Policy Memos for North Carolina Leadership Forum

Submitted by the North Carolina Justice Center & the John Locke Foundation

TABLE OF CONTENTS

PROPOSALS FOR CREATING A MORE ROBUST CAREER DEVELOPMENT SYSTEM

1. **Should North Carolina increase funding for job-training programs provided by the state community colleges – and take other steps to enable students to complete these programs?**

2. **Should we expand and improve programs that provide a pathway from high school into post-secondary credentialing programs that in turn lead to higher wage jobs?**

3. **Should NC employers expand apprenticeship opportunities, and, if so, should the state encourage and/or incentivize employers to increase the number of apprenticeship openings?**

1. Should North Carolina increase funding for job-training programs provided by the state community colleges – and take other steps to enable students to complete these programs?

Answer: The efficacy of state-run job training has not been proven. Leaders should focus on policies that create new jobs, and on eliminating barriers for private training providers.

Analysis: Economic research in job training has frequently found government job training programs to be inefficient and their benefits hard to quantify. Furthermore, it is not unusual to see new programs duplicating existing programs.

The federal Government Accountability Office in 2011 infamously identified 47 separate but mostly overlapping training programs spanning nine federal agencies at a cost of $18 billion in 2009. For North Carolina, in 2012 the Fiscal Research Division of the General Assembly identified 11 different state agencies involved in workforce development at a cost of $1.4 billion (25 percent of which was federal money).

Private-sector programs to train current or prospective workers, which face more immediate incentives than government programs, are ultimately judged on their abilities to place trainees in jobs successfully. Often government training programs don't even self-check their employment outcomes or rein in their excesses, as James Bovard showed in a 2011 piece in *The Wall Street Journal*.

Beyond private vs. public incentives, a related aspect suggested by researchers for greater returns to private and company-sponsored training over government training programs is mutual ownership in the training process; both trainee and trainer are invested in a positive outcome. This aspect *can* be at work with job training in an education setting, be it technical or trade schools or community colleges — if the schools are competing for students as opposed to just competing for government training funds.

Formal or informal on-the-job training is especially good for developing skills needed to succeed. Employees who are "trainable" are highly valued. Being trainable is a *soft skill* that is a forerunner to acquiring hard skills.

In a 2015 *Wall Street Journal* survey of nearly 900 executives, 92 percent rated soft skills just as important or even more important than technical skills, but 89 percent reported having a hard time finding people who have them. Soft skills include an ability to communicate, organization, a team-player attitude, punctuality, critical thinking, social savvy, creativity, flexibility. On a more basic level, they include common sense, proper attire, good hygiene, good work ethic, respect for others, even self-control and sobriety.

Job-training charities such as like StepUp Ministry, Jobs for Life, and STRIVE put particular emphasis on teaching these soft skills to the "hard to employ" people they minister to. A restaurateur interviewed by the *Journal* put it this way: "I can teach somebody how to slice and dice onions. I can teach somebody how to cook a soup. But it's hard to teach someone normal manners, or what you consider work ethic."

The lesson of Janesville, Wisconsin, following the closure of a big General Motors plant provides a sobering reminder of the limits of community college training with respect to retraining displaced workers. A ProPublica report by *Washington Post* writer Amy Goldstein and supported by the Joyce Foundation, Harvard University's Radcliffe Institute for Advanced Study, the Woodrow Wilson International Center for Scholars, and the University of Wisconsin-Madison Institute for Research on Poverty found that displaced workers — 1,740 in total — who went to the local community college (Blackhawk Technical College) were "faring worse than their laid-off neighbors who did not."

It could be that state training programs put the cart before the horse. As Anthony Carnevale, director of the Center on Education and the Workforce for Georgetown University, explained, "Training doesn't create jobs. Jobs create training. And people get that backwards all the time. In the real world, down at the ground level, if there's no demand for magic, there's no demand for magicians."

From that perspective, the focus for North Carolina policymakers should be on policies proven to foster and not hamper the economic growth that creates jobs. That, in turn, will create incentives and opportunities for training to fill those jobs. As the ProPublica report phrased it, "find the macro-level economic alchemy that will generate jobs — even in places such as Janesville."

Primarily that would involve making sure tax and regulatory policies don't unnecessarily discourage people from setting up shop, don't stymie business investment and expansions, and don't add to the expense of making new hires. And for that matter, don't make it harder to set up and support charities that have proven success at equipping the downtrodden and "hard to employ" with the soft skills employers want from them. The community college system is not obviously better at addressing these needs than other providers of job training.

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1. Should North Carolina increase funding for job-training programs provided by the state community colleges – and take other steps to enable students to complete these programs?

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Context

North Carolina's investment in job training and other workforce development efforts has dwindled since the end of the Great Recession, despite the huge economic challenges facing the state's workers and the need to prepare them for the higher-skill jobs that lead to prosperity.

By 2020, 61 percent of jobs in North Carolina will require some kind of postsecondary training or education.[1] Yet just 26 percent of the state's working-age population (ages 18 to 64) has some post-secondary education, and just over one-third have actually completed an associate's degree.[2] Additionally, only 20 out of every 10,000 workers in North Carolina have some type of industry-specific certificate or credential.[3] Unless the state puts more resources into creating a skilled, well-educated workforce, it will continue to fall behind the rest of the nation in career opportunities and family income.

As North Carolina continues to shift from an economy based on manufacturing to one based on providing services, too many of the state's workers are faced with a harsh reality: full-time work no longer guarantees a pathway to the middle class. Jobs in manufacturing industries that once provided families with enough income to make ends meet are being replaced by service industry jobs that all too often end up locking workers into a lifetime of low-wage work.

One key to unlocking more opportunity is strategically investing in skills training and education for adult workers. Research shows such an investment pays off — nationally, workers with even some post-secondary education earn $3,600 more than workers with just a high-school diploma; those with a bachelor's degree earn $22,000, on average, more than those with a high-school diploma.[4] Similarly, participants in training programs supported by the federal Workforce Investment Act saw large annual income gains in the years after completing the programs. Men saw an average $1,700 increase in income every year, while women saw an even larger $2,400 annual increase.[5]

Current Policy Approach

In recent years, North Carolina's policymakers have focused on realigning the state's job training system, but have not invested the financial resources necessary to ensure these realigned programs are delivering services to everyone who needs them.

While it's important to align job training service providers within the state's workforce system and create concrete ways of measuring its success, providing adequate funding for *delivering* training services is equally essential for meeting the challenges raised by a changing economy. Unfortunately, there has been a decline in state investment in workforce development programs, while recent changes in how the programs are run have also failed to extend their ability to reach the communities and demographics that need them most. Specific problems include:[6]

- Overall state funding for North Carolina's workforce development programs has declined by 10 percent in the years since the end of the recent recession.
- Federal funding has declined by 6 percent over the same period.

- In terms of targeting problems, federal workforce development dollars reach less than 1 percent of adults without a high school diploma, leaving those most in need of training without the resources needed for building job skills.
- The Basic Skills Plus program, which supports the development of bridge programs that help adults prepare to pass the GED test and provides industry training in targeted areas, has not received additional funding for several years.

Last, the state is not adequately supporting the Community College System, the primary deliverer of job training services. The FY 2016-2017 budget included a $26 million reduction in community college enrollment funds due to projected fall in the number of students attending. This represents an enormous missed opportunity—instead of cutting funds, budget writers could have taken that $26 million and reinvested it in Basic Skills Plus or other job training programs. While the budget partially restores $12 million in general funding to community colleges that aren't tied to workforce development, only half ($6 million) represents a permanent increase. Serious questions remain as to whether this truncated investment will be enough to support the growing needs of training our state's workforce.

Policy Options

Policymakers face a basic choice: (1) expand job training funding to adequately meet the needs of the state's economy, or (2) keep funding at its current stagnant levels.

Researchers have long stressed the importance of adequate funding for achieving desired outcomes. Increased funding for workforce development raises participants' incomes in the span of just a few years as these workers gain the skills they need to secure higher-paying jobs.[7] Adequate funding has also seen a corresponding 10 percent increase in employment levels for previously jobless workers who now have the skills they need to find work.[8] Without funding, delivering these training programs to the workers who need them would be impossible. Certainly cutting funding has never been found to improve worker skill levels or earnings, since fewer dollars spent means fewer students enrolled, lower-quality instruction, and lack of access to relevant technology and machinery. Additionally, a significant body of research recommends increasing funding for workforce training as a critical tool for improving their effectiveness—especially when tied to robust evaluation of these programs to ensure public dollars are being spent effectively.[9]

Policy Recommendation

North Carolina needs to recommit to putting state dollars toward workforce development goals, particularly improving the skills of low-income workers and targeting resources at industries that can deliver the greatest return to the state. Among the steps it should take:

- **Maximize federal dollars:** North Carolina continues to underutilize employment and training funds available through the Supplemental Nutrition Assistance Program to support workforce development for low-income people.
- **Target state funding to high-need communities and populations:** It is critical policymakers target state dollars to communities and populations hardest hit by the Great Recession, including rural areas and communities of color. This requires ensuring hard-to-reach populations, such as the long-term unemployed, can access workforce development services and connect with job search and training opportunities. Funding for Basic Skills Plus is essential.
- **Target state funding to support training for industry-recognized credentials:** Available data on return on investment suggests workforce development will be most effective if it can train workers for the jobs of the future. It is critical to ensure state funding is supporting institutions like community colleges that are primarily delivering this training.

2. Should we expand and improve programs that provide a pathway from high school into post-secondary credentialing programs that in turn lead to higher wage jobs?

Answer: While certification and licensing programs have promise, they vary widely by value and effectiveness. Policymakers should avoid making sweeping generalizations and focus on removing barriers to experimentation by multiple providers and users.

Analysis: The academic literature suggests that certificate[10] and licensure programs strengthen employment prospects and increase lifetime earnings for those who obtain them.[11] But not all credentials and credentialing programs are created equal.

