

BUILDING ON PIONEER'S AGENDA FOR LEADERSHIP: 2002-2006, AND BEYOND

Since the publication of Pioneer's 2002 Agenda for Leadership, the Institute has strived to implement its recommendations.

Pioneer's recommended that the legislature resist misguided calls for a moratorium on new charter schools, and that the state ease enrollment restrictions that limit the growth of existing charter schools. While this call was heeded, a wide range of those concerned with the implementation of education reform, including the Boston Globe, concur that education reform has stalled—especially in urban districts.

Some state efforts have been made to implement Pioneer's recommendation to promote urban revitalization and business opportunity by easing the regulatory burden on low-income entrepreneurs. For example, the Massachusetts Office of Consumer Affairs and Business Regulations (OCABR), which issues 40% of business licenses, implemented a 10-month regulation review of seven OCABR agencies. Almost 50 pages of regulations have been eliminated. Remaining regulations are more precisely tailored, easier to understand and easier for the agency personnel to apply. OCABR plans to make this an annual exercise.

Various cities have also cooperated with Pioneer's Center for Urban Entrepreneurship to produce regulatory roadmaps for entrepreneurs in Boston, Lawrence, Worcester, Quincy, Springfield, Holyoke, Fall River, Brockton, and Lowell. A Spanish language Regulatory Guide was launched in Boston; a Spanish guide is also being prepared for Lawrence, and a Khmer guide for Lowell.

Pioneer has long promoted the view that market forces can best ease the housing supply crunch. Pioneer called for the state to lower regulatory barriers to housing construction so that the market could produce more affordable housing in Massachusetts. The state took several small steps in this direction through changes to the wetlands regulations, implementation of Chapter 40R and the Commonwealth Capital Program. In an effort to advance broader regulatory reforms, the Institute, in conjunction with the Rappaport Institute at Harvard, developed a groundbreaking study of land-use and zoning regulations in 187 Eastern Massachusetts communities, made detailed recommendations for regulatory reform, and promoted our findings to stakeholders throughout the state.

The state took significant action on Pioneer's recommendation to make human services delivery more humane and rational by undertaking the politically difficult work of comprehensive state agency reform. Pioneer encouraged the state to integrate resources and consolidate offices and programs under HHS. Consolidation of field operations is ongoing, with the Worcester field offices of the Massachusetts Rehabilitation Commission (MRC,) Department of Mental Retardation (DMR) and Department of Transitional Assistance (DTA), currently

being merged. Pioneer also promoted simplified government licensing, procurement, contracting and reporting. The Virtual Gateway, a Web portal that automatically registers those seeking free care for Medicaid, is up and running. Significant steps are also being taken to reform purchasing. Pioneer continues to advocate for the closure of state residential facilities.

Some key steps were taken to implement Pioneer's recommendations to keep the MBTA within its financial means by focusing on proper maintenance of the existing system. Two actions were most helpful: the implementation of forward funding and the start of installation of the automated fare collection system. In addition, the Office for Commonwealth Development (OCD) did revise its view of several Big Dig transit "commitments," in agreement with Pioneer's call to focus on projects that have significant ridership benefits and advance clean air.

Pioneer's call to amend the 1993 legislation that practically outlawed the private contracting of government services has not been heeded. That said, a number of state-owned ice rinks have been put out to long-term leasing arrangements. As detailed by a Pioneer study released this spring, long-term rink leasing has increased usage and capital investment, even as costs were reduced below those of any non-leased state rinks.

The legislature voted to implement many key elements of Pioneer's 2002 recommendation to trim unnecessary costs from public construction projects by freeing public agencies from burdensome restrictions on construction procurement. The legislature voted to overhaul the public construction laws, moving to a design/build model and away from a design/bid/build structure, saving approximately 10% per public construction project.

Many key elements of Pioneer's call to reduce the structural imbalances in the state budget were implemented. For example, a two-year statutory change (passed in FY 2004, expiring in 2006) allowed over \$30m in surplus property to be sold (against \$5m over the previous 3 years). A revised version of the legislation is being debated. "Quinn Bill" bonuses were converted from percentages to flat rates and new standards were put in place to ensure the quality of all related education programs. However, the bill itself has yet to be repealed. Also, state employees' share of healthcare costs moved from a flat 15% to a sliding scale—new employees pay 25% of healthcare costs and more experienced employees with salaries above \$35k pay 20%.

Clearly significant work remains, as structural imbalances are still embedded in healthcare, the pension system and other post-retirement benefit programs, and many of the key entitlement programs. Building on Pioneer's tradition of detailed, practical recommendations, the 2006 Agenda for Leadership tackles these and other vital policy needs.

INTRODUCTION

Elections are the centerpiece of democracy. Yes, campaigns can be dirty and too many candidates offer as platforms the thinnest of platitudes. Yes, it sometimes seems our elected officials fundraise more than they govern. Ultimately, however, elections present opportunities for change and in 2006 change is needed in Massachusetts.

On the surface, Massachusetts appears strong. Our public schools are the best in the country and our economy, while not booming, is at least stable. Dig a little deeper, though, and the soil is not as rich as it needs to be to sustain economic growth. Massachusetts is one of only two states losing population and the only to lose population two years running; housing is scarce and expensive; despite their success in national comparisons, our schools are not globally competitive, and the Commonwealth's healthcare costs are the nation's highest.

Safeguard our competitiveness

Massachusetts is an expensive place to do business. On a broad list of business cost factors – from taxes, to energy, to real estate, to healthcare, to worker's compensation and unemployment insurance – Massachusetts is more expensive than rival states. In the competition for new and expanding businesses, the Commonwealth's primary advantage is its highly educated workforce, but even that is being eroded by our high cost of living and unprecedented competition from other states and abroad. With housing among the most expensive in the nation, health insurance premiums increasing at more than 10 percent annually, and home heating costs soaring, young college graduates are increasingly opting for warmer, cheaper climates. As they move, so too will the companies that employ them.

Globally, the picture may be even bleaker. International benchmarking raises questions as to whether our students have the requisite math and science knowledge to compete for high-tech jobs in a technology-based global economy. As measured by both state and federal standards, hundreds of schools — located predominantly in Massachusetts' cities — are objectively failing to perform. Perhaps even more importantly, racial and ethnic academic performance gaps persist.

Revitalize Middle Cities

Massachusetts' problems are most acute in our urban areas, particularly in our "Middle Cities," which Pioneer has identified based on low average per capita incomes and property values.

In these cities, the schools persistently underperform, unemployment runs well above state and national averages, and results from redevelopment have been inconsistent at best. The one thing that might be said for them is that their home prices are significantly lower than the state average, but only because there is little demand to move into depressed urban centers.

THE MIDDLE CITIES OF MASSACHUSETTS

Worcester	Lawrence
Springfield	Taunton
Lowell	Chicopee
Brockton	Pittsfield
New Bedford	Leominster
Fall River	Holyoke
Lynn	Fitchburg

To keep Massachusetts competitive, these key urban centers must be placed at or near the top of the leadership agenda. State taxpayers spend enormous sums of money on failing schools and expansive social services in these cities, but we cannot continue to invest this money with little more than hope it will help solve their problems. State aid for urban redevelopment must be tied to strict performance benchmarks. It is not unreasonable for the Commonwealth to ask cities what they are achieving in exchange for the enormous sums of money they receive from state taxpayers.

Undertake regulatory reform

Another step that should be taken is regulatory reform. Both the state and local communities need to make it easier to start new businesses and more attractive for companies elsewhere to relocate to Massachusetts. We have the capacity to absorb relocating firms— particularly in the middle cities, where existing commercial, industrial and residential space is significantly underutilized.

Nowhere is regulatory reform more needed than in the area of housing. Three specific actions can be taken to increase the demand for existing stock in weak markets and production of new stock in strong markets, where local zoning too often constricts supply. Deed restrictions on housing units built or rehabbed with state subsidies make it difficult to attract buyers for these units in weak markets and undermine the larger goal of revitalizing blighted neighborhoods. In strong housing markets, the problem is the converse. The supply is simply not large enough to meet the de-

mand. Local regulations either explicitly prohibit multi-family housing or build obstacles into the permitting process that discourage developers from pursuing multi-family projects.

In weak markets, the state should eliminate deed restrictions altogether or, at the very least, reduce the time under which subsidized units are deed restricted. In strong markets, the state needs to develop both a set of exemptions to override local regulations and financial incentives to encourage multi-family projects. Two new pieces of legislation creating overlay districts for downtown redevelopment and incentives rewarding localities for action, known as 40R and 40S, are steps in the right direction, but they fail to address the principal financial cost to towns that embrace growth: educating new students. The state should restructure its school funding formula, tying state aid more closely to school enrollment. If cities and towns come to see growth as a financial benefit, they will be more likely to embrace it.

Keep education reform moving forward

By tying state education aid to school enrollment, the Commonwealth can also begin to establish performance benchmarks for schools, specifically those that underperform by both state and federal standards. But establishing clear benchmarks for school improvement is merely the first step toward creating a system truly based on the principle of accountability, which is desperately needed in our underperforming schools and districts. Tying state education aid to enrollment makes it possible for state funding to follow public school students. If the restrictions on public charter school enrollment are loosened or eliminated, choice and competition will ensue as district and charter public schools vie to attract new students and the state aid that comes with them. Schools that perform will thrive and those that don't will be forced to improve or close.

As if all this—creating a system of choice and establishing accountability in our schools, streamlining local housing and commercial regulations, reforming urban redevelopment and revitalizing our middle cities—were

not enough to do, the state faces enormous unfunded liabilities that will make achieving these goals even more difficult. Public employee pensions are underfunded by approximately \$13 billion. The Commonwealth's unfunded healthcare liability to current employees and retirees is another \$13 billion, and that does not include what municipalities will owe to their hundreds of thousands of employees and retirees. Careful planning and early redress of these enormous liabilities, which will only inflate over time, is simply responsible leadership. Paying down debt may

not be exciting or win votes, but what is included in this document isn't about running for office. It's about governing. Elections lie at the heart of democracy. They present opportunities for change, but we must take advantage of those opportunities and this document presents just a few options for doing so.

Focus on the long-term

Finally, leadership means looking to the future and realizing that even if we have current budget surpluses, over the long term, we face looming liabilities and obligations that threaten the state's solvency and the Commonwealth's prosperity. Forethought and early down payments to address these issues are the basic ingredients of responsible leadership. These decisions are rarely sexy and often unpopular, but like a mortgage, these are obligations that must be paid down.

As always, Pioneer is focused on innovations that will improve the quality of life in Massachusetts by promoting limited and accountable government, individual freedom and responsibility, and competition. In this document, we apply those principles to four issue areas we believe are critical for the next administration to address: Improving our schools, reducing the cost of living and doing business, bringing back our Middle Cities, and securing our children's future. How we address these challenges will determine the answer to the larger question that looms over this election: Will the Commonwealth continue to see slow growth and population loss, or will we maintain and enhance our economic competitiveness?

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AGENDA FOR LEADERSHIP

IMPROVE OUR SCHOOLS

PIONEER'S EDUCATION AGENDA

1. ADVANCE INNOVATION THROUGH CHOICE AND COMPETITION

RECOMMENDATION: Lift the three caps on Commonwealth and Horace Mann charter schools in school districts where at least 60 percent of students score below standard on the MCAS test.

RECOMMENDATION: Establish a system-wide expansion of parental choice across public schools.

RECOMMENDATION: Extend METCO opportunities to all children in districts where 60 percent of the students score below standard on the MCAS test.

2. LET SCHOOLS MANAGE THEMSELVES

RECOMMENDATION: Apply the public charter school principles of school autonomy and enhanced accountability to the largest and poorest-performing school districts in the Commonwealth.

RECOMMENDATION: Assemble and develop a high-quality menu of Turnaround School options, but let districts and municipalities choose the reform option appropriate to their needs.

3. HOLD SCHOOLS AND SCHOOL LEADERS ACCOUNTABLE

RECOMMENDATION: Undertake a managerial audit of the Massachusetts DOE so it can marshal existing and needed talent, and the resources to support local district reform efforts.

