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OFFSHORING AND THE GLOBAL ECONOMY:



A PROGRESSIVE AGENDA

Center for American Progress



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Offshoring And The Global Economy: A Progressive Agenda

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The Center for American Progress is a nonpartisan research and educational institute dedicated to promoting a strong, just and free America that ensures opportunity for all. We believe that Americans are bound together by a common commitment to these values and we aspire to ensure that our national policies reflect these values. We work to find progressive and pragmatic solutions to significant domestic and international problems and develop policy proposals that foster a government that is “of the people, by the people, and for the people.”

Contributors:

Brian Deese
Senior Economic Policy Analyst

John Lyman
Research Associate



Introduction

The U.S. economy faces both unprecedented opportunity and uncertainty in the current global environment. Rapid technological advances, combined with the opening and development of significant new markets around the world, have dramatically hastened the pace of economic activity and increased competitive pressures on U.S. firms to adapt to change. This flurry of economic globalization provides new opportunities for leadership, but the United States will only succeed if it can provide expanded opportunities for the group of Americans that has for so long formed the backbone of the economy: the middle class.

The nation's unparalleled economic success stems from the creativity and imagination of the American people and the ability of its businesses to adapt, innovate and lead in industries that produce high-paying middle-class jobs. The industrial revolution raised living standards for workers and increased profits. The post-World War II economic expansion ushered in a new era, propelling millions of Americans into the middle class. In the 1990s the Internet exploded as a new creative economic force, fueling yet another wave of productivity and opportunity.

In recent years, however, the increasing prevalence of “offshoring” (also known as “overseas outsourcing”) has brought these fundamental strengths into question. As seamless technologies connect U.S. firms to locations all over the world, and as efficient, high-quality services – from financial research to computer programming to technical X-ray analysis – are offered abroad at a fraction of their domestic cost, many are starting to wonder how the U.S. economy will create good, high-paying jobs in the future.

Some experts have expressed concern that offshoring could lead to a “hollowing-out” of the American middle class, and others worry about an economy primarily comprised of a smaller upper tier of highly-educated, mobile workers (a “creative class”) and a larger pool of low-wage workers who would provide services that cannot be offshored (a “services class”).¹

New evidence suggests this could be happening. Although the high end of the income spectrum (\$75,000 and above) has been expanding, the share of the American population clustered around the national median income (\$35,000-\$49,999) has fallen nearly a third over the last 35 years, from 22.3 percent to 15 percent.² To some, it appears as though Americans are either acquiring the skills they need to move out of the middle class or are permanently stuck below it.

Although much has been written about offshoring over the last year, few experts are addressing its root causes. Most cite low labor costs and rising education levels of workers across the globe as the reasons that American companies are hiring more and more overseas service workers. And although there is no doubt that this argument has some validity, it misses the major point: the American economy is not

as competitive as it once was. Rising health care costs, a burgeoning deficit, and a lack of investment in critical education and research infrastructure have left the United States as a less attractive location for investment.

There are certainly short-term steps that policymakers can and should take to address some of the problems associated with offshoring. But those are temporary measures. Until the United States gets serious about addressing the long-term problems that make it less competitive with other countries, companies will continue to find offshoring attractive.

With that in mind, the Center for American Progress has developed a comprehensive progressive policy agenda based on the belief that the success of the U.S. economy in the coming years hinges on the ability to create high-quality jobs at home and expand the middle class.

This agenda is based on the premise that at the core, employers and employees do not have different, competing interests, but are both part of, and benefit from, a dynamic global economy. Policy proposals that favor one group at the expense of the other are, in the end, not helpful to either. Both must work together, as the future of the U.S. economy depends on engaging the international economy and opening up new markets and avenues for products and services. Specifically, maintaining a competitive edge requires that American workers and businesses compete on a level playing field, and that both recognize that if the root causes of offshoring are left unaddressed, the middle class will continue to erode.



Summary

The Center for American Progress' agenda includes both short-term and long-term policy proposals to address the challenges of offshoring.

Immediate steps to address the impact of offshoring on the U.S. economy:

- *Create a New Support System for America's Workers*
Adopt a bold new universal assistance system for displaced workers, with a cushion that includes healthcare, retraining, wage insurance and an updated unemployment insurance system.
- *Reform the Tax Code*
Close loopholes in the tax code that provide incentives for companies to move jobs abroad rather than invest at home.
- *Enforce and Strengthen Labor Laws and Improve Employer/Employee Notification*
Strengthen labor laws and ensure employees are given adequate notice before work is offshored.
- *Re-examine the Federal Contracting Process*
Implement new rules and regulations that take offshoring into account.
- *Update the Economic Data Collection Process*
Improve the economic data collection process so that workers and businesses are able to grasp the true impact of offshoring.