Much of the research in the area examines economic returns for those awarded a so-called "sub degree" or "sub-baccalaureate" credential by community colleges.[12] North Carolina's community college system has been the subject of a handful of these studies and findings have been mixed. A 2014 study of medium-term labor market returns to community college awards in North Carolina concluded that, unlike associate and bachelor's degrees, economic returns from sub baccalaureate credentials were weak – with the exception of credentials in health fields and protective services.[13] On the other hand, a 2016 study using superior methodology found a strong relationship between long-term certification programs, earnings, and employment for students in North Carolina community college sub-baccalaureate credentialing programs.[14]

These and other studies suggest that economic returns are largely dependent on three factors – duration of the program, the field of study, and the credential-granting institution. There are notable differences in returns for students receiving a certificate in a short-term program, which require less than one year to complete, compared to those in long-term programs, which generally require more than one year.[15] For example, in the 2016 study mentioned above, there were no statistically significant economic gains for students who received a short-term certification in a community college.[16] Not all researchers agree, however, and some contend that even the partial completion of a certificate or degree program may have economic value.[17]

That said, certain fields of study can mitigate duration effects. One consistent finding is that labor-market returns are closely tied to the fields of study.[18] Students completing a long-term certificate in a healthcare field enjoyed the strongest returns, while short-term certificates in vocational and healthcare fields provided strong economic returns for men and women, respectively.[19] On the other hand, wages for those earning certificates in hospitality management, communications, human development, educational services, and cosmetology appear to produce minimal gains.[20] The variations of economic returns has led some researchers to argue that sub-baccalaureate credentials perpetuate structural inequalities.[21] Others believe that expanding post-secondary credentialing programs would have the opposite effect.[22]

The credential-granting institutions also plays a role. A recent study found that applicants with a sub-baccalaureate credential from for-profit institutions are much less likely to receive a callback from employers than those who received a credential from a public institution.[23] Yet, for-profit institutions and other private entities play an important role in supplying post-secondary credentialing programs. Private providers may more easily and quickly adapt their training programs to changes in the labor market or technological innovation without the institutional constraints that impede change among degree-granting institutions and government agencies.[24]

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2. Should we expand and improve programs that provide a pathway from high school into post-secondary credentialing programs that in turn lead to higher wage jobs?

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Context

Based on current trends, by 2020 61 percent of all jobs in North Carolina will require some form of postsecondary education and training that leads to advanced credentials (e.g. registered nurse certification, master plumbers' certification, associate's degree, bachelor's degree).[25] Currently just 39 percent of working-age adults in North Carolina possess an associate's degree or higher, representing a "skill mismatch" that will continue to grow in the future wherein there are not enough qualified applicants to fill the growing number of high-wage, highly skilled jobs.[26] Given the ever-increasing percentage of jobs that require higher levels of educational attainment, North Carolina must focus on ensuring far more students graduate high school and college career-ready and that adequate supports are in place to help young adults make the difficult transition from high school to a postsecondary education and career.

Expanding and improving existing programs that provide a pathway from high school into post-secondary education is an essential step toward enabling more North Carolinians to earn a living wage that supports their families. The overwhelming majority of middle-wage jobs ($32,000-$53,000 per year) and high-wage jobs (more than $53,000 per year) currently being created are all in fields that require post-secondary education, as evidenced by sectors that are currently accounting for the most new job openings: Managerial and professional office jobs, STEM (Science, Technology, Engineering, and Math), and Healthcare.[27]

Ensuring students are college and career-ready begins in the earliest years of education that provide the foundation for future learning. The entire education system must be robust enough to ensure there are no skill gaps at any point during a child's development. Expanded, improved college and career pathways must be built on this strong foundation and provide meaningful supports to young adults as they begin careers that will support their families.

Current Policy Approach

North Carolina's college and career readiness program revolves primarily around "Every Student READY" (READY), an attempt to combine college and career readiness initiatives. READY, which operates primarily through the North Carolina Department of Public Instruction (DPI), prepares more students for college and work by developing more rigorous standards, assessments, and accountability mechanisms aligned with the ACT.[28]

DPI's Career and Technical Education (CTE) concentration has successfully increased the number of students obtaining credentials. The CTE initiative offers programs in Agriculture, Business, Finance, and Information technology, Career Development, Family and Consumer Science, Health Science, Marketing and Entrepreneurship, Technology Engineering and Design, and Trade and Industrial Education.[29]

Current attempts to improve this system focus primarily on improved alignment between North Carolina's K-12 education system and the university and community college systems to ensure high school graduates are adequately prepared to succeed in higher education. Over the next three years, DPI will work with the North Carolina Community College System to rollout new curricular models developed by colleges; provide college and career readiness professional development to high school teachers; establish measures of determining readiness by the junior year; and establish analytics that determine successful remediation completion.[30]

The need to focus on alignment issues in North Carolina is understandable given the innumerable efforts to ensure readiness and improve the pathway from high school to postsecondary education and into higher wage job. Such efforts include: Cooperative and Innovative High Schools (including Early College High Schools), partnerships between the UNC system, community college system, and high schools, partnership with the Southern Regional Education Board and College Board, ACT/WorkKeys, credit recovery, and diploma endorsements.[31] Recent bipartisan research from the National Conference of State Legislatures that finds Career and Technical Education play a critical role in building a world-class education system are consistent with our position that this is an important investment for our state. From the report:

> Interest in career and technical education (CTE) is emerging in many top-performing countries as a strategy to boost the national economy and offer a high standard of living and attractive careers to a broader constituency. Singapore and Switzerland, in particular, have built strong systems of CTE with close ties to industry. Singapore uses a school-based model and Switzerland uses an employer-based model.7 In these countries, CTE is not perceived as a route for students lacking strong academic skills, but as another approach to education, skills development and good jobs. CTE is well funded, academically challenging and aligned with real workforce needs. It is hands-on, attractive to students and parents, and can lead to university for students who may seek professional and managerial positions later. For other students, CTE is a pathway to good jobs, by building technical skills that can be achieved much earlier than the traditional academic experience.[32]

Policy Recommendation

North Carolina must strengthen its early childhood and K-12 education system to ensure all students have the resources and supports needed to participate in some form of postsecondary education if students are to fill the need for the increasing number of higher skill jobs that allow them to provide for their families.

The majority of students who fail to meet the current standards for college and career readiness are from low-income families. Not only do they need increased access to early education to stop skill gaps from developing before they start, but they also require supports such as textbooks and instructional materials, high quality teachers, individualized attention, extended learning time, tutoring, and mentoring from professionals in careers students are interested in pursuing.

Students currently have access to a number of CTE programs, but many fail to take enough courses in a given area to truly put them on a path to college and career readiness in a particular field.[33] Improved and expanded professional development for teachers and counselors in these areas, college and career readiness training, and improved counselor-to-student ratios would all help ensure students are taking advantage of these expanded offerings and that their courses align with their personal postsecondary and career goals.

Finally, North Carolina must provide improved and extra instruction to students in 11th and 12th grade as well as incoming first-year college students that offer remediation and support the transition from high school to college – often where many students' postsecondary education ends. All high schools, particularly those that are low performing, should provide transitional, postsecondary-readiness classes to students who are not currently meeting the state's college and career readiness standards.

In summary, North Carolina has improved its system greatly in recent years by working to align high quality college and career readiness standards at all levels of education so that students' courses of study align with the expectations of postsecondary institutions and employers. Yet North Carolina must provide far more individualized educational interventions to help students meet these standards, and these supports should be targeted to low-performing schools with the highest numbers of underprepared students to ensure students can continue on a path toward careers that support their families.

3. Should NC employers expand apprenticeship opportunities, and, if so, should the state encourage and/or incentivize employers to increase the number of apprenticeship openings?

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Answer: The state should strongly encourage, but not offer incentives, to employers who offer apprenticeship and work-based programs if they believe it to be in their best interest to do so.

Analysis: For decades, economists have considered the costs and benefits of adopting variations of highly developed apprenticeship systems operating in Germany and Switzerland.[34] Such efforts are based on the belief that apprenticeships are almost always a "win-win" for employers and apprentices. For employers, it is an efficient and cost-effective way to address skills and knowledge that are deficient in the workforce. For apprentices, it is a way to acquire hard and soft skills that boost employment prospects and wages.

Nevertheless, not all firms have the incentive or capacity to support apprenticeships. Businesses in the United States have reasonable concerns about the costs and benefits of work-based programs. During the initial apprenticeship period, the cost of paying wages to apprentices and trainers, supplying apprentices with requisite equipment and materials, and compensating for lost productivity far exceeds any short-term benefits. Studies of apprenticeship programs in Germany, Switzerland, Austria, and England indicate that between 29 and 88 percent of firms incur a net cost from apprenticeship programs.[35] A separate study found that 60 percent of all Swiss firms that sponsored apprenticeship programs encounter a net cost.[36]

Only when the apprentice obtains knowledge and skills comparable to trained workers, and applies what they have learned for an extended period, does the business begin to recoup their initial investment. Studies of German and Swiss apprenticeship programs indicate that only between one-third and one-half of apprentices remain with the firm that trained them.[37] As such, business may be reluctant to invest in an apprentice because they believe that it will ultimately benefit their competitors. While a valid concern, research suggests that the likelihood of "poaching" talent depends on the industry, the quality of the program, and market conditions.[38]

Multiple legal and regulatory barriers also impair the ability of the business in the United States to retain an apprentice long enough to recover their initial cost training costs. Child labor laws, union contracts, state and federal statutes, agency-enforced rules and regulations, and policies established by educational institutions or sponsoring entities impose limits on the amount of time that an apprentice can work and, thus, limit the return on investment.

The size of the business also plays a role. Larger firms often have the capacity to train several apprentices simultaneously, thereby reducing the marginal cost of training each. Additionally, large businesses are better positioned to recoup their costs because they are likely to have post-apprenticeship job opportunities available. Small and medium enterprises (SME), on the other hand, have limited resources and are less likely to be able to recoup their investment through subsequent employment of the apprentice.[39] Subsidies or tax incentives for firms that sponsor apprenticeships may put SMEs at an even larger competitive disadvantage.

In the end, North Carolina should strongly encourage, but not offer financial or tax incentives, to employers who offer apprenticeship and work-based programs if they believe it to be in their best interest to do so.

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3. Should NC employers expand apprenticeship opportunities, and, if so, should the state encourage and/or incentivize employers to increase the number of apprenticeship openings?

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Context

Apprenticeship programs show great promise as a strategy for growing the incomes of working North Carolinians. According to the U.S. Department of Labor, the average salary for a worker who completes an apprenticeship program is $50,000.[40] Apprenticeship programs are unique from other workforce development strategies in that they combine classroom learning with paid on-the-job training and guarantee job placement upon graduation from the program. The apprenticeship model also sets the path to higher employment opportunities by encouraging life-long learning through trainings that award additional credentials to participants.[41]

The long-term benefits of apprenticeship programs for workers are significant. A cost-benefit analysis of apprenticeship programs in 10 states, conducted by Mathematica Policy Research, found individuals who participated in an apprenticeship program made $66,000 more during the nine-year study period than individuals who did not participate ($114,000 for participants, $48,000 for non-participants). Another study found the average participant in apprenticeship programs experiences an additional $300,000 in earnings over the course of their career. [42]

Current Policy Approach

Despite the benefits, our state underutilizes apprenticeship programs as a way to grow wages. In 2014, only 3,325 adults received apprenticeship training out of a total 93,005 adults leaving workforce development programs in the state, a decrease from previous years. The 2009-2010 apprenticeship cohort, for example, comprised of 7,976 individuals; in 2010-2011 only 5,591 enrolled in programs across the state.[43] Both the numbers of program participants and available apprenticeships in the state have decreased, signaling that more than an improving economy is at play in the decline. The U.S. Department of Labor's registered apprenticeship database yields only 208 current apprenticeship positions in the state, though not all are presently accepting applications for the positions.[44]

This year, North Carolina policymakers allocated $500,000 in state General Fund dollars to expanding apprenticeship opportunities in the state, increasing the net appropriation for the program to $1.4 million for the 2016- 2017 fiscal year. Despite this increase, net appropriations for apprenticeships are $74,446 less than they were three years ago in the 2013-2014 FY budget. North Carolina also falls behind other states when it comes to public funding for apprenticeships. Iowa, for example, saw promising results in apprenticeship expansion after policymakers tripled public funding for apprenticeships, allocating a total of $3 million dollars in 2014. This increase in public funding was used to expand apprenticeship opportunities by way of competitive grants offered to employers. By 2015, 67 employers had applied to receive grants.[45]

Policy Options

In order to increase the number of apprenticeship slots available to workers, there are two primary policy options available to encourage employers to offer these slots.