RECOMMENDATION: Maintain the independence of the Office of Educational Quality and Accountability, and empower the EQA to continue to monitor the progress of education reform in the lowest performing school districts.

RECOMMENDATION: Ensure that the Commonwealth is prepared in an orderly and gradual fashion to comply with coming federal mandates by raising the MCAS test passing score by three points in each of the next eight years.

RECOMMENDATION: Require that information be provided in a manner that is uniform across districts, timed to coincide with decisions to be made by parents (school assignment, METCO, charter, etc.), and based on an understood (100-point) scoring method.

INTRODUCTION

Massachusetts' elementary and secondary school performance is the best in the nation – but there is more work to be done. Since enactment of the Massachusetts Education Reform Act (MERA) in 1993, our schools have improved significantly. Unfortunately, there are still areas of continued failure in public education.

Overall improvement since 1993

Innovation: The number of public charter schools was originally capped at 25 in 1993. Strong parental demand and a generally successful record of performance led the Massachusetts Legislature to twice raise the limit on the number of public charters available. In 1997, it went from 25 to 50. In July 2000 the cap on the original – now called “Commonwealth” – charters was raised and 72 and 48 Horace Mann, or in-district charters, were authorized. Last year, there were 50 public charter schools in operation across the Commonwealth, serving approximately 19,100 students, or 2 percent of the roughly 975,000 public school children in the Commonwealth.

Public charter schools immediately proved to be a catalyst for public school innovation. For example, in order to stem the loss of students to charters, the Boston Public Schools established pilot schools. Many urban charter public schools ranked among the best in the state on the 2005 Massachusetts Comprehensive Assessment System (MCAS) test:

- Boston's Neighborhood House Charter School ranked 1st in 7th grade English.
- Community Day Charter School in Lawrence ranked 2nd in 6th and 8th grade math.
- Boston's Media and Technology Charter High School ranked 4th in 10th grade math.
- Roxbury Preparatory Charter School in Boston ranked 9th in 8th grade math.9

Even after the initial growth spurt slowed, public charter school enrollment has been growing at an annual rate of 9.1 percent since 2001, and growth would be faster if not for enrollment caps.

Accountability: Student MCAS test results have improved steadily since the test was first given in 1998. Since 2003, the passing rate has remained around 95 percent. The number of students passing both the English language arts (ELA) and math MCAS examinations on their first try has increased from 63 percent for the class of 2003 to 82 percent for the class of 2006. The last decade has also seen a steady rise in mean SAT scores in Massachusetts. At the same time, the Commonwealth's National Assessment of Educational Progress (NAEP) scores have improved faster than the national average, particularly in 8th grade.

Financing Equity: Since passage of MERA, the Commonwealth has

poured more than \$40 billion into K-12 public education. This funding has largely eliminated spending disparities between rich and poor districts, and Massachusetts now has one of the most progressive (according to Education Trust) state education funding formulas in the nation.

Large, deep and persistent pockets of failure

On the critical question of student performance, the evidence is mixed: test scores have risen overall, but vital educational subgroups have not kept pace. Student achievement still lags for high achievers, which is a particular concern, given our knowledge-based economy. Moreover, urban and minority students still continue to fail at an alarming rate—one that remains virtually unchanged by reform efforts and tens of billions of dollars in added investment. Only 11 percent of Massachusetts's 8th grade students scored in the 'Advanced' category on the NAEP in 2005 in math, and only 5 percent in English.

The lack of progress in urban districts is illustrated by the following facts:

- As of June 2005, 94 percent of suburban and rural members of the class of 2006 had passed both the ELA and math portions of the MCAS exams, but only 77 percent of urban district seniors had passed both tests.
- In the 22 districts classified by the DOE as urban, 19 were identified for improvement in 2005 for not making 'Adequate Yearly Progress' (AYP) under the federal No Child Left Behind Act (NCLB) in both ELA and math.
- Only 50 percent of limited English proficient (LEP) students, 70 percent of students with disabilities, 73 percent of African-American and Hispanic students, and 77 percent of students receiving free or reduced price lunches (FRL/Y) earned a competency determination by June 2005.
- In more than one out of every three school districts in Massachusetts (including every major city) more than half of the students scored in the 'Needs Improvement' or 'Warning/Failing' categories on the 2005 MCAS test.

The statewide dropout rate is officially 3.5 percent annually, meaning that roughly 14 percent of students entering high school will not graduate. Most of the 10,000 students who drop out of high school are minority students from urban districts. There has been no reduction in the overall dropout rate for these groups, or in the student population at large.

These failures are all the more worrisome due to the absence of political will to advance education reform with the same vigor and focus that existed in the 1990s. Inertia has emboldened those who prefer the status quo. Elements of a successful school are hardly a mystery. The 1993 Reform Act was built on the following principles: (1) competition and innovation; (2) decentralized management that makes the

work and decision-making of principals and teachers more meaningful, and also makes results more apparent; and (3) clear measurement of student performance and accountability for performance.

1. ADVANCE INNOVATION THROUGH CHOICE AND COMPETITION

No one solution can address the level of failure in many urban districts. Below are three recommendations to address the achievement gap and advance better educational outcomes for all students and across the state.

Eliminate arbitrary limits on new charter schools in failing districts

Public charter schools are public schools established by the Legislature as part of the Education Reform Act to encourage innovative educational practices, provide parents and students with greater choice in public education, and serve as models for replication of successful reform in other public schools. The first charter schools opened in 1995.

Charter schools have the freedom to organize around a core mission, curriculum, theme, and/or teaching method. They control their own budgets and have the power to hire and terminate teachers and staff. In return for this freedom, a charter school must attract students – no student is assigned to a charter school – and produce results within five years, or its charter will not be renewed.

Currently, about 19,000 students attend Massachusetts' charter schools. Of the 16,000 more students on waiting lists, over 10,000 are waiting to attend Boston public charter schools. Three statutory caps limit the ability of education entrepreneurs to create new and innovative schools in failing urban districts. Charter schools can account for no more than 4 percent of students in a district and no more than 9 percent of the sending district's net school spending. Statewide, no more than 120 charter public schools – 48 Horace Mann and 72 Commonwealth – can operate at one time.

Recommendation: Lift the three caps on Commonwealth and Horace Mann charter schools in school districts where at least 60 percent of students score below standard on the MCAS test.

Significant reform of school assignment process

In 2005, Boston's school superintendent closed the Grover Cleveland Middle School. The closure demonstrates the challenges facing urban school systems, the glacial pace of reform, and the potential for progress. The challenges

facing urban school districts include engaging parents and creating incentives for unions and school leaders to work for meaningful change. The slow pace of change can be expressed in a single fact: 17 Boston middle schools performed worse than Grover Cleveland, and yet no one expects that their closure is imminent.

The potential is clear. All four of Boston's Commonwealth charter schools scored among the top 10 on MCAS test among Boston middle schools. Looking at high schools, the Media and Technology Charter High (MATCH) School — a school with a student body that is largely minority and poor, by federal standards — outscored Wellesley, Newton, and other wealthy communities on the 10th grade math MCAS test.

By contrast, few of Cleveland's students chose the school through Boston's school selection process. Its unopposed closure marked a step in the right direction, but more needs to be done. Tens of thousands of students are stuck in poor-performing public schools in every major urban school district across Massachusetts.

Competition spurs new ideas and reform. It increases parental involvement—the cornerstone of good education. Other states' and cities' experience has demonstrated that a vigorous school selection process is a crucial way to encourage parental involvement. Edmonton, Alberta went so far as to implement school choice across the entire public system. Parental choice and the subsequent innovations within the public schools were so successful that they prompted many area private schools to join the public system.

By enhancing school choice and competition, Massachusetts can provide parents across Massachusetts with meaningful alternatives within their districts.

Recommendation: Establish a vigorous, system-wide expansion of parental choice across public schools.

Expand Metropolitan Council for Education Opportunity, Inc. (METCO) programs in all Massachusetts cities

METCO is a voluntary, state-funded grant program that is intended to expand educational opportunities and reduce racial imbalance by permitting students in certain cities to attend public schools in other communities that agree to participate. There are currently approximately 3,300 students participating in 34 school districts in metropolitan Boston and in four school districts outside Springfield. In Springfield and Boston, there is a five-year waiting list of over 15,000 interested students.

Recommendation: Extend METCO opportunities to all children in districts where 60 percent of the students score below standard on the MCAS test.

2. LET SCHOOLS MANAGE THEMSELVES

Promote decentralized, school-based administration

Reform efforts undertaken here in Massachusetts, across the country, and abroad provide us with important and instructive data. As noted above, one of the key elements in successful school reform is promoting decentralized school management. The former superintendent of the Edmonton, Alberta public schools, Angus McBeath, took a school system 30 percent larger than Boston's and used school choice and school-level management to generate impressive system-wide improvement. Comprehensive and sustained administrative reforms that have been achieved under Barnstable Public Schools interim superintendent Tom McDonald (recently retired) and Town Manager John Klimm prove that this can also be done in Massachusetts.

When he was the principal of a district-wide K-five school in Barnstable, Tom McDonald felt stifled by layers of bureaucracy when he heard about the possibility of applying for a Horace Mann charter. Unlike typical charter schools, the Horace Mann model requires applicants to obtain approval from both the school committee and the teachers' union. But like charter schools, it shifts decision making from school districts' central office to the principals and teachers. While the model offers increased autonomy, outcomes are closely monitored. McDonald was granted a charter in 1999; Barnstable later received an additional charter.

After being hired as interim superintendent in 2004, McDonald converted several traditional schools into Horace Mann charter schools and devolved authority to principals by:

- Transforming the district's back office functions to enable the principals to act more independently.
- Giving the 10 non-charter schools powers and responsibilities similar to those in the Horace Mann charter schools, but without the burdensome layer of state oversight.
- Consolidated the school department's finance and human resources offices into the municipal offices, reducing redundancy, bringing finances under control, and freeing up money for innovation and improvement.

The town finance director designed 16 new positions to replace the 18 that were distributed between the school department and town. Schools were allowed to keep savings on energy and other costs, and everyone now had incentives to seek improvement and materially benefit from innovation.

Recommendation: Apply the public charter school principles of school autonomy and enhanced accountability to the largest and poorest performing school districts in the Commonwealth. By freeing superintendents and principals in 'underperforming' districts from teachers union restraints

and state regulations, these public school charter districts would escape from central office bureaucracies that are unable to serve the needs of schools, teachers, or – most importantly—students.

Turn around low-performing schools and districts from the bottom up

In 2005, 63 schools in Boston, 23 in Worcester, and 29 in Springfield were placed on the federal “In Need of Improvement” list, as mandated under the No Child Left Behind law. For Massachusetts to develop a meaningful Turnaround Schools program for the 61,000 students trapped in the 100 lowest performing schools, the Commonwealth must strengthen and better support its school- and district- level accountability systems. Together with the provisions of the federal No Child Left Behind Act, these systems are essential for Turnaround Schools to be identified and selected for remediation.

Recommendation: The Commonwealth should assemble, develop, and evaluate a high-quality menu of Turnaround School options, for schools and school districts, from which the districts and municipalities must choose.

Because the needs of each community and school will differ, the options should be varied and credible. This cannot be a top-down process—the community will select the remedy. The state should, however, ensure and reward improved performance. The following are suggested options:

- **University Partnerships:** Considering the number and quality of institutions of higher education in Massachusetts, such partnerships could advance meaningful change in our urban districts. Currently, the Boston University/Chelsea Partnership (BUCP) is charged with reform and revitalization of Chelsea’s public schools. Now in its 15th year, BUCP remains a model of public school district management by a private university. The University Park Campus School, Worcester (UPCS) was developed by Clark University and the Worcester Public Schools in 1997 as a public school of choice, admitting neighborhood students regardless of academic standing. Though admitted by lottery, applicants must accept the school’s academic rigor, including a minimum of two hours of homework each night. Students’ scores on the MCAS test have consistently placed the school among the top 10 percent in the state. UPCS was recently named the top-performing urban high school in Massachusetts.
- **Private Management of Public Schools:** Edison Schools, Inc., founded in 1992, partners with schools and districts in 25 states, Washington, D.C., and the United Kingdom to raise student achievement through research-based school design, aligned assessment systems, interactive

professional development, and integrated use of technology. The more than 330,000 students in Edison schools are achieving annual academic gains well above national norms, while Edison has now been committed to education reform in America for 15 years. SABIS is an international, Pre-K-12 college-preparatory education system. It currently serves 28,000 students in 31 schools in 11 countries around the world. There are several SABIS schools in Massachusetts, including a highly successful public charter school in Springfield.