Longer-term policies to advance U.S. economic competitiveness and the capacity to produce good, high-paying jobs:

- *Improve the Business Climate by Lowering Healthcare and Energy Outlays*
Create policies that lower healthcare costs and improve energy efficiency and productivity.
- *Improve the Investment Climate by Restoring Long-Term Fiscal Discipline*
Rein in the trade and budget deficits and restore fiscal discipline to counteract disinvestment in the United States.
- *Increase Investment in Research and Technology Infrastructure*
Invest heavily in research and development to maintain global competitiveness and develop new technologies.
- *Reform and Improve the U.S. Education System*
Prepare American workers for the global economy by improving the education system and increasing funding for math and science programs.

Addressing the Immediate Impact of Offshoring on the U.S. Economy

Today, U.S. policymakers face the delicate task of addressing the direct and immediate impact of offshoring on the American economy. They must be wary of policies that promise to protect workers from the downside of globalization but that in practice inhibit the dynamism and flexibility of the economy and end up costing jobs and prosperity. Yet, at the same time, they must always ensure that U.S. policies are not affirmatively disadvantaging American workers in the global marketplace and that if offshoring does occur, it is driven by legitimate economic forces, not practices that contradict the American values of hard work and shared prosperity. Below are five areas where the United States needs bold new policy initiatives:

Create a 21st Century Support System for America's Workers

RECOMMENDATION

Create an ambitious new safety net for displaced workers by adopting a universal assistance system with a cushion that includes healthcare, retraining, and wage insurance benefits. Such a system would not only help workers get back on their feet when they lose their jobs, but would give them confidence to take chances and innovate as they look for new work.

A new safety net system is necessary to give workers the opportunity and ability to retrain themselves to adapt to a more dynamic economy. It should not differentiate between those who lose their jobs due to trade or offshoring and those who lose them because of downsizing or technological advances; rather, it should give all workers the same opportunities. Displaced workers should not have to “qualify” for adjustment assistance or go through myriad government departments for help; it should be available to them quickly and easily. As Gene Sperling, the Center for American Progress’ director for economic programs, notes, the system should “allow workers to call a single number or visit one central location for all of the reemployment services and unemployment insurance benefits available to them – regardless of whether their jobs were lost to technological changes, a weak economy, or changing consumer tastes.”³

A new system must also include a wage insurance and temporary healthcare benefit for laid-off workers. The plan policymakers should adopt is one laid out by Lori Kletzer and Robert Litan, which would cover 50 percent of a worker’s wage difference when he or she lost a job and took a new one for less pay.⁴ The healthcare component of Kletzer and Litan’s plan would subsidize health insurance for full-time displaced workers for up to six months or until they found a new job.⁵



In addition, Congress should increase support for lifelong learning and offer employees the opportunity to retrain *before* they are laid off. This will give workers an incentive to retrain and further educate themselves – something that makes sense for both employers and employees. Since half of employers say they have a hard time finding qualified job applicants,⁶ and more than 20 percent of laid-off workers have been involuntarily out of work for six months,⁷ programs that prepare employees for transitions and help close the gap between a lay-off and a next job are clearly good investments for workers and companies alike.

RECOMMENDATION

Update unemployment eligibility requirements so that part-time workers are eligible for benefits, regardless of what type of work they are looking for (part-time or full-time), and mandate that eligibility be determined by hours worked rather than earnings.

In its current form, the unemployment insurance system provides inadequate support for those Americans who have lost their jobs and are searching for new ones. New unemployment insurance programs should make a greater portion of workers eligible to receive benefits when they lose their jobs through no fault of their own. Currently, eligibility requirements are unfair to low-income workers who often do not qualify to receive unemployment benefits because their earnings do not meet minimum standards. Part-time workers are also kept out of the system, but should be included in a reformed unemployment insurance program.

Reform the Tax System

RECOMMENDATION

Reform the tax code by closing loopholes that provide incentives for companies to relocate abroad and shelter their profits in tax havens.

The tax code currently provides a set of affirmative incentives for corporations to relocate production overseas. The cumulative effect of these incentives is to reduce the average effective tax rate that U.S. companies pay in foreign countries to 21 percent, compared to the 31 percent effective rate they pay in the United States.⁸ One of the main culprits is the practice known as deferral, which allows U.S. businesses earning profits overseas to defer paying corporate taxes domestically until the money is repatriated to the United States. If a company can demonstrate that its earnings will be reinvested abroad, it can actually permanently avoid paying U.S. taxes on the income.⁹