First, North Carolina could fund a portion of the cost incurred by employers for placing apprentices directly and reduce the costs by expanding training funded through NC Works. Traditional funding models for apprenticeship programs place a large fiscal burden on employers who are responsible for covering the cost of training, supervision, and salaries for apprentices. Due to the high costs of these programs, employers can only provide a limited number of apprenticeship opportunities, which are not enough to meet the demand among job seekers.

Second, North Carolina could expand employer recruitment efforts to areas that have traditionally seen little to no apprenticeship openings and otherwise market apprenticeships to employers and workers. Lack of information is the primary driver of low levels in apprenticeships. While marketing and recruitment has not proven to increase the number of recipients, it has shown promise in ensuring the diversity of applicant pools and occupational pathways. By building relationships with employers in these areas, state leaders can ensure workers in all regions of the state have an equal opportunity to engage in apprenticeship programs.

Policy Recommendation

The most direct way for North Carolina to increase the use of apprenticeships – and in turn grow wages – is to increase public funding for apprenticeship initiatives across the state. These funds can subsidize an appropriate portion of the cost to employers as well as the operations of apprenticeship placement, trainings, and evaluation through NC Works. Employers depend on NC Works to develop programs that train workers; connect them to instruction providers; provide consultations on recruiting, screening, and testing of potential apprentices; register their programs with the U.S. Department of Labor; and continually monitor and audit their apprenticeship programs. It is clear additional funding is needed in order to support NC Works' efforts and expand their current services to other businesses.[46]

In addition to funding, the role of NC Works could be expanded to create partnerships among industry leaders to discuss competency standards for different apprenticeship positions, identify occupations in industries for which new apprenticeship positions could be created, and continually discuss how existing apprenticeships can be improved. This strategy is successfully being implemented in Minnesota, where 400 industry and education stakeholders continually convene in council meetings to discuss the state's registered apprenticeships.[47] It is critical that these efforts target industries and occupations that place a high priority on outreach to low-wage workers in order to increase earnings for more North Carolinians.

PROPOSALS FOR PROMOTING SMALL BUSINESS ENTREPRENEURSHIP

1. **Should NC reform occupational licensing policies for specific occupations where current practices make it unnecessarily difficult for new entries?**

2. **Should the state support small business incubators that have the facilities and expertise to facilitate tech transfer from academic research into viable small businesses?**

3. **Should North Carolina provide more venture capital for entrepreneurs, either by allowing the State Treasurer to invest more pension funds into NC-based venture-capital funds or by diverting funds away from incentive-based business recruitment programs to a new "revolving fund" that invests in North Carolina entrepreneurs, especially in communities and parts of the state with less access to venture capital?**

4. **Should North Carolina reduce or eliminate its capital-gains tax to encourage more investment in new and expanding businesses in the state?**

1. Should NC reform occupational licensing policies for specific occupations where current practices make it unnecessarily difficult for new entries?

Answer: State leaders should curtail occupational licensing and expand occupational freedom. They should also subject licensing boards and their licenses to sunset with periodic review.

Analysis: An occupational license is essentially official permission from the state to an individual allowing him to work in his chosen field. This permission comes at a premium. The license-seeker must satisfy a state licensing board's requirements of educational credit, class time logged, entrance exams, and licensing fees. These all cost time and money. Without the license, the individual cannot legally work in his chosen field.

North Carolina's Constitution, in Article I, Section 1, recognizes that all persons have a self-evident, inalienable right to "the enjoyment of the fruits of their own labor." Given that, the State of North Carolina should be very reticent to take the extreme step of licensing any field of labor. Licensing should be rare, not commonplace.

Nevertheless, North Carolina is one of the more aggressive states in terms of licensing occupations. In August 2014 the Office of the State Auditor identified 57 occupational licensing boards in the state, regulating over 565,000 licensed individuals (see Appendix C). Over one-fifth (22.0 percent) of North Carolina's workforce is licensed by the state. That figure is from a 2015 white paper from the Obama White House.

Despite the reach of occupational licensing, economic research is inconclusive and not very favorable on whether it achieves its usual foundational purpose: protecting consumers by ensuring safety and quality of service. Researchers tend to agree on another effect of licensing, however.

As University of Minnesota labor economist Morris M. Kleiner wrote in the Fall 2000 issue of the *Journal of Economic Perspectives*, "The most generally held view on the economics of occupational licensing is that it restricts the supply of labor to the occupation and thereby drives up the price of labor as well as of services rendered."

The White House report warned that "by making it harder to enter a profession, licensing can also reduce employment opportunities and lower wages for excluded workers, and increase costs to consumers." Those costs "fall disproportionately on certain populations."

Licensing's costs are very large hurdles for the poor, the less educated, minorities, relocated military families, immigrants, people with criminal records, mothers returning to the workforce, and older workers seeking a new career.

Poorest communities are most negatively affected by occupational licensing because they would most benefit from more jobs and more opportunities for self-employment (entrepreneurship). Federal

Reserve economist Kelly D. Edmiston showed entrepreneurship yields a "double dividend" in low- and moderate-income communities — the other dividend being the goods and services it brings into communities that lack them.

Jobs are created faster when the state doesn't stand guard over entry to professions. Research finds employment within an occupation grows 20 percent faster in states where it is *not* subject to licensure than in a state where it is.

The White House report found that licensing could "cost millions of jobs nationwide and raise consumer expenses by over one hundred billion dollars." Kleiner estimated that occupational licensing accounted for $100 billion in lost economic output per year and transferred $300 billion per year from consumers to people in licensed occupations.

Most legitimate concerns about an occupation are already answered with market competition and government protection through the courts. Where additional government intervention seems warranted, the Institute for Justice recommends pursuing other policy options first, rather than go straight to the most restrictive form of occupational regulation. For example, a state certification option would allow providers to advertise to potential customers that they have met certain training criteria or operational standards without requiring customers to patronize only those who have state certification.

To promote small business entrepreneurship, then, North Carolina's leaders should curtail occupational licensing and expand occupational freedom. They should subject licensing boards and their licenses to sunset with periodic review. Any questionable boards and licenses should be ended. Any legitimate state concern that can be met with less restrictive policies, should be.

For licenses that withstand this scrutiny, any hurdles that can be lowered (lowering fees, reducing or broadening education/experience requirements, expanding recognition of military experience and other states' licenses, and reducing examination requirements), should be.

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1. Should NC reform occupational licensing policies for specific occupations where current practices make it unnecessarily difficult for new entries?

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Context

Occupational licensure is the process by which governments establish qualifications required to practice a trade or profession, so that only licensed practitioners are allowed by law to receive pay for doing work in the occupation.[48] This kind of licensing has grown dramatically over the years—in the 1950s, less than 5 percent of the labor force required an occupational license; by 2008, that number had grown to almost one-third.[49]

When designed and implemented carefully, licensing can offer important health and safety protections to consumers as well as benefits to workers such as ensuring high-quality services, safeguarding against serious harms, and offering workers clear guidelines around professional development and training.[50]

At the same time, however, North Carolina's occupational licensing regime creates substantial costs, and often the requirements for obtaining a license are not in sync with the job's required skills. For example, licensing has been shown to reduce total employment in the licensed professions by raising barriers to entry. Additionally, some researchers have found unlicensed workers earn 10 to 15 percent lower wages than licensed workers with similar levels of education, training, and experience. Lastly, national studies have found licensing laws contribute to higher prices for goods and services, with some estimates ranging between 3 and 16 percent—sometimes without increasing the quality of those goods and services.[51] As a result, the state's current occupational licensing regime may make it harder for businesses to form and workers to earn higher wages.

Given this context, the central problem facing the state as it considers reforming occupational licensing is understanding the extent to which the benefits associated with each licensure outweigh the costs., The state should consider reforming licensures where costs exceed the benefits.

Current Policy Approach

North Carolina currently has over 50 occupational licensing boards and more than 500 licensing requirements for entry into occupations ranging from nail technicians and irrigation contractors to athletic trainers and nurses. While these boards are state agencies, they receive no state general revenue. A recent NCGA Program Evaluation Division report found that these boards operated with insufficient oversight and recommended elimination or consolidation of 20 of these boards.

It is worth noting, however, that even the PED recommendations did not include wholesale elimination of *all* or even *most* occupational licenses in North Carolina.

Policy Options

Although occupational licensing plays an important role in protecting consumer interests, it is clear that licensing can also reduce employment opportunities and lower wages for excluded workers and increase costs for consumers. To address this tension, policymakers have two basic options:

Option #1—Eliminate licensing broads and requirements for some or all of the state's current occupations and replace these standards with voluntary consumer ratings provided via the internet.
Researchers at the Mercatus Center at George Mason University in Virginia presented such an option to the Joint Legislative Administrative Procedure Oversight Committee, Subcommittee on Occupational

Licensing Board Oversight during public comment in March 2016. The Center argued that technologies and consumer ratings opportunities provided through online platforms like Yelp, Amazon, and eBay allowed consumers the means to learn about local businesses and professionals they may want to use, and these voluntary ratings would protect consumer interests just as fully as occupational licensing.[52]

However, there are three basic problems with this option. First, this approach replaces a framework of legally enforceable standards with a voluntary approach that provides little or no recourse for consumers except access to information that may or not be accurate and can be easily manipulated by the business in questions. Second, consumers without high-speed internet access—typically seniors, residents of rural counties, and those with low-incomes—are unlikely to benefit from, access, or even recognize these online rating systems, effectively locking the most vulnerable members of our society out of basic consumer protections. Third, thousands of workers have already invested time and financial resources into meeting the licensure requirements for their chosen occupation, eliminating those requirements punishes those workers for following the laws in place at the time they sought licensure.