- **Commonwealth and Horace Mann Charter Schools** have proven effective at providing high-quality education to thousands of Massachusetts students. They represent one useful approach to addressing the needs of turnaround schools, especially if some accommodation can be made to allow the charter to use the existing public building.
- **Pilot Schools** were developed collaboratively by the Boston Public Schools and the Boston Teachers Union to experiment with innovative instructional models and demonstrate practices that could be replicated more widely. A total of 17 pilot schools educated 5,342 K-12 students in FY2005. Four existing BPS schools converted to Pilot status in FY2004 and at least seven more Pilot Schools will be added by September 2008.
- **Vocational-Technical Education (VTE)** schools and programs offer a dual mission of occupational and academic education and are subject to MCAS testing. Currently, there are approximately 30 regional vocational-technical schools in Massachusetts. VTE programs experienced a 41.6 percent increase in combined MCAS test scores between 2001 and 2005.

3. HOLD SCHOOLS AND SCHOOL LEADERS ACCOUNTABLE

Reform the Massachusetts Department of Education (DOE)

The Massachusetts Education Reform Act (MERA) and the No Child Left Behind (NCLB) Act both advance accountability and the transformation of failing schools. The Massachusetts DOE is on the front lines of implementing education reform. Despite clear strengths in disseminating information, administering standardized testing, and promulgating regulations, DOE expertise is somewhat constrained. It is an agency focused on test compliance; it has little capacity to provide the technical assistance needed to work with districts to drive change. In addition, the significant overhaul of the School Building Assistance Program, which places the new School Building Authority in the Treasurer’s Office, revealed lax management and fiscal oversight on the part of the state

DOE—problems that could be more widespread.

Recommendation: Undertake a complete managerial audit of the Massachusetts DOE to understand how the department uses data and exercises accountability and fiscal oversight of its own functions. The audit should focus on how to reshape DOE so it can marshal existing and needed talent, and the resources to support local district reform efforts.

Maintain the independence of the Office of Educational Quality and Accountability

The Office of Educational Quality and Accountability (EQA) was established by the Legislature in 2000 as part of the accountability system required by MERA. Since its first district assessment in 2002, EQA has evaluated more than 130 school districts. A sizeable number of these districts were previously under-funded districts that now receive the majority of state education aid. These districts also include the largest metropolitan areas, hence a high percentage of statewide enrollment, and in FY2005 received a total of \$4.1 billion, or 49 percent of total state aid.

In recent years, the EQA has received constant harassment from the teachers' unions and other education trade organizations, as well as concerted legislative efforts to fold it into the Massachusetts DOE bureaucracy. Given that state funding for education has more than doubled and to over \$40 billion since enactment of MERA, it is prudent and reasonable to have an independent, fact-finding audit agency that evaluates the financial and educational return on this considerable investment.

Recommendation: Maintain the independence of the Office of Educational Quality and Accountability, and empower the EQA to continue to monitor the progress of education reform in the lowest performing school districts.

Raise the MCAS test passing score to comply with coming federal mandates

Objective measurement of students' competency in the subject areas for which curriculum frameworks were to be created was a key requirement of MERA. The MCAS test was constructed and is administered for those purposes. MCAS is not itself a standard,

but rather one component of a larger standards-based state assessment system. Individual MCAS tests are given each year and utilized in various grades for ELA, math, reading, science/technology/engineering, and history/social science. Beginning with the graduating class of 2003, the Commonwealth required students to score no lower than the 'Needs Improvement' category in ELA and math in order to graduate from high school.

Under the federal No Child Left Behind Act, diplomas will be granted only to those who score at least proficient (240) on each exam by 2014, and science will be added to English and math as a graduation requirement in 2010.

Recommendation: Ensure that the Commonwealth is prepared in an orderly and gradual fashion to comply with coming federal mandates by raising the MCAS test passing score by three points in each of the next eight years.

Simplify MCAS test scoring

Massachusetts law calls for clarity in measuring students, which means parents must be able to easily grasp the significance of the MCAS test score. Current scoring methodology means little to parents or students other than whether a passing grade was attained. Every child earns 200 points just for taking the test. Correct answers can bring the score as high as 280. To obtain a high schools diploma, a score of 220 on the 10th grade ELA and math exams is required. Students are given five opportunities to take the exam. Pro-rating MCAS test scoring to the traditional 100-point system, a passing score of 220 on the MCAS translates into a score of 25 on a scale of 100.

In order to meet the spirit of the law, which means providing clear information on performance to parents, educators and the Legislature, MCAS scoring should be overhauled.

Recommendation: Require that information be provided in a manner that is uniform across districts, timed to coincide with decisions to be made by parents (school assignment, METCO, charter, etc.), and based on an understood (100-point) scoring method.

MCAS TEST SCORING			
Classification	Current MCAS scale	Without 200-pt giveaway	Adjusted to 100-pt base
Perfect score	280	80	100
Advanced	260-280	60-80	75-100
Proficient	240-259	40-49	50-74
Needs improvement	220-239	20-39	25-49
Failing	200-219	0-19	0-24

REDUCE THE COST OF LIVING AND DOING BUSINESS

PIONEER'S COST-CUTTING AGENDA

1. REDUCE THE INCOME TAX RATE TO 5 PERCENT

RECOMMENDATION: Implement the income tax rollback for fiscal year 2008.

2. REDUCE THE COST OF UNEMPLOYMENT INSURANCE

RECOMMENDATIONS: Three basic changes would go a long way toward fixing Massachusetts' unemployment insurance system.

- Bring benefits in line with other states
- Reduce Unemployment Insurance rates generally, but increase them for companies that abuse the system.
- Give the Department of Unemployment Assistance power to garnish wages.

3. REDUCE THE COST OF HOUSING

RECOMMENDATIONS:

- Give municipalities incentives to allow more housing to be built.
- Create exceptions from local zoning authority to make "smart growth" the path of least resistance for developers.
- Give local permitting bodies regulatory tools to facilitate more and better development.
- Amend the state Subdivision Control Law to include standards for road design.

4. STREAMLINE LICENSING

RECOMMENDATIONS: Invest in technology and business process redesign by taking the following actions:

- Examine the efficacy of each license type issued by the Commonwealth and consolidate or sunset unnecessary requirements
- Leverage best practices and achieve economies of scale by consolidating administrative licensing functions into fewer agencies
- Shift state workers to more significant functions by increasing the number of online transactions and expanding outsourcing of licensee training and testing
- Integrate databases so citizens with multiple licenses can, with a single action, make all needed changes to their licenses.
- Link license databases to other state systems

COSTS THREATEN GROWTH

While Massachusetts' economy is recovering, our long-term competitiveness seems more fragile than ever. This year the Commonwealth has added roughly 5,000 new jobs monthly, but still has 148,000 fewer jobs today than in 2001. Massachusetts is one of only two states losing population and the only state to lose population in each of the last two years. The competitive advantage provided by the state's world-class universities is being eroded by its high cost of living. New college graduates, confronted with some of the nation's most expensive housing, rapidly inflating health insurance premiums and high home heating costs, tend to depart for warmer and cheaper climes. As they move, so too will the companies that employ them, a trend already detectable in some of our signature industries, particularly financial services. The Commonwealth must ask itself: Are these trends temporary, or only the beginning of a long, painful economic decline? What can be done to reverse them?

Future growth depends on a systemic reduction in the cost of doing business. Workers' compensation and tax policy reforms in the 1990s did not bring the cost of doing business in Massachusetts in line with rival states. Since then, complacency has set in, despite alarming evidence that other cost factors – regulation, unemployment insurance, energy, housing, land, labor, and healthcare – are also driving jobs out of the state.

These costs affect different business sectors differently, but the impact is always negative. Small and mid-sized businesses that don't have the option to relocate to other states will find growth difficult, and their options limited. The impact of our cost structure on highly mobile growth sectors is even more devastating for the state's economy. Large companies in key industries, such as financial services, defense and aerospace, and information technology, are actively pursuing relocation to other states. Cutting special deals with specific companies in response to competition from other states is just a band-aid on the problem, not a long-term solution. Instead, to retain and attract businesses to the Commonwealth, we should ensure that our cost structures make the state an appealing place for every business.

Streamline permitting and regulation

During the current administration, important steps have been taken to address barriers to growth. These included regulatory reform, appeals reform, and legislative changes such as the passage of Chapter 43D, which, in exchange for state incentives, created an opt-in provision for municipalities to streamline their permitting processes. But more action is needed to address the cost of living and doing business in Massachusetts.

What follows is a partial look at the overall strategy, as some of the other elements of the plan are contained in other sections of this blueprint (e.g., for ways to streamline regulation see the section titled Bringing Back Our Middle Cities). In this section are recommendations regarding:

- Unemployment Insurance
- Housing
- Healthcare
- Licensing

Reduce the income tax

Finally, the current situation's urgency is such that Pioneer has taken a position on an issue that it had not drawn significant attention to in the past—the income tax. This is a departure for the Institute, but given the state's proclivity to prioritize spending over tax relief and an inability to exercise fiscal discipline, we believe that ignoring the issue anymore would be irresponsible.

1. REDUCE THE INCOME TAX RATE TO 5 PERCENT

In 1989, the state Legislature raised the income tax to 5.75 percent and promised that the hike was temporary. The Commonwealth has gone through two fiscal crises (and recoveries) since that time, expects to increase budget expenditures by \$2 billion dollars from 2006 to 2007, and currently has almost \$2 billion in its rainy day fund. Independent projections for fiscal year 2007 forecast another billion-dollar increase in tax revenues, even after a reduction due to uncertainty in capital gains receipts. An income tax rollback to 5 percent would reduce tax revenue by approximately \$700 million, a figure the Commonwealth can afford if it chooses to make tax reduction a priority.

Enforce fiscal discipline

The actions of the Legislature at the end of fiscal 2006 provide further evidence of available funds: it passed two large spending bills – a \$300 million capital supplemental budget and a \$259 million economic stimulus bill. To be

fair, there were positive aspects to each bill, such as an attempt to address deferred maintenance at higher education institutions and the funding of needed infrastructure improvements.

But the excessive spending contained in each bill demonstrates an unwillingness to prioritize tax relief over new spending. Monies were allocated for pet projects like historic meeting houses, boathouses, and a carriage house museum. The simple truth is that without a tax cut to force the return of funds to taxpayers, the Legislature can't resist frivolous spending.

Many observers note that the state has a structural deficit; unfunded liabilities in areas like maintenance, pensions, and employee healthcare; and critical infrastructure needs, which raise questions about the responsibility of a tax cut. Our response is simple: If state government were operating efficiently and devoting the surplus to these areas of future liability, one might make a defensible case for retaining the higher tax rate. The reality is far different – the Legislature continues to develop new programs, while funding existing ones and distributing funds in a wasteful, undisciplined manner.

It should also be remembered that the rollback of the income tax was supported by a 59-to-41 percent margin (winning by almost half a million votes) in a 2000 referendum. While care should be taken in putting cultural and social issues to a referendum vote that may diminish personal freedoms, the clear mandate to return the income tax to 5 percent represents the will of the voters. The tax rate is clearly not a question of minority rights, and we believe the referendum's outcome should be respected.