While deferral provides the incentive to shift jobs and earnings, the tax code contains a host of additional loopholes that allow companies to set up operations in low-tax jurisdictions and shift profits in those areas to lower their overall tax burden. A recent study by former U.S. Treasury economist Martin Sullivan found that U.S. profits in tax havens have increased dramatically in recent years, at a rate that is completely inconsistent with the business operations of U.S. companies overseas. From 1999 to 2002, U.S. profits in major tax haven countries increased from \$88 billion to \$149 billion.¹⁰ Profits in no-tax Bermuda tripled and profits in low-tax Ireland doubled. Meanwhile, profits in countries where U.S. businesses are actually doing business are falling. In 2002, while 56 percent of the employment costs of U.S. businesses abroad were concentrated in European countries, only 22 percent of profits were recorded there.¹¹

Beyond the loss of jobs and tax revenue in the United States, there are additional reasons to worry about these trends. A recent General Accounting Office report found that when competing for federal contracts, “large tax haven contractors were more likely to have a tax cost advantage” than domestic contractors.¹² In other words, “all other things being equal, a company competing for a federal contract that reported income in the United States would face a higher tax cost than a competitor without [domestic] taxable income.”¹³

Congress should reform the tax code to end the practice of deferral and eliminate other incentives for companies to locate production overseas.

Enforce and Strengthen Labor Laws and Improve Employer/Employee Communication

RECOMMENDATION

Ensure that workers have a real opportunity to unionize and to enforce and strengthen current labor laws to give workers the freedom to choose union representation.

As the new economy takes shape, unions can be a framework for training, retraining and job placement, and can serve as a vehicle for winning economic security for high-tech workers as well as temporary, freelance, and part-time employees. American workers and American businesses flourish when they enjoy strong communication and when workers’ rights are fairly and adequately represented. History has shown that labor unions have played an important role in transforming the U.S. economy. As University of California-Berkeley professor Harley Shaiken writes, “In postwar America the labor movement forged the link between economic growth and rising wages, paving the road to the middle class for millions of working families.”¹⁴



Research shows that unionized workers are more productive and less likely to leave their jobs than are non-unionized employees, meaning that companies spend less money on hiring and training costs.¹⁵ This holds true for sectors of the economy that are prone to offshoring – research by Cornell labor economist Rosemary Batt finds that unionized U.S. call center operations are more productive, have a lower employee turnover rate, and invest more readily in improving skills for their employees.¹⁶

The best way to ensure that employers and employees are on an equal footing is to enact legislation like the Employee Free Choice Act.¹⁷ This bill would require companies to mediate with unions when negotiating contracts for the first time, allow civil fines for employers who willfully violate employees' right to organize, and protect the rights of workers to use "card check," the easiest way to form a union.¹⁸

RECOMMENDATION

Require employers with 50 or more employees to offer sufficient advance notice (90 or 120 days) of their intention to offshore production overseas. This would give workers the opportunity to plan ahead for a transition to a new job and allow employers additional time to consider whether the decision to offshore is their best long-term option.

Policymakers should require companies to provide workers and union representatives advance notice before offshoring production. In 1998, Congress passed similar legislation (the Worker Adjustment and Retraining Notification Act) to provide employees and communities with advance notice of plant closings and mass layoffs.¹⁹ Although Ronald Reagan initially vetoed the legislation, the Act has since given workers the opportunity to look for new jobs before they lose their old ones and has not had a measurable negative impact on the economy as many feared.

Employee notification is especially important in light of a recent Forrester research survey that found that the extensive publicity surrounding offshoring was actually driving firms to offshore more jobs.²⁰ Gene Sperling pointed out in a recent article that some corporate boards have echoed the concern that too many companies are rushing into offshoring decisions simply because "everyone else is doing it."²¹ Advance notice would give companies an incentive to consider other local and domestic options and ensure that offshoring is not just taking place because of a "herd mentality." It would also allow workers to voice their concerns, start looking for new jobs, and start retraining before the last paycheck comes and goes.²²

Update the Federal Government Contracting Process

RECOMMENDATION

Require companies that offshore federal contracting work to disclose the locations where they plan to perform the work and ensure that they engage in fair labor practices (i.e., follow minimum environmental regulations and agree to not discriminate in hiring against women, minorities, or other disadvantaged groups).

More than 10 percent of the federal budget – \$275 billion – is devoted to paying for goods and services from private contractors.²³ There is no reason to expect that this number will drop in the coming years – in fact, most expect federal government spending for outsourcing to rise. Federal IT outsourcing (much of which can be done overseas), for example, is expected to rise 127 percent over the next five years (from \$6.6 to \$15 billion).²⁴

Companies that offshore federal government work should be compelled to fully disclose where they plan to perform the work. Such disclosure must be made at the time of bidding on a federal contract and updated throughout the course of the contractual relationship.