Option #2—Pursue recognized best practices in occupational licensure reform. In 2015, the U.S. Departments of Treasury and Labor and the Council of Economic Advisors released a policy framework for addressing occupational licensing reform that included suggested best practices for states to consider.[53] These included:

a) Limiting licensing requirements to those that address legitimate public health and safety concerns to ease the burden of licensing on workers.
b) Applying the results of comprehensive cost-benefit assessments of licensing laws to reduce the number of unnecessary or overly-restrictive licenses.
c) Banding states together and harmonizing their regulatory requirements as much as possible, and where appropriate entering into inter-state compacts that recognize licenses from other states to increase the mobility of skilled workers.
d) Allowing practitioners to offer services to the full extent of their current competency in order to ensure all qualified workers are able to offer services. Researchers at the Brookings Institute, the Hamilton Project, and the Upjohn Institute have also proposed a fifth best practice:[54]
e) Transferring occupations that do not pose a sufficient risk to health and safety from a licensing requirement to a certification requirement, or other form of regulation. This would allow states the flexibility to select occupations that do not meaningfully protect consumer health and safety and change their regulatory approach in a tailored way without doing away with all licenses.

This bundle of policies attempt to take a balanced approach to licensure reform that reduces costs and eliminates barriers to entering occupations, while still preserving those requirements that protect the health and safety of consumers. They provide an important alternative to the complete elimination of important health and safety requirements embodied in Option #1.

Policy Recommendation

Option #2 provides the most balanced approach to reforming occupational licensing while protecting consumer interests. But, as with any application of national best practices, it is crucial for lawmakers to fully study and understand how they translate into North Carolina's regulatory, administrative, and economic contexts. As a result, we recommend the state conduct a careful review of occupational licensing statutes and how these best practices might be applied to our state. As part of this review, we recommend a process that solicits input from a wide range of consumer, business, and regulatory stakeholders and determines how the state can best ensure both access to occupations and the availability and delivery of quality services to the public in a way that ensures accountability and protection of the public.

2. Should the state support small business incubators that have the facilities and expertise to facilitate tech transfer from academic research into viable small businesses?

Answer: While incubators can offer great value to those wishing to start new businesses, state government need not be involved in them — and may crowd out more effective programs.

Analysis: The value of entrepreneurship to economic growth is that it enhances the efficient use of resources. Successful entrepreneurial ventures move resources from less productive to more productive uses and in the process earn the entrepreneurs a profit. Unsuccessful ventures, i.e. those that represent an error in judgment by the entrepreneur, are weeded out of the market because they suffer losses. This is why the system of profit and loss has social value.

The injection of taxpayer money and therefore the choices of non-market government decision makers into entrepreneurial process does not, indeed cannot, improve on the results generated by the normal system of profit and loss. Furthermore, it is likely to hinder economic efficiency because it necessarily puts the state in the position of picking winners and losers. This fact can easily be seen be looking at the basic definition of small business incubators. According to Entrepreneurs.com a business incubator is:

> *An organization designed to accelerate the growth and success of entrepreneurial companies through an array of business support resources and services that could include physical space, capital, coaching, common services, and networking connections… Incubators carefully screen potential businesses because their space, equipment, and finances are limited, and they want to be sure they're choosing to nurture businesses with the best possible chance for success.*

By definition, therefore, the government would need to make choices about which entrepreneurs could take advantage of the services it is funding and which could not. Entrepreneurial success or failure will be influenced by government decision makers using money that is not their own, which means that they have no personal incentive to get it right. This is as opposed to either private for-profit or nonprofit incubator organizations that have at the very least a reputational stake and in many cases a financial stake in carefully vetting and examining the prospects of the businesses being considered.

This does not mean that small business incubators are not worthwhile or do not make economic sense more generally. Such programs run by both for profit and non profit incubator programs appear to make a difference. According to the Upper Coastal Plain Business Development Center, "while only 50-60% of companies that 'go it alone' are still in business after three years, 87% of small businesses starting in an incubator environment are still in business and growing after five years."

Non-state funded incubation programs are common in North Carolina. The North Carolina Business Incubator Association lists 28 member incubation programs in operation across the state. It also should be noted that state-funded incubators would be in direct competition with these programs and could have a “crowding out effect” where more for and non-profit programs may not be able to survive and innovation in the area, which is unlikely to come from a government program, could be stifled. If policymakers want to assist this sector, they should focus on identifying and removing regulatory barriers that may limit the location and operation of private small-business incubators across North Carolina.

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2. Should the state support small business incubators that have the facilities and expertise to facilitate tech transfer from academic research into viable small businesses?

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Context

Small business growth has long been lauded as an important goal in building wealth and locally anchoring employment in communities.[55] Its connection to increasing earnings, however, is more tenuous or indirect. Small businesses, when controlling for factors such as industry and educational attainment of workers, have been found to pay less and provide less employment security than larger firms.[56] And yet in the aggregate the promise of more jobs and stronger connections to local communities could over time generate earnings stability and entry points to the labor force that help increase the number of North Carolinians with adequate earnings.[57]

While small business growth may prove less direct in achieving increased earnings, it could deliver significant benefits to the economic well-being of communities and, by extension, families that make it worth pursuing. To achieve that benefit, however, building accessible systems and supports to entrepreneurs is needed.

One ingredient to building such a successful environment for small business start-ups has been academic research and public universities.[58] The development of businesses from government-funded research grew exponentially with the federal expansion of the rights of universities to patent invention in the 1980s.[59] Tech transfer efforts – through the establishment of offices at universities and processes that connect faculty to business supports – have become part of most university administrations and work to accelerate the benefits of academic research for small business growth, particularly in higher wage industries.[60] Examples of successful technology transfers—SAS and Cree among them—remain today major employers in North Carolina.

Incubators or accelerators—physical sites where new business owners can access the resources and assistance to grow successful firms—have supported small business development, although to varying degrees of success.[61] High-achieving incubators have several key commonalities including, notably for this purpose, an orientation towards creating jobs, fostering entrepreneurial climates locally, and diversifying the local economy. The most high-achieving incubators also received public sector support and long-term funding commitments from the government.[62]

Current Policy Approach

In the past two years, the Governor's budget has proposed grant funding so that academic research could be converted into viable small businesses. The Governor's Innovation to Jobs initiative recommended formally developing networks of entrepreneurial talent statewide to support small business start up and commercialization of academic research.[63] These recommendations have not been funded at the level of the request nor have they included an explicit use of incubators to provide the physical space.

There have been notable efforts in the past to support coordination across multiple stakeholders and develop shared services and resources to promote industry growth that could be beneficial to the state and its workforce. Emergent technologies are being put to use through investments in the Hosiery Technology Center, Manufacturing Solutions Center, and Biotech Center.[64]

Today, the state does not make the same investment in coordination or processes that identify strategic industry-specific efforts and support business development and employment connections for residents as it once did. But past efforts prove that dedicated public funding and physical space can incubate good ideas.[65]

North Carolina's infrastructure – anchored in the University of North Carolina system – does, in fact, support small business development and advancement in the state. These Small Business and Technology Development Centers (SBTDCs) are administered by NC State University in partnership with the U.S. Small Business Administration. There are also at least 13 existing technology transfer offices at public and private universities across North Carolina.[66] In addition, primarily in close proximity to universities both public and private, North Carolina is home to a number of incubators and accelerators that seek to support start-ups in various industries, including technology fields.

The current policy approach to technology transfer and general incubation of small business has not effectively diversified its geographic reach nor been married to an approach that connects North Carolina workers to the skills training and credentials necessary to benefit from jobs in higher wage, high-tech fields. As such, technology transfer and the use of incubators to specifically support technology transfer are unlikely to drive significant change in the earnings of North Carolinians.

Policy Options

The policy options available in North Carolina include: 1) maintaining the status quo where technology transfer offices work to support business creation from academic research; 2) extending the potential of technology transfer from academic research through increased investment using the SBTDC network and the existing entrepreneurial talent in the state; or 3) using existing or creating new incubators to support technology transfer efforts and small business development.

There are a few important points for consideration when contemplating the benefits of these policy ideas to boosting the earnings of North Carolinians. It appears unlikely that the potential of technology transfer supported through incubators alone will connect more North Carolinians to higher paying jobs. It is important to consider the geographic distribution of small business support to extend beyond the metro areas and places in the state already recognized as leaders in the high-tech industry. North Carolina needs to develop a broader set of policies and investments to build out an entrepreneurial ecosystem that supports small business development and is intentionally driven by community and individual economic well-being.

Policy Recommendation

North Carolina's investment in technology transfer will only succeed in enabling more North Carolinians to earn enough to make ends meet if it is a) combined with a workforce development component that aids existing residents in securing placement in new firms and b) extends university connections to communities outside of metro areas. The state should consider the ways in which the existing Small Business and Technology Centers, many of which are co-located on university campuses, can develop bridges to existing university technology transfer offices or where they don't serve that function.

More broadly, the state should consider supporting incubators to prop up entrepreneurs outside of major metro areas and build infrastructure that encourages high-tech, high-wage endeavors in these communities. This would require funding incubators currently operating with limited to no state funding, increasing the state's commitment to broadband funding, and helping community colleges develop training programs that could make high-tech, high-wage work accessible to more North Carolinians.

3. Should NC provide more venture capital for entrepreneurs, either by allowing the State Treasurer to invest more pension funds into NC-based venture-capital funds or by diverting funds away from incentive-based business recruitment programs to a new "revolving fund" that invests in North Carolina entrepreneurs, especially in communities and parts of the state with less access to capital?

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Answer: No, the state should not involve itself directly in venture capital. Policymakers can encourage capital formation in North Carolina by reforming the tax code.

Analysis: "Silicon Valley, Singapore, Tel Aviv — the global hubs of entrepreneurial activity — all bear the marks of government investment. Yet, for every public intervention that spurs entrepreneurial activity, there are [dozens even hundreds of] failed efforts that waste untold billions in taxpayer dollars." Josh Learner, Harvard University

Nothing that flows from economic analysis would suggest that the state, regardless of the particular mechanism, can improve on the economic wellbeing of its citizens by substituting its judgment for the judgment of market participants. And that is exactly what happens when the state decides to take money from taxpayers, who would be choosing to participate in the economy in other ways with that money, and transfer it to what can only be considered favored entrepreneurs in the form of venture capital. The precise mechanism, through pension fund investments or some form of a revolving fund, makes no difference to this argument. As the great philosopher Toby Keith once wrote "there ain't no right way to do the wrong thing."

The basic problem was identified in our analysis addressing the question of whether the state should fund small business incubators. The point made in that discussion is that ultimately the state is, whether consciously or not, choosing winners and losers in the marketplace. Presumably, beneficiaries of the state-provided capital will be those who could not receive the funding through normal market channels. Participants in the market make such choices for a reason, namely that voluntary providers of the venture capital estimate the likelihood of success of the enterprise in question to be low. Any money that is transferred from taxpayers into this process is actually being use to override the decision of private investors. But the state actors have no incentive to get it right. Ultimately the taxpayers are being forced to trust the market related judgments of bureaucrats and elected officials over those of market based venture capitalists using their own money.

With regard to the state pension fund, both taxpayers and public employees pay into the system, after which the latter receives payouts. To encourage or require the state treasurer to use pension funds for venture-capital investment, then, would be to impose unwarranted risks on taxpayers and public employees. The treasurer already has sufficient authority to diversify the pension fund's portfolio, which should be invested to maximize returns to pensioners and minimize future cost to taxpayers — not to engage in economic-development activity in North Carolina.

