interest and fees charged in total by these practices weighs working families down with debt that is hard to escape. Payday lenders routinely charge a 400 percent annual percentage rate, for example. And it is estimated that 76 percent of payday loans are “churned”—meaning borrowers repeatedly take out payday loans to pay off previous loans—with the fees from churning netting lenders \$3.5 billion annually, according to a 2009 study by the Center for Responsible Lending.⁴⁷

Moreover, paying off this debt and fees creates a cycle where families cannot build the savings they need to withstand even a minor financial emergency, which is a particular concern since far too many Americans are financially fragile. Nationwide, 27 percent of households do not have sufficient net worth to subsist at the poverty level for three months in the absence of income.⁴⁸ And when a recent paper for the National Bureau for Economic Research asked American survey respondents in 2009 if they would be able to come up with \$2,000 in 30 days, only about half of all households reported being “certainly able” or “probably able” to come up with the amount.⁴⁹

The policies below will help protect residents from extremely unfair lending practices, prevent this cycle of debt, and promote savings for middle-class Americans.

Ban payday lending

State legislatures should ban payday lending. Payday lenders provide short-term loans that usually span only a few days or weeks—but turn a profit by charging extremely high interest rates.

In order to receive a payday loan, a borrower will write a check to the lender for the amount borrowed plus an additional fee. The lender keeps the check until the borrower returns later with a check, usually a paycheck, for the full amount, or the borrower can roll over the loan for an additional fee. In order to access these short-term loans, borrowers are charged rates astronomically higher than other consumer-finance products. One study found that the annual percentage rate on these loans range from 378 percent to 780 percent.⁵⁰

As of 2012, 14 states have prohibited payday lending.⁵¹ To do this, states require payday lenders to keep their rates and fees below the rate cap for other lenders in the state. Because the business model for payday lenders requires extremely high rates, the practice is effectively banned. Many states place some other limits on payday lenders, but the most effective route is to ban the practice altogether.

The recent experience of Arizona and Ohio show the popular support for eliminating payday lending. In 2000 Arizona passed a law exempting payday loans from the state's 36 percent interest rate cap on consumer loans with the provision that payday lenders would be subject to the cap again in 2010 unless a more permanent action was taken. In 2008 the payday-lending industry attempted to extend the exemption indefinitely through a ballot initiative to legalize payday lending.⁵² The initiative, however, was defeated by a wide margin and the ban was reinstituted in 2010.⁵³

Similarly, Ohio passed legislation subjecting payday lenders to a maximum interest rate of 28 percent. The law, supported by four former governors, survived a ballot initiative in 2008.⁵⁴ While lenders in the state have been aggressively fighting the rule, the public support for banning payday lenders is quite strong.

In Ohio's case, however, lenders have been able to find loopholes in the law by using different types of business licenses. State laws must be matched with enforcement support from state attorneys general as well as state banking and licensing agencies.

Ban auto-title loans

Auto-title loans are a similar short-term predatory lending scheme whereby loans are secured by signing over the title of the borrower's automobile, and in some states handing over a set of keys.⁵⁵ If the borrower fails to pay back a loan, the lender can take and sell the car.

The Corporation for Enterprise Development recommends that states should enact laws that either ban car-title lending entirely or institute a cap on interest and fees with an annual percentage rate of 36 percent.⁵⁶ Significantly more states—31 in total—have outlawed high-cost car-title loans, either through outright bans or interest-rate caps, than have banned payday lending.⁵⁷

Cap check-cashing fees

Americans without bank accounts are encountering more expensive fees as they cash checks at check-cashing centers rather than at banks. Between 1997 and 2006, the average cost to cash a paycheck rose by 75.6 percent,⁵⁸ so that the average blue-collar worker cashing a paycheck in 2006 was charged \$19.66 for a \$478.41 check, according to the Consumer Federation of America—more than 4 percent of the worker's income gone just to cash the check.⁵⁹