Years of delay

The disconnect between the popularity of the income tax rollback and the unwillingness of the public sector to return these funds to the taxpayers finds its clearest expression in the long line of delay tactics and gimmicks intended to defer the implementation of the 2000 referendum. The tax rate was originally raised in 1989, with a promise to repeal the increase once the revenue picture improved. The state has gone through several economic cycles, yet the tax rate has failed to return to 5 percent. After the 2000 ballot initiative, the tax rate was reduced to 5.6 percent, then frozen at 5.3 percent in 2002. Several plans have been put forth to reach the 5 percent rate, most of which represent at least a partial unwillingness to prioritize tax relief over new spending:

- Over two years – Least objectionable was Governor Romney's proposal to roll back the income tax rate over tax years, in order to soften the revenue blow.
- By 2010, we hope – Gubernatorial candidate Chris Gabrieli offers a plan to divert 40 percent of any new revenues above the rate of inflation toward funding a

- tax cut, which he believes will result in a reduction to a 5 percent tax rate by 2010 if revenue continues to grow.
- Only if we increase other spending – In the spring of 2006, the state Senate passed a bill that lowered the income tax rate to 5 percent over three years, but only if other spending categories, such as local aid, rose to exceed inflation-adjusted 2002 levels.
 - Only if we do it slowly and a long time from now – The 2002 legislation that froze the income tax rate allows for a .05 percent yearly reduction of the tax rate, starting in 2010, if certain economic tests are met on a yearly basis.

Taxpayers who have waited since 1989 for promised tax relief have a right to be skeptical. At the same time, they've watched state budget expenditures increase an average of over \$950 million per year over the past ten years. A decrease in the income tax rate from 5.3 percent to 5 percent would reduce annual state revenues by approximately \$700 million, an easily affordable sum based on revenue growth projections and the potential for reining in spending growth.

Recommendation: Implement the income tax rollback for fiscal year 2008.

2. REDUCE THE COST OF UNEMPLOYMENT INSURANCE

This piece was largely drawn from an article written by John O'Leary in the Summer 2006 issue of CommonWealth magazine.

Unemployment insurance in Massachusetts threatens both our competitiveness and our fiscal health. In 2004, the Division of Unemployment Assistance (DUA) sent out about \$1.4 billion in unemployment benefits, more than 6 percent of the Commonwealth's budget. There are several reasons for the program's high cost.

The most obvious is that Massachusetts' unemployment benefits are the most generous in the nation – 76 percent richer than the national average. Not only is the Commonwealth's maximum weekly benefit of \$551 (plus \$25 per dependent child) the highest in the country, but Massachusetts is the only state that allows claimants to collect for 30 weeks. Forty-eight states have a 26-week limit, while Montana's limit is 28 weeks. It also takes less time to qualify for unemployment here. Most states require an applicant to earn wages equivalent to 20 weeks' worth of work to qualify; in Massachusetts it's 15 weeks.

It should come as no surprise that Massachusetts' rich benefits encourage claimants to collect for longer, further adding to the cost. Even in 2000, when state unemployment was well below the national figure, Massachusetts

spent 53 percent above the national average on unemployment benefits. A key reason was that the typical Massachusetts claimant collected for 16.3 weeks, well above the national average of 13.7 weeks.

Compounding this disparity, federal rules allow anyone who earns wages in more than one state to file in any state they choose. Not surprisingly, more than 2,200 individuals with no connection to Massachusetts came here to apply for unemployment insurance in 2004. While the Commonwealth is reimbursed for the cost of benefits by the states in which claimants had worked, applying for reimbursement and handling the claims adds administrative costs. It's also more difficult to verify that non-residents are seeking work, or to ensure that they haven't returned to work without letting us know.

Job Killer

Unemployment insurance benefits are paid for by a tax on employers, and benefit levels ultimately drive the rate of taxation. Nationally, employers pay an average of \$315 per employee in annual UI costs. Generous benefits and liberal eligibility requirements help boost the annual cost per employee to \$637 in Massachusetts. In an increasingly global economy, it keeps getting easier for employers to move their jobs to North Carolina, where the annual tax is \$278/employee; or even right across the border to New Hampshire, where it's \$118/employee.

Gaming the System

In addition to offering generous benefits and liberal eligibility requirements, Massachusetts' competitiveness and fiscal health are further compromised because our system is easily gamed. This is particularly true for owners and employees of seasonal businesses such as construction, school bus companies, landscaping, and businesses in resort or vacation areas.

Unemployment taxes in Massachusetts are "experience rated," which means businesses whose former employees have been heavy users of the system pay more than those whose employees have rarely used it. But the additional cost is more than made up by the generous benefits that can be realized.

For example, a Nantucket jewelry store owner earns about \$50,000 over the summer of 2004, then lays herself off in fall and heads to Florida, where she collects \$17,340 in UI benefits (30 weeks at \$528/week plus \$25 each per week for her two dependent children). Of course, she pays the maximum UI tax, but that amounts to just over \$1,500 per year, meaning she reaps a nearly \$16,000 windfall – all courtesy of other Massachusetts businesses.

In 2004, workers from 3.9 percent of state businesses accounted for almost one-third of benefits paid out by the

state. Those businesses paid \$125 million in UI taxes, but their employees collected \$403 million in benefits.

And 2004 was certainly not an anomaly. More than half the 247,000 people who filed for Massachusetts unemployment benefits in 2004 also did so in 2003. Eighteen thousand people have collected in at least 11 of the past 20 years – and there are some who have collected in 25 consecutive years. The 5,500 Massachusetts companies who were heavy UI users between 2002 and 2004 were subsidized by other state businesses to the tune of \$1.2 billion.

Recommendations: Three basic changes would go a long way toward fixing Massachusetts' unemployment insurance system.

Bring benefits in line with other states

- Reduce maximum benefits to around \$400/week (the national average plus an adjustment of about 10 percent to reflect the Commonwealth's high cost of living)
- Limit collection period to 26 weeks
- Require equivalent of 20 weeks' wages for eligibility

Reduce UI rates generally, but increase them for companies that abuse the system.

- 2004 legislation increased the tax on companies that are heavy UI users, but it was not enough. Those companies still received a \$312 million subsidy in 2005.

Give DUA power to garnish wages.

- DUA uncovers millions of dollars worth of fraud on which it is unable to collect.

3. REDUCE THE COST OF HOUSING

Housing prices in eastern and central Massachusetts have skyrocketed over the last 25 years. Local building restrictions have damaged the market's ability to meet demand, causing homebuyers to bid up the prices of a limited supply. The barrier to development is not physical, but rather political and regulatory. Moreover, poorly drafted zoning regulations have undermined good design principles and have caused development to consume far more land than necessary. Our inadequate regulatory frameworks cost us on many fronts. Workers are leaving the Commonwealth for places where homes are more affordable; open space is developed at a rate of 40 acres per day; and the designs of new subdivisions fail to meet our expectations for charming, walkable New England neighborhoods.

If Massachusetts wants to preserve its long-term competitiveness, it must allow the housing market to meet

demand and accommodate our workforce. Too few towns have been willing to allow development of multi-family housing and single-family homes on moderate-sized lots, even in a portion of the town. Moreover, the tools communities use to limit development have the unfortunate side effect of undermining good design and sustainable land use patterns. Massachusetts is faced with a choice: revise our zoning laws and encourage well-planned increases in housing supply, or else continue allowing only large-lot sprawling development and risk undermining the state's economic vitality as our workers seek affordable housing elsewhere.

Recommendations: The following recommendations are meant to address the factors that serve as a disincentive to municipal development, and to create a regulatory framework that promotes superior design and better environmental outcomes.

Give municipalities incentives to allow more housing to be built.

- Base a significant portion of new state aid to municipalities on achievement of housing production performance standards.
- Re-evaluate formulae for school funding to ensure that communities with growing school-aged populations do not face inappropriate fiscal burdens.

Create exceptions from local zoning authority to make "smart growth" the path of least resistance for developers.

- In residentially zoned districts, allow by right accessory apartments in owner-occupied single-family homes that meet certain standards. This would be a low-impact source of rental housing across the suburbs, where supply of rental units is inadequate. Many municipalities prohibit accessory apartments, and others restrict occupancy of the units to relatives of the homeowners.
- Allow by right certain mixed-use developments within 1/2 mile of public transit stations within districts locally zoned for commercial development. State statute should allow developers to build two stories by right of residential units above ground floors that contain commercial uses. The state invests in developing and maintaining public transit, but by zoning for low-density development, localities often work against state efforts to achieve levels of ridership that would make the investments worthwhile. Allowing mixed-use development would increase residential construction, lead to livelier business districts, and increase transit use.
- Allow by right "conservation subdivisions" that contain protected open space and clustered residential development. Developers could either build under local zoning rules or opt for by-right conservation subdivision, with the allowed density of housing (units per

acre) specified in state law and regulations. The more open space protected on the parcel, the more units allowed. The municipality could negotiate development of the open space in exchange for funding to be used for open space protection at another site. Conservation subdivisions would be a tool to allow the market to meet demand for housing while also protecting open space.

Give local permitting bodies regulatory tools to facilitate more and better development.

- Create zoning tools (similar to “friendly 40Bs”) in state law that local planning boards could use to grant special permits for cluster developments, mixed use, conversions of old houses and mills to multi-family, and transfer of development rights. Just as some municipalities have used the Local Initiative Program, or “friendly 40B”, to permit desired dense residential development that would not be allowed by local zoning, municipalities could use these tools to permit other types of desirable development. Localities currently write their own zoning requirements, and most are poorly crafted to meet growth management goals. Under this proposal, local planning boards could grant special permits for certain types of development that are not allowed in their local bylaws/ordinances.
- Explicitly authorize local planning boards, in state statute, to grant special permits that would double the number of units allowed “as of right” under local zoning in exchange for negotiated benefits from the developer. This is a direct empowerment of planning boards to negotiate density, even where local zoning bylaws/ordinances do not currently grant them the authority. For projects that by right could include five or more units, planning boards could negotiate density bonuses in exchange for: (a) open space set-asides; (b) superior site design; (c) infrastructure improvements; (d) inclusion of affordable units; or (e) donations to a fund that could be used for open space protection, infrastructure improvements, schools, etc.

While many town meetings and city councils currently authorize the Special Permit Granting Authority (usually the planning board, zoning board of appeals, or city council) to negotiate increased density, they often place strict limits on the types of development and number of units that can be negotiated. Most municipalities feel they absorb the impacts of development, such as school costs, loss of open space and increased traffic, but enjoy few of the benefits. Empowering planning boards to negotiate benefits in exchange for density will give them greater incentive to allow development in the context overall community improvement.

- Amend the state Subdivision Control Law to include standards for road design. The state standards for road design would represent “best practices”, and serve as a ‘default’ for communities without the resources or will to develop effective standards. Municipal planning boards could adopt local amendments to the state standards. Many local road design standards represent “worst practices” in terms of landscape design, and some appear to be designed to increase the cost of subdivision for developers. Some planners have commented that the planning boards frequently waive requirements that do not make sense, but that they do not have the resources to promulgate better subdivision rules, so outdated rules remain on the books.

4. STREAMLINE LICENSING

Each year, millions of citizens and tens of thousands of businesses seek state licenses or permits. Dozens of state agencies and several hundred state employees provide licensing information, process applications, track compliance, and collect licensing fees. The Commonwealth could save money, enhance service quality, and speed job and business creation by optimizing its licensing activities.

Scope of Licensing Activities

The Commonwealth issues 138 major license or permit types, with most categories broken down into sub-types. There may be as many as 24 different sub-types for a single license, resulting in thousands of distinct licenses issued by the Commonwealth. Twenty-six state agencies within 10 separate executive offices issue licenses or permits. The licensing process is handled by the various agencies’ main offices as well as 45 field offices and more than 400 licensing agents. The Office of Consumer Affairs and Business Regulation (OCABR) administers 40 percent of all state-issued licenses. The table below illustrates the breadth of state licensing activities, including the large number of full-time employees (FTEs) dedicated to licensing.