That having been said, there are ways for the state to reduce the cost of capital in general, including venture capital, by working through the tax code, that would enhance rather than distort the market process and the efficient allocation of investment resources in the state.

The main reason we are interested in the cost of financial capital is that it is used to purchase physical capital; plant and equipment. This is particularly true in the start-up phase of a business where there tend to be fewer employees. The state can help to reduce the cost of physical capital, thereby making financial capital go further, by changing the way plant and equipment purchases are written off for tax purposes. North Carolina should switch from a system of depreciation, where capital purchases are written off over a codified period of time, to a system of immediate expensing that allows capital expenditures, including real estate, to be written off in full in the year that they are incurred. The current system penalizes investment in longer-lived capital equipment and prevents investors from realizing the full value of their expenditures in their tax deductions.

Other ways that the state could reduce the cost of physical capital through the ongoing process of overall tax reform is by eliminating the sales tax on business-to-business sales, which is a form of double taxation. Reducing the capital gains tax has also been shown to increase venture capital investment. This issue is discussed in a separate analysis.

Additional articles:

http://www.governing.com/topics/economic-dev/State-Governments-Latest-Venture-Capitalists.html

http://www.economist.com/news/finance-and-economics/21651248-industry-specialises-spotting-potential-insurgents-faces-some-its

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3. Should NC provide more venture capital for entrepreneurs, either by allowing the State Treasurer to invest more pension funds into NC-based venture-capital funds or by diverting funds away from incentive-based business recruitment programs to a new "revolving fund" that invests in North Carolina entrepreneurs, especially in communities and parts of the state with less access to capital?

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Context

Public sector-sponsored venture capitalism is nothing new but it has seen renewed attention in recent years. With state and local governments looking for new ways to repair the damage of the Great Recession, many states have experimented with new venture capital programs,[67] including New York[68], Illinois[69], Pennsylvania[70], and Texas[71].

At the same time, economic development practice has broadly moved its focus to entrepreneurship,[72] a development that started well before the recession. Large companies still receive the overwhelming majority of economic development incentives in most states[73], but there is an evolving recognition that many programs supporting local entrepreneurs provide greater return on the investment of public resources.

North Carolina ranked 9th in VC activity for the second quarter of 2016, consistent with the state's ranking in total population.[74] However, there is a huge drop off from the top three states for VC activity (CA, NY, MA) to everywhere else, so North Carolina is still well behind the national leaders. While there is an economic role for venture capital, scant independent research demonstrates no positive impact on wages or earnings. Traditional venture capital has been exceedingly concentrated in high-tech, high-risk, high-margin companies, often under-serving sectors of the economy, communities, and entrepreneurs most in need of investment. Deployment of North Carolina state funds as venture capital should carry requirements to serve under-capitalized industries with viable futures, accompanied by investments to make sure all North Carolinians can take advantage of the created opportunities.

Current Policy Approach

North Carolina investments in entrepreneurship have not kept pace with many other jurisdictions, and the state has not moved as aggressively into venture funding as some state and local governments.[75] More broadly, North Carolina supports a variety of programs designed to support entrepreneurship, but many of those efforts have not expanded to keep pace with conventional recruitment grants. Examples of the state's modest involvement in venture funding include:

- Participation in the State Small Business Credit Initiative was more limited than many states, including some that are smaller than North Carolina like Georgia.[76]
- The North Carolina Rural Center had conducted significant and successful venture investment activities for years, but the loss of state funds has seriously undermined those efforts.
- Passing "crowd-funding" language to enable non-certified actors to invest in North Carolina companies could open up new ways for people to invest in local companies. But without funding to prevent fraud and abuse in these new spaces, or ensure that everyone has equal access to the opportunities, their future effect is unclear.

Policy Options

Investment structure: Policymakers would need to weigh the pros and cons of different mechanisms for deploying state funds as venture capital.

- Direct investment: State hires staff to directly manage investments in specific firms.
- Co-Investment Funds: State funds are invested in companies alongside private venture capital. In many cases, deal identification and assessment is done primarily by private venture funds, which then bring in state funds on deals that meet set requirements.
- Fund of Funds: Invest state resources in a series of venture funds that are then managed by those VC fund managers
- 3rd Party Fund: State contracts directly with a single, private venture fund. Some allow comingling of public and private capital, others do not.

Stage of business: Engaging in venture funding will require choices about which types of companies to target. The private VC market tends to be highly specialized, with many funds focusing on companies at specific points in their maturation.

- Seed/Startup: Many entrepreneurs struggle securing start-up capital before the business model has been proven. As such, many state-sponsored VC funds emphasize providing funds at the early stages of business development, including 64 percent of state venture funds that participated in the Small Business Credit Initiative.[77]
- Growth and Mezzanine: Most companies need additional capital to scale from startup to expansion and mature firms. Because the challenges facing growing firms are often different from the start-up phase, many VC funds choose to specialize in one or the other.

Create mechanisms to allow North Carolinians to invest in in their own communities. Investing state funds can have some effect, but the scale will likely not prove widely transformative. Exploring ways to seed funds that would allow North Carolinians to invest in local businesses could give everyday residents new ways to rebuild their communities, and could dramatically increase the amount of venture capital available.

Policy Recommendation

North Carolina needs to make sure entrepreneurs have access to the capital they need to start or expand a business. Here are a few recommendations to best reach those who most need capital and have the potential to grow wages:

- **Consider establishing and strengthening revolving loan funds and loan guarantee programs:** VC is not the only type of capital that can address the startup, operating, or growth needs of small businesses. North Carolina should ensure revolving loan funds, loan guarantee programs, and other structures for augmenting the availability of debt capital are not ignored in favor of VC.
- **Include support for recruiting and training potential entrepreneurs from struggling communities:** Many venture funds struggle not from a lack of financing but from a lack of viable deals to invest in. The challenges inherent in conceiving, pitching, and starting new companies prevent many potential entrepreneurs from ever getting started. As such, it is necessary to invest in the broader entrepreneurial ecosystem of support, particularly if the aim is to benefit workers and communities where employment opportunities and earnings remain low.
- **Assess specific needs in the VC space:** Investment of state funds is most effective where it is moving into spaces that are not currently served by the private VC market. As such, it is critical to identify geographic areas, stages of business development, and industries where private VC is most lacking, and where deployment of new capital could have the most dramatic impact. It is clear that seeding a venture fund is preferable to tax credits. It is also clear that venture capital funds will only be successful at delivering economic benefits if other policy choices don't hamper investment in the state.

4. Should North Carolina reduce or eliminate its capital-gains tax to encourage more investment in new and expanding businesses in the state?

Answer: Yes, such a policy would increase business starts, job creation, and incomes.

Analysis: A problem area that still remains in North Carolina's tax code is the state's treatment of capital gains. Historically North Carolina has taxed returns on capital investment, in particular capital gains on stocks and real property, at the same rate as all other income. While this may sound counterintuitive at first, the state's policy here serves as double-taxation of the returns from these investments, therefore creating a systematic bias against capital formation and business creation in our state.

Capital gains, as a return on investment, can be realized in several different ways, but they all relate to the purchase and sale of assets. Those assets can take the form of stocks or bonds, a home or other investment property, or an existing business. The difference between what these assets might be purchased for or, in the case of a business, the cost of the investments and the sale price is what is called the capital gain (or loss in the cases in which the asset loses value). Particularly with regard to small business entrepreneurship, the possibility of realizing capital gains when a business is ultimately sold is an important reason why small business will put so much effort into growth, brand and reputation enhancement, etc. In this sense it can be viewed as a specific tax on investment in small business assets. This is why economic theory and empirical evidence both suggest that reductions in capital gains taxes can spur venture capital investment.

Indeed, for a business, particularly a small business, one of the most important ways that it realizes returns on its investment is through increasing its value, which, in turn, is realized when the business is sold. In North Carolina, this difference between the purchase price and the sale price, assuming that the latter is greater, is taxed the same way as other income — even though it has already been taxed at an earlier stage.

In other words, the North Carolina tax code double-taxes capital gains. A simple example could help clarify this. Imagine that an income earner has $100 in pre-tax income that he is deciding what to do with. The choice is between investing it in the purchase of one share of a stock or a mutual fund, for which he can expect a 10 percent gain in one year, or using it to take his wife out to dinner. In other words, the income earner makes a choice between investment and consumption. He will compare the satisfaction that he would experience from the night out to dinner, i.e. the "return to consumption spending," to the expected $10 return in a year from the $100 stock investment. He will make his choice based on his individual preferences for immediate satisfaction as compared to a greater amount of satisfaction in the future after realizing the capital gain.

Now assume that we have a 10 percent income tax *but without a tax on income from capital gains*. The tax reduces the returns to consumption, from $100 worth of dinner with his wife to $90, and his returns to his investment from $10 to $9. Both the returns to consumption and the returns to investment are reduced by the same amount, namely 10 percent.

An additional layer of taxation on capital gains, in essence, double-taxes the investment return, reducing it by another $.90 to $8.10. This added layer of tax will bias the person's decision against making the capital investment and in favor of the dinner. In a broader economic sense, since economic growth springs from such capital investments, including the return on investments made in small businesses across the state, the taxation of capital gains is a penalty on growth.

A static analysis of what abolition of the tax might mean for revenues flowing to the state has been provided by the Beacon Hill Institute at Suffolk University. Its researchers estimate that elimination of North Carolina's capital gains tax would reduce revenues by about $500 million in 2017, assuming the new rate of 5.499%.

If complete elimination is considered to be too big of a hit to the state treasury, a phase-in process could be put in place similar to the approach taken to reducing the corporate income tax, possibly using revenue triggers. This can be done by allowing for an exclusion of a certain percentage of gains that could be gradually increased over time. For example, a 25 percent exclusion would cost the treasury about $125 million annually, and a 50 percent exclusion would proportionately cost about $250 million.

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4. Should North Carolina reduce or eliminate its capital-gains tax to encourage more investment in new and expanding businesses in the state?

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Context

Ensuring that investment capital is available to North Carolina businesses is important to fostering a healthy and attractive business climate. Access to capital is an important part of the life blood that drives business growth and success in the marketplace. Businesses at all stages of existence – startup, emerging and mature businesses – rely on capital to fund their growth and expansion, which allows for new jobs to be created. Providers of investment capital include traditional financial entities (e.g. banks and credit unions), alternative funding sources (e.g. venture capital and private equity), as well as family and friends for many startups and small businesses.

Lack of capital is one reason promising businesses never get off the ground and why some businesses are unable to grow into job-creating enterprises. New, small businesses – which account for nearly all net, new job creation and almost 20 percent of gross job creation[78] – play an important role in fostering a vibrant state economy and local economies. Many innovative and successful firms grow rapidly and become a source of job and economic growth, which is important for North Carolina and the need to attract and keep good-paying jobs in the state.[79]

Eliminating or cutting the capital gains tax has been proposed as a way to encourage more investment in North Carolina businesses. Capital gains are profits from the sale of assets such as stocks, bonds, art and vacation real estate, which are taxed once the asset it sold.[80] Accordingly, favorable tax treatment for capital gains income, per this logic, would make more investment capital available – in the form of tax cuts for select taxpayers – for businesses in the state.