The U.S. government has consistently set domestic industry standards for worker compensation, job conditions, flexible work hours, and other labor practices. Companies that offshore federal government work should engage in fair labor practices, follow a minimum set of environmental regulations, and should not be allowed to discriminate against disadvantaged groups.²⁵

RECOMMENDATION

Limit national security- and privacy-sensitive contract work to U.S. companies that will perform the work domestically.

There are real security and privacy concerns that arise when sensitive national security data and information (missile plans or intelligence documents, for example) must be shared with foreign entities. Companies have already experienced privacy problems when they offshore work (an employee in Pakistan, for example, recently posted a client's private medical information online after a dispute with her employer).²⁶ These concerns are serious enough for the federal government to mandate that national security- and privacy-sensitive work be performed in the United States.



Reform and Update the Economic Data Collection Process

RECOMMENDATION

Create a non-partisan statistical working group comprised of key experts at the Bureau of Labor Statistics, the Bureau of Economic Analysis and the U.S. Census Bureau to establish the best ways to gather offshoring job churn data and assess the economic aspects of offshoring.

To improve Americans' understanding of the impact of offshoring on the economy, it is essential that the U.S. government collect better data. The offshoring numbers as they currently stand are gross estimates of job losses, ranging from 300,000 to 3.3 million over the past three to five years. Because these numbers only account for job losses and not jobs gains, they do not provide an accurate picture of the net number of jobs lost due to offshoring.

Since the numbers are only rough estimates, they are often as notable for what they do not count as for what they do. For example, the Bureau of Labor Statistics recently released a new offshoring component to its quarterly Mass Layoff Survey, which was met with significant public fanfare. Yet the survey is very limited – looking only at instances where 50 or more workers were laid off, and only at firms with 50 or more employees. Indeed, a recent Government Accountability Office report found the government's statistics to be lacking: “[U.S. government data] do not provide a complete picture of the business transactions that the term offshoring can encompass.”²⁷

One of the least well understood realities of the past three years is that job destruction has not been the driving force behind the prolonged weakness in the labor market. During 2002 and 2003, approximately 200,000 fewer jobs were destroyed per quarter than in the late 1990s. The difference is that the economy has not been *creating* enough new jobs to keep net job creation from lagging well behind the historical average for recoveries.

In order to address the workforce and industries most directly affected by offshoring, experts need a better understanding of the underlying data.²⁸ The U.S. government should form a working group from the various agencies (the Bureau of Labor Statistics, the Bureau of Economic Analysis, and the U.S. Census Bureau) to develop a methodology to collect better data to address these data concerns.

Addressing Long-Term Challenges to Economic Competitiveness

Over the past decades, the U.S. economy has flourished because of a superior business climate, excellent job creation, and investments in cutting edge technology and research and development. In order to maintain its competitiveness, the United States needs to continue to attract business investment and invest in human capital.

However, the recent economic slowdown and the growth in offshoring have shown in stark terms that the United States may be falling behind. Skyrocketing healthcare and energy costs are spiraling and impeding job creation. The United States is 11th among all countries in terms of broadband penetration; is failing to educate large numbers of the population, particularly in science and engineering; and is witnessing an erosion of economic confidence based on huge budget and trade deficits.

Offshoring didn't create any of these problems, but it did put an exclamation point after each one. Policymakers need to develop a comprehensive long-term strategy that addresses these challenges and provides a road map for progress.

Improve the Business Climate

Healthcare

RECOMMENDATION

Address the inadequacies in America's healthcare system by adopting universal healthcare. The current system's inefficiencies directly affect the 45 million Americans without health insurance and those workers who are either laid off or not hired in the first place because companies cannot afford their healthcare. A new system should address rising healthcare costs, protect workers from losing their health insurance when they lose their jobs, and improve the competitive environment for U.S. companies.

One of the most important factors in a company's decision to offshore jobs is the total cost of labor. Benefits constitute a large portion of that cost, and for the first time ever, healthcare has overtaken other benefit components as the largest non-wage contributor to labor costs (health benefits currently account for 23 percent of non-wage employee compensation).²⁹ Corporations are already offshoring jobs to workers in other countries because they have lower wages than their American counterparts. Since these



same workers rarely receive health benefits through their employers, they also have lower benefits costs. This puts both American workers and American companies at a disadvantage.