Current Practice

Licensing is still a paper-intensive process. Even when done electronically, the process is often a fragmented one. Applications can be filled out and submitted via the Internet for only a subset of the 138 major license types. Applicants can download forms to print, fill out, and mail for the majority of license types; applications for the remaining license types are not available online in any form.

Because licensing activities in the Commonwealth are conducted independently by a number of different agencies, each in its own “silo,” applications are not processed in a coordinated or efficient manner. Most licensing agencies are unaware of what other licensing agencies are doing, even when they perform similar activities or are in the same building. As a result, there is no common computing platform across the agencies, and few shared best practices. The good news is that there are large, untapped economies of scale to be had. The state’s Division of Professional Licensure (DPL) has

achieved significant economies by consolidating processing for its 36 licensing boards, and centralizing and rationalizing processes.

With more than 30 separate licensing systems in use, agencies often ask for duplicative demographic and other information. There are few links among licensing databases, so even higher order checks across agencies on critical matters like criminal records prove difficult.

Recommendations: Invest in technology and business process redesign by taking the following actions:

SCOPE OF LICENSING ACTIVITIES				
	LICENSE TYPES	FTES	CALL VOLUME	TOTAL LICENSES
CONSUMER AFFAIRS AND BUSINESS REGULATION				
Consumer Affairs & Business Regulation	0	0	-	-
Alcoholic Beverages Control Commission	27	24	93,141	31,047
Board of Registration in Medicine	3	9	16,500	30,000
Department of Telecommunications and Energy	6	143	34,548	11,516
Division of Banks	10	157	12,405	4,135
Division of Energy Resources	0	0	-	-
Division of Insurance	23	29	33,000	221,048
Division of Professional Licensure	194	51	1,533,615	511,205
Division of Standards	6	18	67,221	22,407
State Racing Commission	24	43	12,000	8,267
Total	293	474	1,802,430	839,625
ENVIRONMENTAL AFFAIRS				
Department of Environmental Management	3	1	1,800	600
Department of Environmental Protection	4	6	29,058	9,686
Department of Fisheries, Wildlife and Environmental Law Enforcement	3	8	1,767,000	12
Department of Food and Agriculture	12	36	82,116	27,372
Total	22	51	1,879,974	626,658
HEALTH AND HUMAN SERVICES				
Office of Childcare Services	4	75	41,580	13,860
Department of Public Health	20	113	1,060,101	4
Total	24	188	1,101,681	367,227
ADMINISTRATION AND FINANCE				
Department of Revenue	3	9	27,540	9,180
TRANSPORTATION				
Highway Department	2	4	11,430	3,810
LABOR AND WORKFORCE DEVELOPMENT				
Division of Occupational Safety	4	20	18,912	6,304
BOARD OF BAR OVERSEERS				
Board of Bar Overseers	1	4	217,203	72,401
EDUCATION				
Dept of Education	30	25	270,900	90,300
SECRETARY OF THE COMMONWEALTH				
Secretary of State Securities Division	3	0	-	-

- Undertake a review to examine the efficacy of each license type issued by the Commonwealth and consolidate or sunset unnecessary requirements. Each license should be assessed objectively by asking why a license is required and what public benefit will result from licensing this activity. While not easy, it is important to question the need for many existing licenses that were created in response to lobbying from industry groups.
- Consolidate administrative functions for licensing into one or few agencies in order to leverage best practices and achieve economies of scale.
- Increase the number of online transactions, allowing licensing staff to focus on verification of data or redeploy to compliance and inspections.
- Make website navigable for end users. Compliance with licensing requirements should be made simple, so that no willing licensee gives up due to difficulty finding information or completing a transaction.
- Integrate databases so citizens with multiple licenses can, with a single action, make all needed changes to their licenses. This would also allow for better tracking of licensees.
- Link license databases to other state systems, such as the online Department of Revenue, Criminal Offender Record Information, Department of Social Services, and the Office of Child Care Services databases, to allow for checks on back taxes, child support arrearages, and child care licensing.
- Let agencies, not the Legislature, determine the best way to administer licensing programs.
- Expand the outsourcing of licensee training, with the state certifying the curriculum but state employees focusing on more important functions.
- Outsource testing so state workers do not waste time proctoring exams. The state requires tests for a wide variety of certifications, ranging from Title 5 inspectors to cosmetologists.

AGENDA FOR LEADERSHIP

REVITALIZE OUR MIDDLE CITIES

PIONEER'S MIDDLE CITIES AGENDA

1. MAKE SUBSIDIZED HOUSING A PATHWAY HOME

RECOMMENDATIONS:

- For neighborhoods where the market price of housing is affordable to people making 80 percent of median income, adjust requirements for affordability deed restrictions. Index the resale price to increases in the area median income, and reduce the duration of the resale restriction to five years.
- Simplify resale restrictions so they can be understood by homebuyers and housing professionals alike.
- Redeploy state resources to invest in development of market-rate units in weak market neighborhoods.

2. STREAMLINE REGULATION AND PERMITTING OF URBAN NEIGHBORHOOD BUSINESSES

RECOMMENDATION: Promote a single set of regulations and permits for core neighborhood businesses across the Middle Cities by creating a one-stop online portal for all local, state and federal regulatory requirements.

3. REORGANIZE THE STATE'S ECONOMIC DEVELOPMENT AGENCIES

DIRECT INVESTMENT AND STATE LOANS TO PRIVATE COMPANIES

RECOMMENDATIONS:

- Examine each program to ensure that it fills an actual 'capital gap' that the private market would not address and provides a benefit to the state economy in cost-efficient manner; and does not crowd out private investment or subsidize inefficient or otherwise unbankable businesses.
- Restructure the programs to provide funding for actual 'capital gaps' (if any) that can be addressed through state intervention.

WORKFORCE TRAINING

RECOMMENDATIONS:

- Work with the business community to determine current and projected skill gaps in the Commonwealth's workforce.
- Assess how current job training efforts are connecting the unemployed and underemployed to these opportunities.
- Reallocate existing job training resources to address these gaps.

4. COORDINATE THE STATE'S APPROACH TO URBAN REVITALIZATION

RECOMMENDATIONS:

- Benchmark for progress on key education, public safety, business development and community redevelopment, and fiscal management measures.
- Pay for performance on the basis of a municipal scorecard covering the benchmarked categories.
- Establish a Governor's designee for each target city, who will work with city and neighborhood groups to determine "anchor neighborhoods," and coordinate technical assistance and funding.

INTRODUCTION

Massachusetts, like many other northeast and Midwest states, has old cities facing challenges that come with age: Sclerotic political culture, significant infrastructure costs, chronically underperforming schools, lackluster retail and manufacturing sectors, crime and gang issues, and poorly targeted state programs. While Boston, Cambridge, and more recently Somerville are able to attract businesses, improve quality of life, and retain younger workers, the Commonwealth's "Middle Cities" suffer from underutilized housing and commercial capacity.

"Middle Cities" are urban communities with over 50,000 residents and significant immigrant populations that are having difficulty creating, attracting and/or retaining businesses. These cities historically (during industrialization and beyond) played a central role in the Massachusetts economy. Many experienced strong population and economic growth during periods in which they were regional leaders in specific sectors.

Each one of these economic success stories has been followed by varying degrees of decline as textile, shoe and other manufacturing moved to lower cost, higher technology centers domestically and abroad; as fisheries suffered from declining stocks and overseas competition; and as the defense industry consolidated and/or moved to other parts of the country. After the loss of jobs, these communities have struggled to reinvigorate themselves, even as surrounding towns have benefited from new development. The Middle Cities lag the rest of the state in all four core areas of urban policy concern—education, public safety, economic development or fiscal management. Their citizens are poorer, less educated, and more likely to be victims of crime; their economies are stagnant; and their governments are in poor fiscal health.

Sustained, integrated vision

Existing efforts to revitalize Middle Cities have had little sustained impact. State efforts to stim-

ulate redevelopment are typically based on large public works “ribbon cuttings,” or an uncoordinated mix of agency grant or loan programs, and/or technical assistance. This incoherent approach means that state agencies often work at cross-purposes.

The revitalization of our Middle Cities requires a vision of what the state can actually accomplish and how to attract private investment. Such a vision and recognition of the level of resources required to be successful will in and of itself lead to an overhaul of numerous state programs.

With nearly one-fifth of the Commonwealth’s population residing in the 15 Middle Cities, the state cannot ignore the potential these cities represent. The Middle Cities’ residents, held back by the lackluster local economy, are also a major driver for Medicaid costs and other state budget busters. A comprehensive Middle Cities Initiative could benefit their citizens and add another weapon to state’s economic arsenal.

1. MAKE SUBSIDIZED HOUSING A PATHWAY HOME

In most of Massachusetts, the market price of housing exceeds the cost of development. But some Massachusetts cities include neighborhoods where the price of housing is less than the cost of new construction. These are blighted areas with vacant properties, high crime rates, and concentrated poverty – where the housing market has stopped functioning. The emphasis of state housing programs has shifted toward creation and preservation of affordable housing in booming markets, but such programs are less effective tools for revitalization of blighted neighborhoods. Massachusetts needs to take a more nuanced approach to address both affordability in the Commonwealth’s over-heated housing market and also revitalization of weak market neighborhoods.

Regardless of neighborhood, housing units built or rehabbed with state subsidies must currently be deed restricted for a period of years for buyers or renters who qualify as low or moderate income. Resale prices and rental rates are required to remain at affordable levels. The effect of the restrictions on blighted neighborhoods is to further concentrate low-income residents and to undermine the potential for income diversity and new investment.

Long-term affordability restrictions and income limits make sense in the state’s heated housing markets. These policy tools ensure that public funds are appropriately targeted and

MIDDLE CITIES SUMMARY DATA

City	Population	Med. Household Inc. per capita	EQV per capita	Dropout rates
Worcester	175,966	\$35,623	\$55,094	5.84%
Springfield	152,091	\$30,401	\$37,994	8.10%
Lowell	103,655	\$39,192	\$56,286	4.53%
Brockton	95,099	\$39,507	\$63,132	5.02%
New Bedford	93,979	\$27,569	\$49,874	9.71%
Fall River	92,526	\$29,014	\$46,946	10.23%
Lynn	89,485	\$37,364	\$65,852	5.91%
Lawrence	71,858	\$27,983	\$40,079	11.20%
Taunton	56,648	\$42,932	\$80,154	6.31%
Chicopee	54,838	\$35,672	\$48,725	6.95%
Pittsfield	44,285	\$35,655	\$57,613	7.97%
Leominster	41,911	\$44,893	\$73,122	4.67%
Holyoke	40,058	\$30,441	\$42,145	11.08%
Fitchburg	39,910	\$37,004	\$51,090	9.55%
Massachusetts		\$54,077		3.69%

Source: (July 2004 Population Estimate, 1999 Household Income Data, 2004 EQV, from Division of Local Services; 2003- 2004 Academic Year Dropout Rates, Department of Education)

prevent subsidies from turning into major gifts of equity to only a few lucky families. In weak market neighborhoods, though, the market price of housing is the “affordable price”, so a homebuyer of units redeveloped with subsidies could not resell the unit for a huge equity windfall. Homebuyers in blighted neighborhoods take a risk in buying a property, whether it is deed restricted as affordable or not. If property values continue to fall, the homebuyer’s investment will be at risk. While buyers of homes without restrictions hope to realize appreciation, buyers of restricted units take the risk of declining values with no hope of a significant financial benefit. While most of the Commonwealth has long waiting lists and lotteries for restricted affordable units, in blighted areas the challenge is to recruit buyers.

The buyer of a deed-restricted ‘affordable’ unit in a blighted neighborhood benefits from living in a rehabilitated or new house, but the greater benefit of redevelopment goes to the whole neighborhood. Public money for building rehabilitation is spent primarily to jumpstart the neighborhood’s market, not to provide an affordable unit to the homebuyer. Given the primary goal, it makes sense to allow people of varying incomes to buy the property and to allow the buyers the potential to benefit financially from being a pioneer in urban revitalization.