Not withstanding that argument, no direct relationship exists between cutting or eliminating capital gains tax rates, job creation, and economic growth. Analysis by the Congressional Research Service of reductions in top marginal rates – including the capital gains tax rate – at the federal level over time found little association with saving, investment or productivity.[81]

Capital gains are highly concentrated among the wealthiest taxpayers. In 2012, less than 1 percent of North Carolina taxpayers earned $1 million or more in annual income, yet accounted for 60 percent of total net capital gains income for all North Carolina taxpayers.[82] To the contrary, only a small fraction of all taxpayers in North Carolina reported net capital gains as part of their income.[83] Accordingly, this tax break would flow largely to the state's highest income earners, while providing little by way of creating new good-paying jobs and boosting economic growth in the state.

Eliminating capital gains from the state's personal income tax would have reduced annual state revenue by more than $500 million for 2014, dollars arguably needed to meet the needs of a growing state.[84] With tax cuts for high income individuals or business less likely to be spent and less effective as a stimulus,[85] the likely return on investment from this proposed tax cut would predictably be low for North Carolina.

Current Policy Approach

Currently, North Carolina's tax code treats capital gains income the same as other income – e.g. wages or ordinary income. However, state leaders have made clear their desire to eliminate the income tax altogether and shift to a consumption-based tax system that heavily depends on the sales tax. Since 2013, lawmakers have passed multiple income tax cuts that largely benefit the wealthy and profitable corporations while simultaneously expanding the sale tax to more services. Once all tax changes are fully in place, net annual revenue loss will reach more than $2 billion relative to what would have been available if the pre-2013 tax code were in place.

Eliminating or cutting the capital gains tax will make the state's tax system even more unbalanced and further reduce limited tax dollars available for public investments that help drive the success of businesses in the state – quality public schools, colleges, and universities, efficient court system, quality public infrastructure and transportation networks, etc. Eliminating the capital gains tax would have carried a price tag of more than $500 million in 2014, dollars needed to meet the demands of a growing state.

Providing preferential tax treatment to capital gains income in an attempt to attract more investment capital for businesses raises important public policy questions and concerns. Would such a tax break truly increase the availability of investment capital for businesses in the state? Furthermore, given the uncertainty of realizing stated outcome, does the costly price tag – in the form of the reduction in annual revenue – warrant such an expensive experiment?

Policy Recommendation

North Carolina should not pursue eliminating or cutting the capital gains tax rate.

PROPOSALS FOR INCREASING WAGES AND EARNINGS

1. **Should North Carolina reinstate the Earned Income Tax Credit?**

2. **Should North Carolina increase the state minimum wage? If so, by how much, and should the increase be uniform across the state or tiered based on cost of living? If not, should North Carolina instead increase the wages it pays State employees?**

3. **Should we encourage employers to "ban the box" for some jobs to eliminate questions about prior criminal records that can block past offenders from higher-paying job opportunities?**

1. Should North Carolina reinstate the Earned Income Tax Credit?

Answer: No. Increasing per-child tax credits and exempting more household income from the tax base would be a better way to alleviate the tax burden on workers of modest incomes.

Analysis: Allowing North Carolina's EITC to expire was part of the General Assembly's overall package of tax reforms, including the expiration of a sales-tax hike in 2011 and the passage of personal income tax cuts in 2013. Based on sound economic analysis, the idea was to lower and flatten tax rates for all, eliminate special tax incentives, and simplify the tax code to reduce everyone's cost of tax compliance. This process of reform has continued since 2013 with rates being lowered by a quarter percent from 5.75% after the 2013 reforms to 5.49%.

The EITC disappeared within this context. It added complexity and compliance costs for lower income workers and opened up the system to fraud and calculation errors that could both shortchange taxpayers or find them receiving more credits than they should. It was recognized that these benefits could be achieved more efficiently with a simpler system based on large zero tax brackets (to be created by personal exemptions or standard deductions) and increased child tax credits. Ultimately, lost tax benefits for lower-income workers from eliminating the EITC were replaced in many cases by a combination of a reduction in rates, a more than doubling of the standard deduction, and larger per-child tax credits.

It has been estimated that for families earning under $25,000, even after including the elimination of the EITC, the total savings was $157 million or about $79 for the average household in that income group. For families earning between $25,000 and $50,000 the total saving is $192 million or $68 per family. The biggest boost for low-income wage earners came with the increase in the personal exemption from $6,000 to $15,000 for a couple filing jointly. This means that a low-income couple, filing jointly, with an income of $50,000 was now paying an effective tax rate of only 2.875%, and this is before taking the child tax credit or realizing any other deductions. The child tax credit was increased from $60 to $125 per child. This was all done while reducing compliance costs for those same workers.

The best way to increase real take-home earnings for low-income families through the tax code would be to continue on North Carolina's current path. And this seems to be the strategy that the legislature is adopting. For example, in 2016 the zero tax bracket was raised to $17,500, almost triple what it was in 2012.

The possibility of increasing the per-child tax credit should also be examined. This would have two advantages. First is that it is consistent with the idea of tax simplification. In other words, it can be done without adding any new complexities. But secondly, it is consistent with improving the economic efficiency of the code. Part of the original plan for tax reform was to remove the double-taxation of saving and capital investment. The fact is that in the long run, children are a contribution to what economists call human capital, and therefore at least a portion of income spent on child rearing can be viewed as long-term investment that should, ultimately, be exempt from taxation since it will generate an income stream in the form of future earnings that the child will generate after becoming an adult and joining the labor market.

What this means is that that an increase in the per-child tax credit can be justified not only on the more humanitarian grounds of helping those at the bottom rung of the income ladder but also as sound economic analysis. It is both pro-family and pro-growth, while avoiding the compliance problems associated with the EITC.

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1. Should North Carolina reinstate the Earned Income Tax Credit?

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Context

Two years ago, North Carolina's working families claimed the state EITC that helped them make ends meet in an off-kilter economy for the last time. The tax credit went to workers earning low wages and helped them keep more of what they earned so that they could stay in the workforce, support their children, and avoid poverty.

The EITC is a highly effective anti-poverty tool and has lasting, positive effects on children. The federal EITC is the nation's most effective tool for reducing poverty among children. It kept 268,000 North Carolinians—half of whom were kids—above the poverty line in 2011-2013.[86]; North Carolina's EITC built upon that success. Most people claim the credit only one to two years at a time before moving on to better-paying jobs or getting back on their feet. That temporary help can have a lasting effect. Children in families with additional income from programs like the EITC do better and go further in school, and they also work more and earn more as adults.[87,88]

The EITC also significantly increases recipients' work effort, according to a large body of research. In particular, the EITC is effective at encouraging work among single mothers earning low wages, with studies finding the tax credit to be the "biggest factor" in improving their attachment to the labor force. [89]

Current Policy Approach

Lawmakers established the state EITC in 2007; by 2013 the tax credit allowed nearly 1 million working households to keep more of what they earned, benefitting 1.2 million children in all 100 counties. The credit was only available to those who worked and earned income from wages, salaries, or self-employment. The benefits of the tax credit extended to the broader economy by promoting work and helping families afford things that make it possible to work, such as gas and child care.[90,91]

The state EITC also served as an important equity component in the state's tax system. It was refundable, meaning that a taxpayer could reduce their income tax liability to zero and receive a refund based on the additional value of the credit. The state EITC helped to offset the disproportionate share of income low-wage workers paid in total state and local taxes—not just income taxes—compared to their wealthy counterparts. Without the state EITC, North Carolina's tax system asked *nearly 1.75 times* more from the bottom 20 percent of taxpayers as it did from the top 1 percent in 2015.[92]

In tax year 2013, the average state credit was $109—an amount that built upon a generous federal EITC averaging $2,462.[93] The value of the credit depends on a worker's earnings, marital status, and number of children. Before eliminating the tax credit in 2013, lawmakers reduced the value of the state credit from 5 percent of the federal credit to 4.5 percent. While modest, the tax credit made a big difference by helping working families pay for the basics such as a monthly utility bill or a week's worth of groceries.

North Carolina is the only one of 26 states, plus District of Columbia, with a state-level credit to have eliminated its credit.[94] There is strong bipartisan support for this bottom-up tax cut for working families at the national and state levels. Last year, Governor Christie of New Jersey expanded their working family tax credit to 30 percent of the federal EITC.

Policy Options

There are a range of policy options available to lawmakers to support work, boost paychecks, and help children and communities thrive in an economic reality where hard work doesn't guarantee economic security. When it comes to strategies that enable workers to keep more of what they earn, the policy debate in North Carolina has predominantly pitted the state EITC against raising the standard deduction.

Legislative leadership claims low-income taxpayers are better off without the state EITC due to raising the standard deduction by $2,500 in 2017 as part of recent tax changes. A zero percent tax bracket reduces taxes for everyone, not just low-income families, so it is more costly and ineffective at fixing the disparity between the tax load for the rich and poor.

A state EITC is a better tax policy tool to address tax equity in the state's unbalanced tax system. Some moderate- and low-income North Carolinians are not subject to a state income tax because they don't earn enough income. Raising the standard deduction provides *no benefit* to these taxpayers. Because the state EITC is refundable, it better addresses the increasing reliance on the sales tax, which asks more from low-income taxpayers who spend more of their earnings on basic goods. The EITC has an income cap and is better targeted to families who most need the income boost compared to a zero tax bracket. Only 28 percent of the tax cut from the $2,000 raise in the standard deduction enacted this year will go to taxpayers with incomes below $35,000—but 60 percent of the tax cut will go to the top 20 percent.[95]

Policy Recommendation

Because of the state EITC's proven track record and because economic struggle in any community hurts us all, lawmakers should quickly reinstate this tax credit. Restoring a state EITC at 5 percent of the federal EITC amount would cost around half the price tag of raising the standard deduction by $2,000. Lawmakers ought to consider freezing scheduled income tax cuts and implementing the state credit at a higher percent of the federal credit so that it can better help families make ends meet.

2. Should North Carolina increase the state minimum wage? If so, by how much, and should the increase be uniform across the state or tiered based on cost of living? If not, should North Carolina instead increase the wages it pays State employees?

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Answer: No, state government should not mandate a higher minimum wage.

Analysis: At first glance, having the state increase the minimum wage would seem an easy way to increase wages or earnings. It certainly would increase the lowest-allowed wage level. But that number is presumably not a measure of the real goal of the policy — which is to increase total wages paid, itself a product of wage rates and wage earners.

Most economic research finds that the effect of increasing the minimum wage on employment is negative. In terms of wages and earnings, that means the end result of a minimum wage increase is fewer wage earners than before, especially among the very ones the increase is thought to help: the poorest, the least skilled, and the disadvantaged.