The United States now spends 14.9 percent of its GDP on healthcare (by comparison, costs in Switzerland, Germany, Canada and France range from 9.5 percent to 10.9 percent³⁰), three times the percentage spent in 1960.³¹ In that same year, healthcare benefits accounted for 1.1 percent of the total compensation; in 2002, they made up 7.5 percent of employee compensation.³² As a result of these rising expenditures, employers are passing many costs on to their workers. According to the Kaiser Family Foundation, workers now pay 27 percent of health insurance costs for family coverage and at least five million fewer jobs provide health insurance in 2004 than did in 2001.³³ Approximately 70 percent of the uninsured have at least one full-time worker in their family.³⁴

The inadequacies of the healthcare system are an increasing problem for the U.S. economy. The Institute of Medicine estimates that America's failure to provide universal coverage costs \$65 billion to \$130 billion per year in lost productivity and foregone health.³⁵ Businesses struggling with rising healthcare costs are more reluctant to hire people and employees are more likely to be offshored as a result. Workers are wary of taking risks and changing jobs in the current labor marketplace because of fear of being left without coverage.

Covering the uninsured would lower overall healthcare costs in the United States while improving conditions for U.S. workers. In addition to the health and financial benefits that workers without health insurance would receive, all workers would no longer have to worry about losing health insurance when they lose their jobs. Employers would benefit from the productivity gains of a healthier population. And employers, employees, and taxpayers would no longer have to foot the bill – an estimated \$41 billion per year³⁶ – for the “uncompensated” costs of treating the uninsured.

In addition to improving the extent of coverage, federal leaders should improve the value of coverage by demanding better efficiency, quality, and outcomes from the health care system. A reformed healthcare system, in which everyone has stable coverage and access to affordable, high quality healthcare, would improve the nation's personal well-being, national economic vigor, and global competitiveness.

RECOMMENDATION

Invest in modernizing the healthcare information infrastructure by upgrading information technology in doctors' offices and hospitals.

The healthcare sector has yet to reap the benefits of the information revolution. Although doctors' offices and hospitals whirl with impressive new medical technology, information technology is largely absent.

Medical equipment churns out volumes of information, most of which is reduced to paper and stuffed in files along with handwritten notes. This antiquated system takes an enormous toll on Americans' health and healthcare costs. Investments in cutting-edge information technology, structured to safeguard patients' privacy, have the potential to dramatically improve administrative efficiency and clinical outcomes while at the same time reducing costs.

RECOMMENDATION

Expand the national health research portfolio to encourage high-quality, high-value care.

Most healthcare research focuses on determining whether a particular medicine or treatment is safe and works. There is little credible information comparing the relative value of one treatment versus another. As a result, patients often receive care that drives up healthcare costs without improving health outcomes, while foregoing high-quality, high-value care. Federal investment in research on the comparative clinical and cost effectiveness of available treatment options would enable patients, providers, and payers to make sensible healthcare choices.

Energy**RECOMMENDATION**

Extend tax credits for energy-efficient cars, houses, and appliances and launch a major federal initiative to generate biofuels as a domestic alternative to oil.

RECOMMENDATION

Strengthen energy-efficiency requirements in building codes, create a commercial energy rating system, and promote economic incentives to install efficient equipment and reward the commercialization of new technologies aimed at achieving this goal.



RECOMMENDATION

Use federal procurement policies and federal investments to spur efficiency technologies and reduce dependence on unstable sources of energy. The federal government is a major consumer of energy, with a fleet of more than 380,000 cars, trucks, and vans.³⁷ By utilizing energy-efficient vehicles, it can help lower the cost of energy for other sectors of the economy.

Energy costs are a major factor in businesses' decision-making. Numerous opportunities exist to improve efficiencies in building, appliance, and automobile energy use that could substantially reduce energy overhead costs. Federal investments in efficiency, combined with new technologies, can often reduce energy use by 75 to 90 percent while maintaining or improving performance. Studies now also show that economic returns on efficiency can exceed 30 to 50 percent per year.³⁸ Strong funding for energy efficiency, improvements in the electrical grid, and policies and tax incentives that advance market penetration of energy efficient products and services, should be the cornerstone or the nation's economic policy.

Over one-third of the U.S.'s energy consumption comes from office buildings, yet market barriers currently hamper the potential for energy-efficiency gains. Since building developers are almost exclusively concerned with keeping construction costs low, they rarely have an incentive to install energy-efficient technology – even if future tenants could quickly make up the costs of installation through lower energy bills. A more transparent system would allow tenants to understand how much they are spending on utilities and make them more cognizant of potential savings.

Congress should set standards for energy efficiency in office buildings. The Department of Energy's previous efficiency standards have been extremely cost-effective (experts estimate that the regulations set in 1997 will save the nation \$27 billion through the year 2030).³⁹ Congress should also adopt legislation that provides tax incentives for building energy-efficient commercial buildings, schools, and housing, as well as laws that provide incentives for the purchase of efficient air conditioning, heating, and cooling systems.