State legislatures should protect the unbanked by capping check-cashing fees to modest amounts. The American Association of Retired Persons, or AARP, has created a model state statute which ensures that no check-cashing location may charge more than 1 percent or \$5, whichever is less, for the cashing of a check that is either a payroll check or a government check, and grants the consumer a private right of action to sue for any fraud.⁶⁰

So far 24 states have passed laws to cap check-cashing fees.⁶¹ New York, for example, caps the amount that can be charged on cashing checks at 1.91 percent of the face value.⁶²

Treat rent-to-own contracts as credit transactions

Rent-to-own contracts should be treated as credit transactions and regulated as such, subjecting them to interest-rate caps and truth-in-lending requirements.

Stores with rent-to-own programs allow customers to take possession of good in return for regular payments over a period of time. The stores claim that customers are essentially renting out goods for a short period of time. A customer, for example, might want to rent a large screen television to watch a big football game with friends. But in reality, the large majority of customers actually intend to buy the good at the end of the rental period. According to the Federal Trade Commission, 90 percent of merchandise that customers made substantial contributions toward were purchased and only 10 percent were returned.⁶³ So instead of serving as a rental service, the company essentially has provided a loan to the consumer. And for the most part, the final cost of rent-to-own goods is much higher than the cash price.⁶⁴

Forty-seven states regulate the rent-to-own industry, with the majority of the regulations being very similar.⁶⁵ These laws require contract disclosures, restrictions in fees, and disclosures of in-store fees.

Only a few states recognize rent-to-own sales as credit transactions. Courts in states including Wisconsin, Minnesota, and New Jersey have ruled that rent-to-own transactions are credit sales and can be regulated under state laws governing credit sales.⁶⁶ New Jersey regulates the transactions and subjects them to an interest-rate cap.⁶⁷

Vermont does not consider rent-to-own a credit transaction, but it does require the disclosure of effective interest rates.⁶⁸

Require an opt-in for sharing of private financial information

States should require financial firms to receive an affirmative response from a customer before they share private information with a third party.

Financial institutions are currently allowed to share and even sell private information about an individual to other institutions, such as retailers, airlines, and telemarketers.⁶⁹ This information can include what you have purchased recently, how much you've borrowed, and whether you pay back your loans on time.⁷⁰ Financial institutions are required to disclose the information to customers and allow them to opt-out of the information sharing. This process, however, puts the burden on the customer to protect her or his privacy.

Requiring the financial institution to get confirmation from the customer that they can share information would function as an opt-in option. The burden would

therefore be shifted onto the financial institution. Furthermore, customers would be more aware of and have more control over their private information when faced with having to consent to the sharing of information.

California was the first state to require an opt-in provision for the sharing of private financial information, and 22 states have now enacted these provisions.⁷¹ While opponents of the California law challenged it in federal court, the 9th Circuit Court upheld the law and the Supreme Court declined to review it.⁷²

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Conclusion

Americans believe in an economy that works for everyone. But the American promise—the idea that if you work hard you can achieve the good life, exemplified by a secure paycheck that grows year after year, a nice home in a safe neighborhood with decent schools, retirement savings, health care, some leisure time to spend with friends and family, and the ability to send your kids to college and pass along to them a bigger share of the American Dream—is slipping out of the grasp of far too many.

State governments have a tremendous responsibility to help restore this promise and can be part of the solution to rebuild a strong and growing middle class. Progressive state leaders can help chart a course that underscores American ideals of fairness, equity, and opportunity, recognizing that our country’s greatest strength has always been our people. Doing so is essential for a vibrant democracy and a healthy economy—and for our conception of what the United States is all about.

This report presents a middle-class agenda that is big and bold, and rises to the scale of the challenges we face. Adoption of the proposals we’ve detailed here will help states fulfill their obligation to significantly improve the lives of residents by strengthening the middle class and the economy.

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