Given the broad focus being on increasing wages or earnings generally, just how many wage earners are at the minimum wage? It is a small cohort. According to Pew Research Center in 2014, it is only ("[p]erhaps surprisingly") about 2.6 percent. Slightly over half of minimum wage earners are between the ages of 16 to 24 (one-fourth are between 16 to 19). Nearly four out of five are white, and about two-thirds work part-time.

In 2006, economists David Neumark and William Wascher published a paper for the National Bureau of Economic Research surveying the economic literature on minimum wages. Among their findings:

- Negative employment effects was a "relatively consistent" finding — especially from "almost all" of the studies providing the "most credible evidence."
- Conversely, "very few — if any" studies provided "convincing evidence of positive employment effects."
- Of key interest here, there was "relatively overwhelming evidence of stronger disemployment effects" for the least-skilled workers in the labor market.

In the five years after the last large increase in the minimum wage (in 2007), the employment rate of teenagers fell by 10 percentage points. A Today/Reuters analysis in 2012 found that the teens hardest hit were also "those who may need the money most: teens from poor families in which a parent is out of work." Least affected: teens from wealthier families with working parents.

Algernon Austin, director of the race, ethnicity and the economy program at the Economic Policy Institute, said of his analysis of 2009 data of 16- to 19- year-olds from poor families, not attending school but seeking work: "In terms of need, it is backwards."

Recently President Obama and Democrats in Congress proposed raising the federal minimum wage from $7.25 per hour to $10.10, a 39 percent increase. A study published in the December 2014 issue of the *Journal of Labor Research* by Andrew Hanson of Marquette University and Zackary Hawley of Texas Christian estimated the hike would eliminate as many as 1.5 million jobs nationwide. For North Carolina, Hanson and Hawley estimated it would eliminate as many as 46,100 jobs.

Others calling for raising the minimum wage have focused on a target of $15 per hour. Such as raise would be 107 percent higher than the current minimum wage. The negative effects of such a hike would necessarily be much greater than those of an increase to $10.10 per hour.

In 2015 the University of New Hampshire Survey Center found large majorities of economists believe that a $15/hour minimum wage would result in:

- Lost jobs
- More skills required to get any job, even an entry-level job
- Fewer young people finding work
- Business closings, especially of small businesses

A higher minimum wage can't increase the skill level of any worker. It can't expand payrolls. It can't keep the hours offered by employers steady. It can't make automation less price-competitive to more expensive human labor. Finally, it can't make employers stay in business. All it can do is make it more expensive to employ low-level workers.

For the poorest, least skilled, inexperienced, marginal, "let's give him a chance to see what he can do" workers — the ones we'd like to see have more opportunities to become productive workers in North Carolina — they're the ones most likely to be left behind by a minimum wage increase.

The unintended consequences of a minimum wage increase would work in *opposition* to the broad goals outlined here of increasing earnings as well as promoting small business entrepreneurship and making career development more robust.

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2. Should North Carolina increase the state minimum wage? If so, by how much, and should the increase be uniform across the state or tiered based on cost of living? If not, should North Carolina instead increase the wages it pays State employees?

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Context

North Carolina needs an economy that works for all and ensures broadly shared prosperity. That means creating jobs that pay workers enough to afford the basics for themselves and their families—buy groceries, pay the rent, put gas in the car, and children in day care. Unfortunately, the jobs that paid decent wages are largely vanishing as low-wage service jobs replace manufacturing jobs that once provided generations of North Carolinians with vital pathways to the middle class. This trend has only accelerated since the end of the Great Recession.[96]

According to the Living Income Standard – a market-based assessment of what it takes to make ends meet – a family of one adult and one child needs to earn $33,700 per year in order to afford the basics.[97] Yet the majority of the jobs created over the past seven years don't pay enough to meet these needs or lift families out of poverty, and one in five North Carolina families now fall below this threshold.[98] Women and people of color are disproportionately affected—people in families with incomes below the LIS are more likely to be women (59 percent), working age (56 percent), and have a high school degree or less (63 percent). A greater share of Latinos (23 percent), African-Americans (13.5 percent), and Asians (14.1 percent) are living under the LIS than whites (9 percent).[99]

The current minimum wage in North Carolina is $7.25 an hour—the same as the national minimum wage. At this hourly rate, a full-time minimum-wage worker earns approximately $15,080 per year, about $1,000 less than the federal poverty level for 2016 for a family of one adult and one child and more than $18,000 below what analysis shows a family needs to make ends meet, according to the North Carolina LIS.[100] Additionally, over the last 40 years, the inflation-adjusted value of the minimum wage has eroded by nearly one-third. While food, healthcare, and housing costs continue to increase, the purchasing power of the minimum wage has decreased dramatically.[101] The minimum wage has lost approximately 7 percent of its value since the last time the federal minimum wage was raised in 2007.[102]

Given these trends, it is clear that the minimum wage does not provide workers with enough to make ends meet or escape poverty despite working full-time.

Current Policy Approach

North Carolina's current minimum wage is $7.25 an hour. Our policymakers have the opportunity to join a growing list of state and local governments that have recently acted to raise the minimum wage for the employers within their jurisdictions, including Arkansas, Nebraska, Alaska, South Dakota, New York, and California. These states have recognized that the current national minimum wage simply doesn't pay enough to make ends meet, and that by raising their own wage floors they can help workers and boost their overall economies. North Carolina should follow suit.

Policy Options

There are three basic options for policymakers: (1) Do nothing and allow the minimum wage to remain at $7.25 an hour; (2) Raise the minimum wage by the same amount for all workers across the state; or (3) Raise the minimum wage at different rates for rural counties than for urban counties.

Option (1) simply perpetuates the status quo of a low-wage economy and lack of social mobility.

Option (2)—raising the state's minimum wage—will boost businesses and the state's economy without hurting overall employment. Although the economics literature in the 1980s and 1990s suggested raising the minimum wage would result in minor job losses, recent advances in statistical analysis since the turn of the century, coupled with a flood of new state-level decisions to raise the wage in the last 15 years, have contributed to more accurate studies that paint a very different picture. Economists increasingly found states that increased their minimum wages have seen better economic performance, lower unemployment, and higher job creation rates than those states that didn't raise their wages**,** controlling for regional economic trends.[103] The empirical evidence clearly and repeatedly contradicts claims that increasing the minimum wage forces employers to offset greater payroll costs by reducing the number of employees.[104]

Raising the minimum wage creates more customers, more sales, and bigger profits. Recent studies have indicated that raising the minimum wage to $10 an hour would increase paychecks for North Carolina's workers by $2 billion a year. That's $2 billion in increased consumer spending at local businesses, boosting business sales, business profits, and creating more than 5,000 new jobs.[105] Additionally, this would put more money in the pockets of workers most likely to spend it. For example, boosting the wage floor to $10 an hour would affect approximately 1 million workers in North Carolina. And because of the boom in low-wage work, the vast majority of North Carolinians benefitting from the wage increase are no longer part-time, teen-aged workers who once filled the bulk of entry-level jobs in past generations. Now, more than 85 percent of workers benefitting from a minimum wage increase are older than 20 years of age, and more than half work full-time.[106] A half-million children in the state would experience increased security thanks to their parents' higher wages.[107]

Raising the minimum wage helps small businesses reduce payroll costs by reducing employee absenteeism and turnover while simultaneously boosting productivity. Economists have long recognized that better-paid workers are more efficient, more effective, and more productive.[108] Most importantly, increasing wages at the bottom rung reduces absenteeism and turnover—the two biggest drags on business productivity. Turnover requires managers' time to review application, interview applicants, and provide on-the-job training and supervision for new workers once they are hired. Higher wages persuade workers to stay on the job longer. These positive effects of a minimum wage increase outweigh the costs for local businesses and will not lead to layoffs. Taken together, the extra sales and stronger employee productivity more than outweigh the additional wage costs to businesses. And even where businesses do feel the need to reduce labor costs, 25 years' worth of studies by labor economists have shown that businesses don't respond by laying off workers; they respond by reducing workers' hours. For example, a 10 percent increase in the minimum wage can reduce employee hours by about 1 or 2 percent.[109] But low-wage workers still come out ahead—even after seeing their hours go down, they see a net increase in wages of 8 to 9 percent.

Taken together, the evidence suggests that raising the minimum wage on balance will benefit the economy. But it may take time for the positive spill-over effects in increased sales and productivity to compensate for the up-front increase in labor costs. That's why several states, notably New York and California, have scheduled a phase-in of their minimum wage increases over time—for example, a $1 an hour increase every year through 2020.

Option (3) recognizes that there are multiple labor markets with multiple wage levels in a state of North Carolina's size—differences that may be particularly pronounced between urban and rural counties. As a result, lawmakers may consider phasing in a minimum wage increase at a slower rate for rural counties. For example, New York established a statewide minimum wage of $15 an hour but required rural counties to achieve the increase over a determinate number of years.

Policy Recommendation

North Carolina should raise the state's minimum wage to a level that allows workers and their families to make ends meet and then index it to inflation to ensure its purchasing power does not erode over time. To allow businesses time to realize the spillover effects in higher sales and productivity, policymakers should phase-in the new wage over a five-year period in metro counties and a longer period for non-metro counties.

3. Should we encourage employers to "ban the box" for some jobs to eliminate questions about prior criminal records that can block past offenders from higher-paying job opportunities?

Answer**:** When implemented in good faith by willing employers, ban the box policies can help mitigate the harm caused by over-criminalization. However, the decision of whether to implement such a policy should be left to the individual employer and not imposed by statute.

Analysis: In the past, standard employment application forms almost always included a question asking about the applicant's criminal record. Recently, however, some employers have begun using forms that do not ask that question. Instead, they give otherwise-qualified applicants a chance to explain their criminal histories in detail at a later stage in the application process.

Retail giants Walmart and Target have "banned the box." So has Koch Industries, a Wichita based multinational corporation that employs over 100,000 people, including more than 60,000 in the United States. Last month general counsel Mark Holden discussed Koch's decision to adopt the new policy in an opinion piece in the *New York Times*:

> *An estimated 70 million adults in the United States, or one in three, have some type of criminal record. Considering these statistics, it doesn't make sense to reject an individual at the outset of the hiring process based on a past mistake, especially given the imperfections of the criminal justice system. Banning the box has worked well for Koch Industries and has led to the hiring of individuals who are productive and dedicated employees. It's also a proven way to remove barriers to opportunity for all Americans, help people improve their lives and keep our communities safer. Other employers should consider doing the same, but the decision should be free from government influence or mandate. Ultimately, the decision to ban the box should only be made by the employer based on the specifics of its business.*

This is sound advice. While many "ban the box" advocates want states to impose the policy by statute, doing so is counterproductive. The risk of employing someone with a criminal record varies greatly from employer to employer, and so does the employer's capacity to mitigate that risk by making a detailed, individuated assessment of each prospective employee. Imposing a one-size-fits-all solution is bound to lead to unintended and undesirable consequences.