Historically, government has used a variety of tools to bring vitality to distressed urban neighborhoods. The early urban renewal programs, characterized by their critics as “the federal bulldozer”, often tore down whole neighborhoods to create new urban centers, damaging the historic

fabric of a city. Following urban renewal efforts came the federal Community Development Block Grant (CDBG) program – a major source of funds for city-specific efforts to improve infrastructure and drive economic development. Until the federal HOME program in the 1990s, CDBG was also the primary vehicle for cities to redevelop housing in the neighborhoods. As rapid escalation in housing prices became an issue in most of Massachusetts, the focus of state-level housing programs became the creation and long-term preservation of affordable dwelling units. Over time, funds available for renovation and development of houses and vacant lots in even the Commonwealth's most blighted neighborhoods have come with increasingly strict restrictions on income eligibility and duration. The focus on eliminating blight has been replaced by a focus on preserving affordability.

Recommendations:

- For neighborhoods where the market price of housing is affordable to people making 80 percent of median income, adjust requirements for affordability deed restrictions. Index the resale price to increases in the area median income, and reduce the duration of the resale restriction to five years.
- Simplify resale restrictions so they can be understood by homebuyers and housing professionals alike.
- Redeploy state resources to invest in development of market-rate units in weak market neighborhoods.

2. STREAMLINE REGULATION AND PERMITTING OF URBAN NEIGHBORHOOD BUSINESSES

Regulations have long been a point of contention between businesses and government. Some state regulatory agencies have, over the past decade, adjusted their regulatory processes to emphasize performance-based approaches. On the other hand, because of feared fiscal impacts and a pernicious set of political incentives to discourage development, many localities have increased the number and purview of their regulations, made them less transparent, and insisted upon command-and-control models, such as requirements for special permits. As a result, local regulations are now often considered a greater barrier to development than state or federal regulations.

Progress on permitting reform

To address this challenge, the state in the last legislative session adopted Chapter 43D, which was the first practical attempt to create a streamlined permitting

process. The legislation makes use of a site-based approach, where localities could receive technical assistance and incentives from the Commonwealth in exchange for identifying specific parcels that are appropriate for development. Localities can opt into this approach, and cities like Springfield are already revising their permitting process to trigger state financial incentives.

While potentially helpful in attracting certain new businesses, these changes will have little effect on the development of existing small and mid-sized businesses—core “neighborhood businesses” such as groceries, markets, convenience stores, laundromats, restaurants, hair salons, street vendors, and others—that are crucial to vibrant commercial districts and the quality of life in urban centers.

Unnecessary hurdles remain

Pioneer research on urban small business regulations suggests that there are unneeded hurdles for entrepreneurs at the local level and that state agencies often have duplicative and unnecessary oversight of these businesses. Traditional home rule fragmentation and a strong spirit of independence have resulted in 351 self-sustaining, highly autonomous municipal governments. While many benefits stem from this system of governance, it also leads to inefficiency, excessive regulation, contradictory requirements and duplicative services.

Streamlining regulations could enhance local commercial tax revenues and boost state revenues as well. According to the Small Business Administration, there were more than 125,000 firms with fewer than twenty employees in Massachusetts in 2003, employing more than a half a million people and paying nearly \$19 billion in wages. From 2001 to 2002, these companies showed 13,693 net job gains, while companies with twenty and more employees lost approximately 121,000 jobs.

The creation of a unified and transparent regulatory scheme across the Middle Cities would require state and local collaboration, and gubernatorial leadership to make it a priority. Previous administrations have attempted to initiate a one-stop shop, but the practical reality is that the sheer number and depth of regulations and permits have made it difficult to untangle the knots of cross-agency jurisdiction and vested interests. As we seek to ensure our future competitiveness, we should not ignore that many rival states are undertaking similar work; e.g., California's CalGold, Pennsylvania's Open4Business, and Rhode Island's “Every Company Counts” efforts.

Recommendations:

- Promote a single set of regulations and permits for core neighborhood businesses across the Middle Cities by

NAVIGATING REGULATIONS IN 9 CITIES AND 3 LANGUAGES

Pioneer has over the past four years created a series of roadmaps to guide small- and mid-size business entrepreneurs through the maze of local regulations that control business creation for 20 business types:

- Auto Body/Repair Shop
- Barber Shop
- Beauty Salon
- Catering/Restaurant
- Child Care
- Cleaning Service/Sewing Shop/Shoe Repair
- Dry Cleaner
- Flower Shop
- Home Improvement/Interior Decorator/Landscaper
- Laundromat
- Livery
- Retail Store/Small Grocery Store
- TV/Radio Repair Shop

The Navigating Guides series will cover nine cities by the end of December 2006. In addition to the already published guides for Boston, Quincy, Springfield, Lawrence, and Worcester, there will be additional guides for New Bedford, Fall River, Brockton, and Lowell.

In 2005, Pioneer released its first translation, into Spanish, of the Boston Navigating Regulations. In 2006 and 2007, Pioneer is scheduled to issue the Lawrence guide in Spanish, and the Lowell guide in Khmer and the guide for Quincy in Cantonese.

creating a one-stop online portal for transparent, easy-to-navigate information on all local, state and federal regulatory requirements and permits related to core neighborhood small, middle- and low-income businesses. The one-stop shop should be developed through an outside contractor, with a team that is led by business organizations and includes state and local officials. Steps toward creating a one-stop online portal include:

- Catalogue all local, state and federal regulations and permits related to neighborhood businesses.
- Identify conflicting permits and regulations, or other bottlenecks.
- Provide access to online documents in a transparent and easy-to-navigate manner through a portal, organizing information based on business type
- Resolve key conflicts and bottlenecks.
- Integrate local, state, and federal regulations and permits into a one-stop shop for all small, middle- and low-in-

come businesses in our major cities.

3. REORGANIZE THE STATE'S ECONOMIC DEVELOPMENT AGENCIES

The competitiveness of Massachusetts' business community is crucial to the overall health of our communities and the success of our citizens. Pioneer has long believed that state government can contribute by providing a reasonable and predictable tax environment, an education system that prepares skilled employees, and a sensible regulatory structure.

State government also operates a number of proactive programs designed to promote economic development. These programs range from international marketing efforts to workforce training to assorted grant programs.

Recommendations: The next Governor should examine the state's efforts in two specific areas of economic development: (1) direct investment and lending of state funds to private companies; and (2) workforce training. These efforts are currently being conducted in an atomized way across multiple programs and departments, without any comprehensive evaluation of their utility, impact, or efficiency. They should be examined to determine their appropriateness as a state-funded activity, and then restructured to optimize their impact.

Direct Investment and State Loans to Private Companies

The Commonwealth, either directly or through quasi-independent entities, invests in and lends millions of dollars per year to private, for-profit companies through programs such as the Massachusetts Technology Development Corporation, the Economic Stabilization Trust, and the Emerging Technology Fund. These expenditures are based on two rationales: they bridge the "capital gap" that occurs when private investors are unwilling to provide growth capital and they steer economic growth in directions policymakers deem desirable.

Recommendations:

- Examine each program to ensure that it does fill an actual 'capital gap' that the private market would not address and provides a benefit to the state economy in cost-efficient manner; and does not crowd out private investment or subsidize inefficient or otherwise unbankable businesses.
- Based on these findings, restructure the programs to provide funding for actual 'capital gaps' (if any) that can be addressed through state intervention.

Workforce training

The Commonwealth has a number of job training programs. Meanwhile, Massachusetts employers are having difficulty filling certain skilled positions with a statewide job vacancy rate of 2.6 percent, which rises for certain high skill professions, such as healthcare and professional services. This limits economic growth and makes the state less attractive to businesses.

Recommendations:

- Work with the business community to determine current and projected skill gaps in the Commonwealth's workforce.
- Assess how current job training efforts are connecting the unemployed and underemployed to these opportunities.
- Reallocate existing job training resources to address these gaps.

4. COORDINATE THE STATE'S APPROACH TO URBAN REVITALIZATION

The Commonwealth's relationship with its Middle Cities is ill defined and frequently counter-productive. While it spends significant sums of local aid money, it does not define what it hopes to achieve through these expenditures. A range of executive agencies provides numerous grants to promote revitalization, but these are scattered, uncoordinated and generally ineffective.

Not all Massachusetts cities are in dire condition, but Chelsea's receivership and the fiscal crisis in Springfield stand as warnings for other Middle Cities. Rather than waiting for the bottom to fall out on another city, or for the Boston-Cambridge economy to tug these other vessels forward to economic stability, the Commonwealth needs to provide greater vision and leadership.

State aid, but no performance measures

The Commonwealth pours enormous resources into the Middle Cities via education aid, distribution of lottery revenue and the Additional Assistance program. In FY05, approximately \$1.2 billion in Chapter 70 money was sent to the 14 Middle Cities. In Springfield, school aid reached 90 percent of total per-pupil spending; in Holyoke 81 percent, and in Lawrence 98 percent. Of the \$378.5 million in FY05 Additional Assistance expenditures, approximately \$39.9 million went to Middle Cities. Of the \$661.4 million in lottery distributions that year, approximately \$201.5 million went to Middle Cities.

Proportionally, Middle Cities receive more state funding

than other communities in the Commonwealth. This is appropriate, given the extent and depth of the challenges they face. However, unlike the federal government, the Commonwealth does not set performance standards and does not attach funding incentives to ensure that grants and intergovernmental transfers lead to real results.

Lack of coordination, focus

There are a host of state resources that impact the economic revitalization of urban neighborhoods, including numerous grant programs in the Executive Offices of Transportation, Environment, Economic Development, Department of Housing and Community Development, and Public Safety, as well as many quasi-public agencies (e.g., MassDevelopment) and authorities. These grants are characterized by the following weaknesses:

- Investments tend to be scattered, with little coordination within a city and little measurable impact
- They are not the result of an overarching revitalization strategy for the city
- The actual impact of these investments is limited if they are not focused on the two pillars of quality of life—public safety and education
- The Commonwealth often seeks to micromanage certain aspects of city administration without providing clearly defined or measurable expectations.

Programs from across the executive agencies also provide technical assistance to Middle Cities,ⁱ but the effectiveness of this assistance is diminished by a similar lack of coordination and focus.

Finally, the Commonwealth has focused too many of its efforts on "ribbon cutting" projects such as various convention centers across the state, initial funding for Union Station in Worcester, and the Basketball Hall of Fame in Springfield. None of these has been an effective catalyst for additional economic development.

While the state has, through the Office for Commonwealth Development, taken initial steps to increase coordination of grants to drive smart growth goals, an effective strategy to truly revitalize the Middle Cities would require interagency coordination and a clear set of goals and incentives.

Recommendations:

- Benchmark for progress on key education, public safety, business development and community redevelopment, and fiscal management measures. For example, the state should set benchmarks for educational improvements using MCAS scores, drop-out rates, etc.; for public safety improvements using violent and property

crime rates; for business development and community redevelopment improvements using the number of tax delinquent and abandoned lots, commercial and property tax rates, and permitting efficiency; and for fiscal management improvements using debt service ratios and the adoption of best practices such as enterprise accounts for infrastructure investment.

- Pay for performance on the basis of a municipal scorecard covering the benchmarked categories.
- Establish a Governor's designee for each target city, who will work with city and neighborhood groups to determine "anchor neighborhoods," coordinate technical assistance, and steer program funds from across state agencies.

AGENDA FOR LEADERSHIP

SECURE THE COMMONWEALTH'S FUTURE SOLVENCY

PIONEER'S FISCAL AGENDA

1. MAKE THE PENSION SYSTEM FAIR TO EMPLOYEES AND TAXPAYERS

RECOMMENDATIONS:

- Enact pay-as-you-go language to require full funding of legislative changes.
- Base benefits on actual lifetime contributions, not the four-factor formula.

2. SAVE LOCALITIES MONEY THROUGH LOCAL PENSION SYSTEM REFORM

RECOMMENDATIONS:

- Centralize all public pension assets in a single trust
- Enhance oversight of local pension systems.