There are a host of new technologies that show promise for improving the way energy is delivered, further reducing inefficiencies and improving energy reliability. Smart grids, which incorporate high-tech monitoring systems, information technology and updated communications components, are one example.⁴⁰ Grid improvements would reduce the strain on an overloaded energy system, sending energy where it is needed on a real-time basis. It would reduce the risk of blackouts, which can have catastrophic effects on businesses operating at the margins or in industries where computerized data flows are critical (like banks or hospitals). A smarter grid would also protect against the mounting risk of damage to energy infrastructure from terrorism. Finally, it would allow energy produced remotely from solar panels,

fuel cells and wind farms to be connected to the electricity grid, dramatically expanding the potential for growth in renewable, local forms of energy.

In addition to improving efficiency, policymakers need to realize that relying on oil as the dominant fuel in the American transportation sector leaves the economy far too dependent on unstable regimes. High oil prices have dramatic ripple effects, destabilizing the economy and driving up overall business costs. Unfortunately, approximately one-third of the total energy used each year in the United States goes toward the transportation sector, which relies almost exclusively on oil (transportation consumes roughly two-thirds of the oil Americans use, 56 percent of which is imported).⁴¹

To address this problem, the federal government should launch major new initiatives to deploy hybrid vehicles and harness biomass fuels (which the Energy Future Coalition estimates could generate as much as the equivalent of 60 percent of the world's total energy use).⁴² It should also authorize and conduct a one-time competition – a procurement “fly-off” – aimed at building five to ten commercial-scale demonstration biomass energy plants over the next five years. Finally, federal expenditures for bioenergy research and development should be increased to reflect the magnitude of oil's impact on national security.

RECOMMENDATION

Implement energy-efficiency and renewable energy technology policies that promote U.S. job growth.

U.S. investment in energy efficient technologies, in addition to saving consumers and businesses money, will create jobs for American workers. This economic stimulus can come from a variety of areas. The Department of Energy, for example, estimates that energy-efficient standards on appliances like washing machines and water heaters will create 120,000 jobs through 2020.⁴³ A number of states have moved aggressively toward renewable energy targets, and the Union of Concerned Scientists estimates that increasing the use of renewable energy from 2.5 percent today to 20 percent by 2020 would create more than 355,000 new jobs.⁴⁴ Because energy-efficient buildings and appliances have higher labor content than traditional technologies, these jobs are also more likely to employ high-skilled laborers.



Restore Fiscal Discipline

RECOMMENDATION

Reverse the Bush administration's fiscal policy by restoring a bipartisan commitment to fiscal discipline and deficit reduction.

RECOMMENDATION

Rein in the trade and budget deficits and restore fiscal discipline to counteract disinvestment in the United States.

The business climate in the United States is increasingly handicapped by a reckless fiscal policy that has returned the nation to record deficits and undermined confidence in America's fiscal future. In 2001, the nonpartisan Congressional Budget Office projected that the United States would enjoy surpluses of \$7.5 trillion from 2005 to 2014. Today, independent organizations from Goldman Sachs to the Committee for Economic Development are projecting deficits of more than \$5 trillion over the same period.⁴⁵ This unprecedented \$12.5 trillion fiscal deterioration not only makes it more difficult to meet pressing challenges, but threatens to undermine investment in the economy by putting upward pressure on interest rates.

In recent months, the International Monetary Fund, Organization for Economic Cooperation and Development, and Bank of International Settlements have all warned of the danger that this fiscal situation poses to the sustainability of the economic recovery. Former Treasury Secretary Robert Rubin, writing with economists Peter Orszag and Alan Sinai, explained that “the inability of the federal government to control the budget deficit could be interpreted as a broader failure of the nation to address its economic problems, and thus prompt a loss of business and consumer confidence, which would undermine capital spending and real economic activity.”⁴⁶ To address this concern, policymakers need to act quickly and decisively to signal a return to fiscal responsibility that puts us on a path to substantial deficit reduction.

Policymakers also need to work to rein in the trade deficit. U.S. external imbalances are already higher than what many economists consider sustainable, and projections for the future do not bode well.⁴⁷ Foreign investors hold a growing share of government debt, and if they become overexposed they may want to diversify by moving their funds elsewhere. If this were to happen, the result would likely be higher interest rates and a lower value of the dollar, which would reduce consumption and investment.

Fiscal discipline would reduce the government's need to borrow abroad. As Christian Weller, a senior economist at the Center for American Progress notes, working with China on currency revaluation is also essential. The Chinese are a large creditor of the United States and are likely heavily concentrated in U.S. assets. According to the People's Bank of China, the country's official reserves were \$361 billion in September 2003 – a time when experts estimated that China held approximately \$122 billion, or one-third of its reserves, in U.S. treasuries. Negotiating with the Chinese government in order to achieve a sensible revaluation of the yuan could boost exports to China and, in turn, lessen the U.S. trade deficit.⁴⁸

Improve the U.S. Research and Technology Climate

Science and Technology Research

RECOMMENDATION

Make the Research and Experimentation tax credit permanent, with additional incentives for private sector collaborations with university researchers.