In fact, several recent studies suggest this may already be happening in jurisdictions that have implemented ban the box (BTB) laws. One study compared callback rates in New York and New Jersey and found that, "Before BTB, white applicants to BTB-affected employers received about 7% more callbacks than similar black applicants, but BTB increases this gap to 45%." Another study analyzed national employment statistics and found that BTB laws significantly reduced the probability of being employed for young, low-skilled black and Hispanic men. "These findings," the authors said, "Support the hypothesis that when an applicant's criminal history is unavailable, employers statistically discriminate against demographic groups that are likely to have a criminal record."

In response to these studies, some ban the box advocacy groups have recommended supplementing BTB laws with more rigorous—and more rigorously enforced—anti-discrimination laws, but that recommendation fails to address the underlying problem. The reason more than 70 million Americans have criminal records is that we already have too much law and too much law enforcement. Solving that problem requires less of those things, not more.

When implemented in good faith by willing employers, ban the box policies can help mitigate the harm caused by over-criminalization. However, the decision of whether to implement such a policy should be left to the individual employer and not imposed by statute.

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Notes

1. The opinion piece by Mark Holden appeared on the New York Times' *Room for Debate* blog on April 13, 2016 (http://www.nytimes.com/roomfordebate/2016/04/13/should-a-jail-record-be-an-employers-first-impression/employers-should-decide-on-their-own-to-ban-the-box).

2. The studies that found that ban the box laws harmed black and Hispanic job-seekers were:

   Agan, Amanda Y. and Starr, Sonja B., Ban the Box, Criminal Records, and Statistical Discrimination: A Field Experiment (June 14, 2016). U of Michigan Law & Econ Research Paper No. 16-012 (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2795795); and

   Doleac, Jennifer L. and Hansen, Benjamin, Does 'Ban the Box' Help or Hurt Low-Skilled Workers? Statistical Discrimination and Employment Outcomes When Criminal Histories Are Hidden (July 1, 2016) (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2812811).

4. The National Employment Law Project has been one of the leading proponents of ban the box laws. Its response to the studies cited in appeared in a Policy Brief published on its website at: http://www.nelp.org/content/uploads/Policy-Brief-Racial-Profiling-in-Hiring-Critique-New-Ban-the-Box-Studies.pdf.

3. Should we encourage employers to "ban the box" for some jobs to eliminate questions about prior criminal records that can block past offenders from higher-paying job opportunities?

Context

This year, more than 23,000 prisoners will be released from state custody and returned home.[110] An additional 85,000 probationers are currently being supervised in communities across North Carolina.[111] These men and women are just a portion of the 1.5 million North Carolinians with criminal records who often face severe barriers to employment several years—even decades—after their entanglements in the criminal justice system.[112]

Commonly referred to as "the Box," questions about job applicants' criminal histories have become ubiquitous on job applications since 2001 and often result in the automatic disqualification of otherwise qualified applicants.[113] Several studies—most notably, Devah Pager's 2003 audit study of 350 employers in Milwaukee, WI—demonstrate that a criminal record has a significant impact on employment opportunities.[114] Using four testers only distinguished by race and a fabricated criminal record of one felony drug conviction, Pager's study found employers were unwilling to consider equally qualified applicants on the basis of their criminal records in 50 percent of cases.[115] The study also revealed race to compound the destructive impact of a criminal record, finding just 5 percent of black applicants with criminal records advanced to the next stage of consideration, whereas prospective employers advanced 14 percent of black applicants with no criminal records, 17 percent of white applicants with criminal records, and 34 percent of white applicants with no criminal records.[116]

Gainful employment is the single biggest indicator of successful reentry outcomes. Studies have shown the lack of economic opportunity reflected in these figures contributes to high rates of recidivism.[117] Public and private hiring policies in North Carolina that automatically exclude applicants with criminal records from employment facilitate a revolving-door criminal justice system with a 2-year recidivism rate of 40 percent and a budgeted corrections cost of $1.3 billion.[118]

A growing body of evidence demonstrates that restoring employment opportunities to individuals with criminal records can significantly reduce recidivism, thereby enhancing community safety, preserving state resources, strengthening families, broadening the tax base, and making communities more prosperous.[119] In response, almost half of U.S. states have established "Ban the Box" policies that prohibit automatic disqualification of job applicants with criminal records. In April 2016, Governor Bill Haslam signed legislation making Tennessee the 23rd state to "Ban the Box" for public hiring. Generally, such polices delay consideration of an applicant's criminal history in order to facilitate a deeper, more holistic assessment of the applicant's suitability for the specific job position. These policies have typically been applied to public hiring, but a handful of states and local governments outside of North Carolina have required private employers to use "Ban the Box" policies.

Current Policy Approach

Individuals with criminal records are not a protected class under state and federal employment laws. Accordingly, public and private employers in North Carolina may generally discriminate against applicants based on their criminal histories, including dismissed charges and long-ago, minor convictions.[120] In recent years, bipartisan coalitions of local and state policymakers have attempted to restore employment opportunities to North Carolinians with criminal records through a variety of significant legal reforms. Since 2010, our state's expunction laws that provide for the erasure of certain criminal records have broadened on several fronts. During this same time period, almost 20 local governments in North Carolina have adopted "Ban the Box" policies for local public hiring, including Wake County in April 2016.

The Wake County ordinance delays consideration of the applicant's criminal history until the applicant has been identified as the most suitable candidate for the job. Once the criminal record is considered, the policy specifies the factors to be examined, including the seriousness of the offense, the length of time since commission of the offense, the relevance of the offense to the specific job position, and evidence of rehabilitation. An analysis of employment outcomes of the Durham County policy shows that the number of applicants with criminal records hired by Durham County tripled between 2011 and 2013.[121] Of the 101 applicants provided conditional offers of employment, only four had their employment offers withdrawn based on consideration of their criminal records.[122] There was no increase in the rate of work place incidents of theft or violence associated with the policy.[123]

Policy Options

Several local governments in North Carolina appear to be receptive to establishing "Ban the Box" policies for public hiring. Successfully encouraging local governments to "Ban the Box" for public employment would provide better access to significant pools of local jobs and an opportunity to model a better hiring practice that more precisely selects better candidates. The nature of North Carolina's governing structure, along with recent statutory reforms, likely deprives local governments of the power to require private employers to use "Ban the Box" policies for their hiring.

A second bipartisan approach is to press state legislators to significantly expand access to certificates of relief—a civil legal relief currently available to individuals convicted of single misdemeanor or low-level felony offenses—in order to encourage private employers to consider qualified applicants with criminal records for employment. A 2012 study by the Society for Human Resource Management found a majority of employers cite potential negligent hiring liability based on employing an individual with a criminal record as a primary reason for their reluctance to hire qualified applicants with criminal records.[124] Responding to this inordinate but consequential fear of liability, Rep. David Guice—now the DPS Commissioner of Adult Corrections and Juvenile Justice—successfully sponsored the Certificate of Relief Act in 2011 which shields employers of certificate holders from negligent hiring liability. In order to receive a certificate of relief, a person must return to the court of conviction at least 12 months after completing their criminal sentence and convince the presiding judge that alleviating certain civil disabilities triggered by the individual's criminal history is worthwhile and would not put members of the public at undue risk.

There is significant bipartisan support for expanding eligibility for certificates of relief at the North Carolina General Assembly because the relief does not change or hide a person's criminal record. Moreover, it responds to a common constituent problem in a manner that encourages rather than restricts the practices of private employers. In 2015, a provision expanding certificate of relief eligibility to multiple misdemeanor and low-level felony convictions passed the House of Representatives twice, but was not taken up in the Senate.

Policy Recommendation

The Justice Center strongly recommends encouraging local governments to adopt Ban the Box hiring policies for public employment. There are already several successful models to draw upon in North Carolina. Significantly expanding access to certificates of relief would encourage private employers to replace automatic exclusion policies with hiring practices that facilitate a more robust, holistic assessment of applicants with criminal records. Local government and state legislators appear receptive to these meaningful, bipartisan policy reforms.

Appendix: About the John Locke Foundation & NC Justice Center

The John Locke Foundation was created in 1990 as an independent, nonprofit think tank that would work "for truth, for freedom, and for the future of North Carolina." The Foundation is named for John Locke (1632-1704), an English philosopher whose writings inspired Thomas Jefferson and the other Founders. The John Locke Foundation is a 501(c)(3) research institute and is funded solely from voluntary contributions from individuals, corporations, and charitable foundations.

JLF's Vision

The John Locke Foundation envisions a North Carolina of responsible citizens, strong families, and successful communities committed to individual liberty and limited, constitutional government.

JLF's Mission

The John Locke Foundation employs research, journalism, and outreach programs to transform government through competition, innovation, personal freedom, and personal responsibility. JLF seeks a better balance between the public sector and private institutions of family, faith, community, and enterprise.

The North Carolina Justice Center is a non-partisan nonprofit organization whose mission is to eliminate poverty in North Carolina by ensuring every household in the state has access to the resources, services, and fair treatment it needs to achieve economic security. Our vision for North Carolina is that the economy should work for everyone and we believe public policies and public investment can improve access to opportunity and support thriving communities across the state to make that vision a reality.

We are grateful for the opportunity to provide input as the North Carolina Leadership Forum considers policy ideas best suited to answer what we believe is one of the fundamental issues facing our state**:** ***How can we enable more North Carolinians to earn enough to support their families***?

This is the question guiding much of our work at the North Carolina Justice Center. It is one we firmly believe requires a collective and bipartisan commitment to building the systems that allow individuals access to opportunities and communities—from city neighborhoods to rural towns. It is one we believe left unanswered—or answered with flawed policy ideas–will undermine the success of the economy for all North Carolinians and for the future of our state.

We are in agreement with members at the Forum that at the highest level the three key levers for North Carolina to boost earnings, and in turn the economy, are as follows:

- Increasing the number of jobs created in order to generate the market pressure that grows wages;
- Improving labor standards and institutions to ensure wage growth is broad-based; and
- Improving the match between worker skills and job demands so more individuals have access to good-paying jobs.

We have not attempted in these memos to assess the relative value of any single policy approach over another. That being said, there is clear evidence to suggest some of these policy ideas—and others not included, like collective bargaining rights and employee misclassification—would have a far greater impact than others in terms of how many North Carolinians would be affected and the sustained effect on the broader economy.[125]

In the broadest terms, we assessed these policy proposals through our mission and the following core questions:

1. Is the policy idea supported by a broad base of evidence and connected to higher earnings?
2. Does it effectively target low- and middle-income North Carolinians who have not experienced strong wage gains as part of the state's economic expansion?
3. Is it able to effectively reach those who have historically and geographically been excluded from economic opportunity?

ENDNOTES

[1] Carnevale, Anthony P. and Nicole Smith, (2012). A Decade Behind: Breaking out of the low-skill trap in the southern economy. Center on Education and the Workforce: Georgetown University, Washington DC

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