3. ADDRESS THE LOOMING POST-RETIREMENT HEALTHCARE BENEFIT LIABILITY

RECOMMENDATIONS:

- States and localities should measure their liability
- Consider OPEB costs when applying Massachusetts General Law Chapters 32A and 32B

Administrative Reform options:

- Create an Irrevocable Trust
- Consolidate OPEB management for all state and municipal entities under one manager.
- Amortize unfunded pension obligations over a longer time horizon.

Benefit Adjustment options:

- Change the health insurance benefit structure
- Increase cost sharing
- Consider OPEB costs in all collective bargaining negotiations
- Consider the Utah model for unused sick time and vacation at retirement

4. REDUCE THE COST OF GOVERNMENT THROUGH REASONABLE COMPETITIVE CONTRACTING

RECOMMENDATIONS:

- Adopt a model similar to the Texas Performance Review of service delivery.
- Eliminate requirement that employers pay at least the same percentage of health benefit costs for private employees working on a state contract as the Commonwealth pays for state employees.
- Eliminate the foregone tax revenue addition to private bid costs .
- Limit the grounds on which the Auditor can reject a privatization proposal.

5. KEEP THE MASSACHUSETTS HEALTHCARE REFORM AFFORDABLE

RECOMMENDATIONS:

- Assess the execution of the Connector as a market and alter incentives as needed to improve its performance.
- Determine the impact of Healthcare Reform legislation on the private insurance market (in the form of crowd-out measures) and alter incentives to maximize the usage of private insurance.

INTRODUCTION

Conventional wisdom says that since the 2002-03 fiscal crisis, government has been crippled by painful austerity measures. This is a dangerous misconception. Since 2002, state government spending increases have outpaced inflation. Revenues exceeded estimates by over \$300 million in 2006, but growth in the state budget has more than kept pace. Budgeted expenditures and other uses in FY2006 were 6.7% percent higher than in FY2005, and FY2007's are 9.7 percent larger than in FY2006. This rate of growth is not sustainable.

As a result, even in the face of comparatively good economic times, the FY 2007 Conference budget recommended spending \$550 million from the rainy day fund – in a year when revenue increased by \$1 billion – to help pay for its record 949 special amendments.

New programs created during good times are only sustainable if we keep overall spending at a level that can be managed in a downturn. Since all new programs create or are the result of a supporting constituency, they are almost never eliminated. Instead, they limp along at “subsistence” funding levels. Inevitably, during the next downturn, we will go through the same exercise of laying off state workers, enacting early retirement programs that increase unfunded pension liability, and making drastic program cuts.

Good economic times are the right moment to eliminate the structural deficit. These changes are needed to keep the state nimble, to invest in infrastructure, and to carry out vital reforms, such as the Massachusetts Healthcare Reform Act of 2006.

The Commonwealth has many commitments that are not going away, including structurally deficient bridges, massive transit maintenance backlog, water supply and wastewater infrastructure needs, and the neglected state parks and coastal infrastructure and facilities. In addition, the public employee retirement benefit and pension systems require urgent reforms. If the Commonwealth wants to continue offering a level of services that will maintain the quality of life in Massachusetts, it will also need to expand competitive contracting.

1. MAKE THE PENSION SYSTEM FAIR TO EMPLOYEES AND TAXPAYERS

Massachusetts operates a retirement system for state employees and teachers that faces an unfunded liability in excess of \$13 billion. The unfunded liability is exacerbated by systemic flaws that allow some employees – including legislators – to game the system and unfairly inflate their pensions. Each employee's retirement benefits are determined by an arcane formula based on four factors: years of eligible service, salary during three highest-paid consecutive years, "group" (job classification), and retirement age.

Each of these factors, as laid out in more than 500 pages of controlling statute, amendments, and case law, can be manipulated by finding or creating eligibility exceptions, ambiguities, and loopholes. Abuse by employees and/or the Legislature takes the form of:

- Service years inflated through early retirement incentives, special teachers' provisions, ability to "buy back" service years, and full credit for partial service years.
- In 1999, the Legislature passed a special retirement program specifically for teachers with 30+ years of service. The present value of that benefit was estimated to be \$1.2b by the state. No additional funding was provided to the pension fund at the time to pay for this benefit.
- Salary calculations inflated with second jobs, temporary raises, inclusion of non-salary benefits, large raises near the end of a career. For example, Charles Lincoln was a career Brockton Police Officer who took a second job at the Plymouth County Jail for precisely three years prior to his retirement. Attendance records indicate that he made extensive use of 'sick' leave at his Brockton job on days when he worked at the Plymouth facility (for which he was recently sued by the City of Brockton). By adding a second public salary for three years, he was able to boost his pension from \$69,164 per year to over \$130,000.
- Manipulation of job classification by statutorily designating certain positions as 'hazardous', to provide

enhanced benefits. For example, every municipal conservation officer in the state is considered a Group 1 employee, with the exception of Haverhill's, who is considered a Group 4 employee. This change in status provides a benefit worth an additional \$240,000, based on the position's current salary.

Pension eligibility abuse has at a minimum added an estimated \$3 billion to state's pension liability, which requires taxpayers to kick in an additional \$125 million annually.

Recommendations: The problems with the public employee pension system are serious — but solvable. Two major reforms could address the most serious abuses:

- Enact pay-as-you-go language to require full funding of legislative changes. The arcane laws of the pension system have been used for years as means of providing benefits to select individuals and groups in a manner that is opaque to most citizens. The Legislature should restrain this practice by pledging to put enough money into the pension fund to cover any benefit changes it enacts.
- Base benefits on actual lifetime contributions, not the four-factor formula. This could be accomplished through significant reform of the current system, or by moving to a defined contribution system. In either case, common sense dictates that an employee's pension should be based on his or her contribution to the system, and not inflated through the use of loopholes.

2. SAVE LOCALITIES MONEY THROUGH LOCAL PENSION SYSTEM REFORM

Existing public employee pension fund management in the Commonwealth is fragmented and wasteful. While the state's Pension Reserve Investment Trust (PRIT) manages \$35 billion, another \$15 billion is splintered among 104 separate local funds, each with its own board and management. Sub-par performance, diseconomies of scale, and weak state oversight make these small funds a burden on municipal budgets. As a result, over the past 10 years, poor investment performance in locally managed pension funds has cost taxpayers an estimated \$1.6 billion. By consolidating these funds under PRIT, the state could ease the tax burden while protecting retirees.

"Taxpayers are currently in the process of shouldering a \$3 billion burden caused by underperformance in local pension funds," concludes Dr. Ken Ardon in a recent Pioneer white paper, *Leaving Money on the Table*. "The underperformance of local pension funds is a costly problem that has an obvious and easily accessible solution, in the form of PRIT."

The Public Employee Retirement System consists of

106 separate municipal, district, and authority retirement systems. PRIT consists of the two largest funds, covering state employees and teachers, and holds over \$35 billion in assets. The remaining 104 funds, holding over \$15 billion in assets, have the option of pooling their funds with PRIT. However, only 20 invest entirely with PRIT and another 29 invest a portion of their assets with PRIT.

Pioneer's research reveals that almost all of the smaller 104 pension funds underperformed PRIT. Over a 20-year time horizon, only six local systems have beaten PRIT's annual return. By not investing in PRIT, local funds missed out on \$1.6 billion in additional investment returns in the past decade.

Most of these 104 smaller pension funds face several challenges. Their size presents an obstacle to attracting the best money managers and accessing high-return investment vehicles. Superior money managers naturally gravitate toward funds that have the most resources and offer the highest pay. Local pension funds simply cannot offer the same incentives as the much larger state system.

PRIT's size allows for much more diversification than the local funds. PRIT invests across 11 investment classes and over 100 investment managers. Many local funds invest in just a few asset classes with far fewer managers. In a recent letter to all Massachusetts retirement boards, Joseph Connarton, the executive director of the Public Employee Retirement Association Commission (PERAC), stated that PRIT's "superlative performance... over the past three years is a testament to the benefits of diversification".

PRIT's size also allows it to achieve economies of scale in administrative costs. Each local fund must hire its own staff and management team, which creates liabilities that drain a larger percentage of the fund's assets. As with the fund's investment return, even seemingly small differences in costs can compound over years to reduce returns. For a \$10 million fund, an extra 0.25 percent in costs each year results in a loss of \$2 million in 20 years.

Recommendations: In order to protect retirees and decrease the ongoing burden to taxpayers, the following reforms should be adopted:

- Centralize all public pension assets in a single trust. By consolidating assets in a single entity, local funds would save on costs and potentially access higher returns. Twenty local funds already centralize their assets with PRIT, so this reform has already been adopted in some localities. The change would apply only to management of assets; eligibility decisions would still be made by local retirement boards.
- Enhance oversight of local pension systems. By extending the state's Uniform Procurement Act to local pension systems, creating uniform standards for travel expenses and conflict-of-interest issues, and requiring

more frequent audits, many of the excesses of local pension systems would be curbed.

3. ADDRESS THE LOOMING POST-RETIREMENT HEALTHCARE BENEFIT LIABILITY

Before establishing the Public Employee Retirement System in 1987, the Commonwealth had no mechanism for paying down its pension liability. Despite the need for reform described above, the pension system is at least working to pay down its unfunded liability. In 2006 we face a new unaddressed liability: public retiree healthcare benefits.

Much has been made of the fact that Enron's accounting practices were negligent—even criminal—and that large corporations like General Motors are having difficulty living up to retirement promises made to their workers. But state and local governments have also made irresponsible promises to their retired employees regarding healthcare benefits.

The Government Accounting Standards Board (GASB) recently released two Statements that will profoundly affect American public finance. These Statements establish clear, stringent standards for measurement and disclosure of the massive unfunded liability for government employees' non-pension post-employment benefits. Published estimates of the total "Other Post-Employment Benefits" (OPEB) liability for the nation's 88,000 state and local governments have hovered around \$1 trillion, compared to an estimated \$293 billion for the private sector.

The looming challenge for state and local government in Massachusetts is on the order of \$13.3 billion for the Commonwealth, and an as-yet-unknown amount for municipalities. It raises fundamental questions about responsibility for retired public employee health benefits, and difficult political decisions that will need to be made to address this newly measured liability. Ignoring the problem may adversely impact state and local bond ratings.

Recommendations:

- Measure their liability - Projecting the OPEB liability using financial disclosures is difficult, since governments differ in the level and kinds of benefits they offer, ages of those who are eligible for the benefits, level and mechanisms for funding, and the trend rate assumptions underlying the estimate. The Commonwealth of Massachusetts - exclusive of authorities, municipalities and separate districts - has disclosed a \$13.3 billion liability to pay for post-employment benefits already earned by current employees, retirees and survivors. The Commonwealth must decide whether to fund this liability, and if so, how.
- Consider OPEB costs when applying Massachusetts General Law Chapters 32A and 32B - Governments across the Commonwealth in recent years reduced payrolls via employee retirement incentive programs. However, the

reduction in payroll was often accompanied by an increase in pension and OPEB costs – it amounted to sending the bill to our children. The Legislature should recognize that changing retirement ages, vesting, contribution percentages and other variables affect OPEB liabilities.

- Consider their options - Available options can be grouped in two categories: Administrative Reforms and Benefit Adjustments.

Administrative Reform options:

- Create an Irrevocable Trust, as a separate investment trust within or similar to the Pension Reserves Investment Management (PRIM) – A new investment trust, similar to PRIM, could be used to take advantage of the higher rate of return afforded by an irrevocable trust. However, the Commonwealth could consider taking an even bolder move:
- Consolidate OPEB management for all state and municipal entities under one manager. There are 106 separate public pension plans in the Commonwealth, each with different administrative structures. There are many other health benefit collaboratives and local entities. The Commonwealth could adopt a different, potentially less expensive approach by consolidating OPEB management for all governments under one domain. The Group Insurance Commission (GIC) has a long and successful history of aggressively managing the cost of healthcare for its members. Consolidating these separate health benefit entities into either a GIC-like commission for municipalities or the existing GIC could play an important role in holding down costs and managing beneficiary claims. However, traditionally, Commonwealth government has been centered on local decision-making, embodied in the town meeting. Creation of a municipal GIC would require even more reform of General Laws Chapter 32B than might be needed under other alternatives.
- Amortize unfunded pension obligations over a longer time horizon. Current plans call for the state pension system will be fully funded by 2023 and local systems by 2028. Fully funding pensions is important for many reasons, not the least of which is that Massachusetts public employees do not contribute to or receive retirement benefits from Social Security. However, bringing both the pension and OPEB systems up to fully funded status according to the current schedule may strain governmental budgets, encouraging some entities to slow the rate at which they fund their pension plans.