RECOMMENDATION

Increase support for curiosity-driven research, particularly in the physical sciences and engineering, and double the National Science Foundation budget.

RECOMMENDATION

Identify policies that will help accelerate the commercialization and widespread adoption of new technologies.

Federal support for research and development has played a central role in creating America's high-tech industries, particularly in the post-World War II era. Federally funded research led to key information technologies like the Internet, graphical user interfaces, design tools for semiconductors, advanced microprocessors, the first graphical Web browser and wireless communications.

In the 1960s, the federal government provided up to 64 percent of the nation's total investment in research and development, but since then the federal share has steadily declined. In 2002, it accounted for only 28 percent of the nation's total expenditures in research and development.



Furthermore, government support for research has dropped from around 0.6 percent of GDP to 0.38 percent. Private sector research and development is rising, which is good news. The bad news is that the federal government's investment in research has failed to keep pace. The administration's most current five-year budget would cut the inflation-adjusted research and development budgets in 21 out of 23 science agencies. This is troubling because the government alone is in a position to support long-term, high-risk research that is beyond the time horizons of individual companies (almost all private sector investment goes to "development" as opposed to "research").

The federal government must reassert its leadership role in investing in research and development. It should begin by doubling the budget of the National Science Foundation, an agency that supports basic scientific research that fuels economic growth. In addition, federal supports, like tax credits, are necessary to move producers of new energy technologies down the "learning curve" so that they can eventually compete against fossil fuels without government subsidies. Making the Research and Development tax credit permanent is an essential step in recommitting the United States to investments in technology

RECOMMENDATION

Enable more foreign-born Ph.D. recipients in math, computer science, and engineering to live and work in the United States. These talented individuals help make the American economy innovative and competitive, yet current immigration laws prevent many of them from permanently working in the United States.

Policymakers need to update U.S. immigration policies to reflect the reality that immigrants and foreign workers play an important role in the economy. In 2001, foreign students made up 49 percent of Ph.D. recipients in math and computer science and 56 percent of Ph.D. graduates in engineering.⁴⁹ Policymakers should recognize that the U.S. economy has benefited significantly from the foreign talent in these fields. The United States' ability to draw the best and the brightest students from abroad is an asset Americans should continue to benefit from. This means not only attracting foreign students to American universities, but also making it easier for them to stay in the United States after graduation and further contribute to the U.S. economy.

Technological Infrastructure

RECOMMENDATION

Develop a credible broadband national strategy aimed at achieving universal access in five years. Increase investment in National Telecommunications and Information Administration (NTIA) grant programs by \$1 billion, using half the funds to develop new technologies and the other half to encourage sustainable technological partnerships between businesses and local government, and schools, libraries, and community centers.

RECOMMENDATION

Offer new tax credits for technology investments in low-income and underserved areas.

The United States is falling behind when it comes to offering a cutting edge technology infrastructure to attract new businesses and help existing businesses stay ahead. During the 1990s, the deployment of cellular and broadband networks across the country was an important factor in spreading innovation, increasing productivity and sustaining strong investment-led growth. Yet over the last four years, the United States has fallen from fourth to 11th in broadband penetration – not only behind high-income countries like Germany and Sweden, but middle-income countries like South Korea.⁵⁰

Policymakers should combat this problem by increasing investment in NTIA grant programs. These grants provide funds for telecommunications and information technologies for economic development, public safety, health, and other essential services and are essential tools for bringing the benefits of digital network technologies to communities around the country.

For many low-wage areas in the United States, access to the newest technologies is the difference between presenting a viable alternative to low-wage nations and losing out on jobs. A number of domestic call center operations, for example, have been willing to absorb somewhat higher wages to keep operations in the United States because of the tangible and intangible benefits of working with locally-trained, native English speakers. In areas that have been historically underserved, the federal government should issue development grants to build advanced communications infrastructure.

The government should also develop a comprehensive universal broadband strategy that not only establishes a lofty goal of universal access within five years, but provides the resources to make such a goal a reality. Such a plan should expand tax credits for investments in broadband, with generous credits provided for (a) investments in the highest speed technologies and (b) investments made in low-income



urban and rural communities, and those areas negatively affected by offshoring. The FCC, the NTIA, and federal-state joint board for Universal Service should be fully funded to track and report every two years on the deployment and subscribership of advanced communications technology.

Get Serious About Improving U.S. Education

RECOMMENDATION

Overhaul the U.S. education system by developing a 21st century learning system that will meet America's growing needs.

Over the course of U.S. history, the skills and education of the American workforce have been a major determinant of output, productivity and long-term economic growth.⁵¹ At the turn of the century, the decision to make high school universally accessible in the United States helped fuel the industrial revolution. During World War II, Franklin Roosevelt's farsighted decision to open the doors to college with the GI Bill helped usher in a new era of higher education in America and produce a \$7 economic return for every dollar of investment.⁵²

Today, Americans face another educational challenge that could determine future standards of living. The rapidly changing economy is demanding an increasing number of highly skilled workers. More than 80 percent of the 23 million jobs that experts predict will be created in the next ten years will require some sort of postsecondary education.⁵³ Yet as the demand for skill rises, the growth in the supply of college-educated workers is slowing.⁵⁴ This is unlikely to change soon: over the next two decades, as the baby boomers retire and traditionally disadvantaged groups make up a larger share of the workforce, the proportion of the labor force that is college-educated will grow at one-third of its current pace.⁵⁵

At the same time, countries like China and India are rapidly improving their education systems, catching up to and, in some cases, outpacing the United States. As Intel CEO Craig Barrett noted recently, "Chinese universities confer more than three times as many engineering degrees as U.S. universities."⁵⁶ Presumably, most of these students in Indian and Chinese engineering schools are native-born as well, whereas 56 percent of engineering Ph.D. degrees in the United States are awarded to foreign students (at least some of whom eventually return to their native countries).⁵⁷

Addressing these problems will require rethinking every piece of the educational pipeline – from pre-kindergarten to post-graduate learning – and developing a 21st century learning system to meet America's growing needs. The Center for American Progress has initiated a national conversation on improving the education system, and in the coming months will announce components of a

comprehensive overhaul plan. In the context of offshoring, there are a few particular reforms that are especially important.

RECOMMENDATION

Make pre-school universally accessible and work to improve the quality of pre-kindergarten instruction.

The key to ensuring that the American workforce continues to compete for and retain the high-skill, high-wage jobs of the future may very well lie in the earliest years of life. Extensive brain research conducted in the late 1990s found that many of the cognitive functions most important in the dynamic workforce – including the ability to think critically, write, and read at high levels, and adapt to changing tasks – are significantly influenced by brain activity in the first three years of a baby’s life.

Thus, upon entering pre-school, many children in the United States are already at a significant disadvantage from which they may never catch up. Because of this, some of the nation’s top business organizations have come to see early education not only as an issue of fairness, but one of fundamental importance to the economy. The Business Roundtable has cited the economic returns of pre-school as approximately \$4 to \$7 for every dollar invested, and has called on government to accelerate funding for these programs.⁵⁸ The Committee for Economic Development has called for a national commitment to making early education 100 percent free,⁵⁹ and the Minneapolis Federal Reserve found that quality pre-school has a total social return as high as 16 percent a year.⁶⁰

RECOMMENDATION

Renew focus on middle school education, with a specific focus on improving student performance in math and science.

The middle school years are another critical juncture for American students, and unfortunately, they are a period when many fall further behind. The RAND Corporation recently concluded a major international comparison of middle school performance, which is a sobering call to action. It found that only one-third of 8th grade students in the United States achieve proficiency in core subjects: 27 percent in math, 32 percent in science and 33 percent in reading. The 8th grade figures are particularly troubling because they mark a significant decline from the performance of 4th graders, suggesting that the problem may lie in the middle school years.⁶¹



Improving performance in middle school may require broader reforms, including rethinking the utility of the separate middle school structure that most U.S. public school systems continue to employ. One clear component is improving the quality of instruction during these years. The RAND study also found that “many middle school teachers do not have a major, a minor or certification in the subjects they teach, particularly in the biological and physical sciences.”⁶² A staggering seven in ten math classes in high-poverty middle schools are assigned to teachers who lack even a college minor in mathematics or a related field.⁶³

RECOMMENDATION

Build a ladder from middle school to high school and college to increase the number of American students who pursue education and careers in math, science and engineering.

Math, science, and engineering jobs are in high demand in the economy, and offer the highest wages and greatest opportunity for advancement. Yet the United States is falling behind in these fields. In 1974, Americans were third in the world in the share of 24-year-olds with engineering degrees; today the United States ranks 15th.⁶⁴ American students continue to lag behind other countries in these areas of study: according to the National Assessment of Educational Progress, only one-third of them are proficient in math and science.

Policymakers should set a national goal of leveling the playing field in math and the sciences within a decade. Doing so will require strengthening programs in middle school to keep kids engaged in these subjects; revamping high school curricula to get as many students as possible on college prep tracks in science and math; and investing in college-level programs to support students, particularly those from disadvantaged backgrounds, in choosing to pursue these subjects as majors.

Endnotes

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