Benefit Adjustment options:

- Change the health insurance benefit structure – Restricting health insurance would be politically difficult, given the sweeping health insurance reform and its goal of universal coverage. However, some governments, and certainly private industry (which has a 15-year history implement-

ing similar standards), have considered or will consider it. Among the options the Commonwealth could consider are offering a defined contribution healthcare plan or a voluntary employee benefit association mechanism at some future date or for new hires, effectively capping costs.

- Increase cost sharing – Most governments will consider requiring employees and retirees to bear more of the OPEB cost. Currently, the Commonwealth funds 85 percent of its healthcare pay-as-you-go (PAYGO) costs, while employees fund 15 percent. Moving to a 20 percent employee contribution could yield millions of dollars of additional funds available for future benefits. The Commonwealth has shifted contribution rates before, including during the most recent fiscal crisis earlier in this decade. However, such a change would likely not apply to retirees, reducing the immediate benefit from cost sharing.
- Consider OPEB costs in all collective bargaining negotiations - For the Commonwealth, healthcare benefits are not part of union negotiations. However, for municipalities and other government employers in the Commonwealth, they are. In some cases, rates are set with individual unions within the same entity. All governments need to know what their liability is and be able to do a sensitivity analysis on that liability for various changes in the benefit package.
- Consider the Utah model for unused sick time and vacation at retirement— The cost to the Commonwealth of unused sick and vacation compensation at retirement was estimated at \$500 million as of June 30, 2005. Most employees “cash out” these accrued benefits at the end of their tenure. But the Commonwealth and the municipalities could explore whether the portion paid out at separation could be used instead to fund an irrevocable OPEB trust.

4. REDUCE THE COST OF GOVERNMENT THROUGH REASONABLE COMPETITIVE CONTRACTING

When faced with insufficient revenues, state governments typically have four options: Increase taxes, reduce expenditures, spend down reserves (if any are available), or seek ways to provide services more efficiently and effectively through contracting with private providers. Massachusetts, for the most part, can only avail itself of the first three due to legislation passed in 1993. The legislation includes the following provisions for any privatization contract valued at over \$200,000:

- Instead of comparing a private contractor's bid to the current cost of delivering that service, the bid is compared to what the cost would be were public employees to work “in the most cost-efficient manner.”
- Prior to the cost comparison, the private bid is “adjusted” in several ways.

1. The proposed vendor must pay employees working on the contract wages equal to the lesser of those paid to state employees performing comparable jobs or the average private sector wage in the relevant industry.
 2. The vendor must pay at least the same percentage of employee health insurance premiums as the Commonwealth does.
 3. The state agency seeking to contract must add lost tax revenue to the cost of the private bid if any part of the work is performed outside Massachusetts. No corresponding addition is made to the public sector bid for foregone tax revenue that would be realized if the work were to be performed by a private entity subject to state taxes.
- The State Auditor reviews the privatization proposal and can reject it for a range of reasons, including his determination that the contract is not "in the public interest."

Massachusetts bucks the trend

Governments across the country and the world are improving services and focusing their investments more effectively because of a wider use of competitive contracting. Florida, North Carolina, California, Virginia and Arizona have been leaders in competitive contracting. In Europe, New Labor has advanced everything from competitive contracting to advancing school choice through private purveyors. Even the coalition led by Italy's Democratic Party of the Left, which included die-hard factions of the Communist Reformation Party, supported the competitive contracting of new bus lines in parts of Rome.

The procedure Massachusetts agencies must follow under the 1993 law is so onerous that only nine proposals have been submitted to the Auditor since its adoption. Prior to the law's implementation, the Weld administration issued 36 privatization contracts, saving taxpayers an estimated \$273 million. Since then, only six small proposals and one relatively large proposal have been approved; one large and one small proposal have been rejected.

So just how much privatization has Massachusetts been missing out on? According to the Government Contracting Institute, the value of federal, state, and local government contracts with private firms increased by 65 percent between 1996 and 2001, to a total of over \$400 billion. The Government Performance Project at Syracuse University reported that at the end of 2000, contracting consumed on average about 19 percent of state operating budgets. A 1998 survey by the Council of State Governments found that 60 percent of state agencies had expanded their use of privatization in the previous five years, and 55 percent expected to expand their use

of privatization further in the following five years. Not all states or agencies responded to the survey, so the results are only suggestive.

Case study in competition: Skating rinks

There is little argument from unbiased sources that competitive contracting can lead to real cost savings and better service. Right here in Massachusetts, opening the operation of state-owned skating rinks to competition demonstrates the potential benefits of competition. In 1991 and 1992, the Department of Environmental Management contracted out operation of its 18 skating rinks. In 2000, the Legislature authorized the Division of Capital Asset Management and DEM to enter into long-term leases for the rinks. Three years later, DEM and the Metropolitan District Commission, which also operated skating rinks, were merged to create the Division of Conservation and Recreation. In 2004, the Legislature authorized DCAM to enter into competitive long-term contracts to manage eight former MDC rinks.

The results from competitive contracting have been impressive:

- Availability – In fiscal 2005, rinks operated under competitive contracting were available an average of 43 weeks per year, compared to 34 weeks when managed by the Commonwealth.
- Affordability – The average hourly cost of ice time at rinks under competitive contract has grown from \$110 in 1991 to \$160 in 2005, an annual growth rate of only 2.7 percent. State-owned rinks under private contract are the least expensive of any rinks in Massachusetts.
- Attendance – Rink usage has risen far more than cost, growing from 2.3 million in 1991 to almost 4.9 million in 2005.
- Capital Investment – Private operators invested \$2.28 million in state-owned rinks during 2005 alone.

Despite this record of success, earlier this year the Legislature refused to authorize long-term leases for the last few state-owned rinks.

Massachusetts' skating rink experience is not unique. A Reason Foundation compilation of studies in 10 areas ranging from highway maintenance to nursing homes found savings of 5-60 percent. Among the areas in which Massachusetts might be able to achieve better value through competitive contracting are:

- Building Maintenance
- Human Resources
- MBTA Vehicle Maintenance
- Property Management

- Prison Operations
- Park Maintenance and Concessions

Refining the privatization process

The 1993 changes to Chapter 7 did raise crucial issues for all government agencies and companies seeking to contract with government to provide services. While the Weld privatization proposals were largely successful, there were questions surrounding public officials later accepting positions at private companies with whom they had negotiated contracts. States that have enjoyed the most success from competitive contracting have enacted clear procedures to guide the process.

Taking the politics out of competitive contracting

Three states have established in-house programs designed to make state government operations more efficient. The benefits of such an approach is that they focus on obtaining objective (non-politicized) analyses and make informed judgments about the merits of a competitive contracting proposal. Unfortunately, Massachusetts does not have such a system. There are good reasons to question the objectivity of the Auditor's review of some past proposals. For example, among the costs he assigned to privatization in determining that a proposal to contract out operation of about 40 percent of the MBTA's bus routes wouldn't save money was the cost of age-related repairs to a maintenance facility – as if the repairs would not have been needed absent privatization. In the same proposal, the Auditor declared that fuel for MBTA buses would now be subject to taxation, even though it would still be used for the same public purpose. Similarly, the Auditor rejected a proposal that would have provided the MBTA with free cleaning and maintenance of bus shelters in return for revenue from selling electronic advertising on the shelters. He rejected that proposal on grounds that it did not provide for an even playing field, since the public employees that were cleaning the shelters had no access to a potential revenue source like advertising.

One example for policymakers to consider is the Texas Performance Review (TPR), a commission under the state comptroller, which began in 1991 with a comprehensive report detailing almost 200 proposals to improve and streamline state government. Fifty Recommendations included internal reengineering, privatization, and sometimes adding new services or redirecting resources to other areas. In the end, around two-thirds of the recommendations were implemented, saving the state \$2.4 billion. The next three years saw the TPR repeat its success, conducting in-depth examinations of state government functions and devising hundreds of specific legislative or

administrative reforms—ranging from common sense to revolutionary—which, if implemented would have saved over \$1.2 billion. In 1998 the TPR published “Home Improvements: A Manual for Conducting Performance Reviews,” which provides detailed guidance on conducting performance reviews.

Recommendations:

- Adopt a model similar to the Texas Performance Review Commission under the Office of the State Comptroller, with the Auditor/Inspector General and an appointee from the Senate and House Committees on Ways and Means, to weigh proposals.
- Compare private bids to the actual current cost of service delivery.
- Eliminate requirement that employers pay at least the same percentage of health benefit costs for private employees working on a state contract as the Commonwealth pays for state employees. Few private employers pay 85 percent of health insurance costs as the Commonwealth does.
- Eliminate the foregone tax revenue addition to private bid costs for work performed outside Massachusetts.
- Limit the grounds on which the Auditor can reject a privatization proposal to substantial non-compliance with procedures or a finding that the facts in a state agency's proposal are clearly erroneous.

5. KEEP THE MASSACHUSETTS HEALTHCARE REFORM AFFORDABLE

Healthcare is one of the Commonwealth's most vital industries, accounting for over 8 percent of Gross State Product. Within state government, the Executive Office of Health and Human Services accounted for almost \$14 billion in expenditures in 2005. It is one of the key cost drivers for area businesses and a significant concern to all of the Commonwealth's citizens.

Healthcare's impact on our economy is significant. Medical centers like Massachusetts General Hospital, UMASS Medical Center, and Bay State Medical Center are among the largest employers in our major cities. Locally based health insurers such as Harvard Pilgrim, Tufts, and Fallon are also major employers. Costs associated with healthcare directly affect the ability of our businesses to keep up with competitors in other states and countries.

Massachusetts' landmark healthcare reform, passed in April 2006, has attracted significant national attention. The difficult work of implementing the law and developing the regulations that underpin and define its provisions has just begun.

The centerpiece of the reform is “the Connector”, a state-run marketplace for private insurance products that will

offer affordable, subsidized plans to lower income individuals, as well as combine the small group and individual markets. Depending on the speed of the rollout and market penetration, the Connector will begin offering products to consumer within the next 6 months.

The next governor should carefully monitor the performance of the "Connector" marketplace and evaluate its effectiveness across several criteria:

- Affordability – What are the premiums (and subsidies) for various plans? What impact do deductibles and co-pays have on affordability?
- Breadth of Coverage – Does the Connector offer a choice of plans across the Commonwealth and across hospital systems?
- Depth of Coverage – How many plans are available to users in various locations? What variations in service levels are available?
- Sustainability – What are the costs to insurance companies and healthcare providers? Are revenue sources (premiums, co-pays, out-of-pockets) and reimbursement rates enough to keep players in the market?

Healthcare reform is intended to expand coverage to the uninsured without disturbing the current private insurance market. The law contains several incentives to keep companies from dropping workers from private insurance (the \$295 'fair share' charge for uninsured workers) and for individuals to have insurance (an income tax-based penalty system). The phenomenon of 'crowd-out' – a state-subsidized product replacing a private market one – is a concern. Crowd-out can take the form of "push out" (employers eliminating healthcare plans) and "opt-out" (employees dropping employer plans for more affordable state-subsidized products).

Much like the state has already done to analyze which firms have workers using free care or Medicaid, the next Governor should analyze pre- and post-coverage levels for private firms to determine added cost to the state for those dropping healthcare for their employees. Similarly, the number of individuals dropping private plan to utilize state-subsidized plans should be tracked and analyzed. Based on this analysis, the incentives for each party should be altered to encourage maximum usage of private market products.