Department of Legislative Services
Maryland General Assembly
2007 Session

FISCAL AND POLICY NOTE
Revised

House Bill 430 (Delegate Taylor, *et al.*)
Economic Matters Finance

State Procurement Contracts - Living Wage

This bill requires State contractors to pay their employees a "living wage." For fiscal 2008, the living wage is set at $11.30 in Montgomery, Prince George's, Howard, Anne Arundel, and Baltimore counties and Baltimore City. It is set at $8.50 for all other areas of the State. The living wage rates will be adjusted for inflation annually by the Commissioner of Labor and Industry. The bill exempts specified State contractors and employees from the living wage requirement, and allows employers to reduce the wages they pay if they provide health insurance to affected employees or make employer contributions to employees' tax-deferred retirement accounts.

The bill applies prospectively only to contracts awarded after the bill's October 1, 2007 effective date.

Fiscal Summary

State Effect: Potential moderate to minimal expenditure increase in the short-term, all funds, from contract cost increases passed on to the State; long-term effects are less certain but could be significant. General fund revenues would increase from liquidated damages and penalties imposed by the Division of Labor and Industry. The following table shows only the general fund administrative costs and penalty revenues associated with the bill.

(in dollars)	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
GF Revenue	$0	$90,000	$90,000	$90,000	$90,000
GF Expenditure	114,800	138,900	146,500	154,500	163,000
Net Effect	($114,800)	($48,900)	($56,500)	($64,500)	($73,000)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Bill Summary: The higher living wage rate ($11.30) applies to contracts in which at least 50% of the contract services will be performed in locations subject to the higher rate, as determined by the State agency responsible for the contract. The lower living wage rate ($8.50) applies to all other contracts. State contractors or subcontractors with a State contract for services valued at greater than $100,000 must pay the living wage to employees who spend at least half their time during any work week working on the State contract. However, the living wage requirement does not apply to employees who are under the age of 18 or who work full-time for less than 13 consecutive weeks for the duration of the contract. Employers who provide health insurance to workers may reduce wages by all or part of the hourly cost of the employer's share of the premium for each employee. The bill authorizes the Commissioner of Labor and Industry to allow an employer who contributes to its employees' tax-deferred retirement savings accounts to reduce the living wage rate by the hourly cost of the employer's contribution, up to 50 cents per hour.

State contractors are not required to pay a living wage if doing so would conflict with a federal requirement or if they are:

- providing emergency services to prevent or respond to an imminent threat to public health or safety;
- a public service company;
- a nonprofit organization;
- another State agency;
- a county government (including Baltimore City); or
- a firm with 10 or fewer employees that has a State contract valued at less than $500,000.

The bill requires the commissioner to adopt regulations, investigate wage complaints, issue orders for hearings, issue determinations, serve each interested party, and determine the amount of restitution for violations. Every three years, the commissioner must assess the appropriateness of the inflation measure used to recalculate the living wage rate on an annual basis (the Consumer Price Index for all Urban Consumers in the Washington-Baltimore metropolitan area). The commissioner must also assess whether Maryland counties are subject to the appropriate living wage rates, given labor costs in their jurisdictions. The bill allows an employee to sue for damages when an employer fails to pay the living wage, regardless of whether the State has required the employer to pay restitution.

Employers who violate the living wage requirements must pay the affected employees the amount determined by the commissioner and pay the State $20 per day per employee in liquidated damages. The bill also requires employers to post a notice of the living wage rate, the employees' rights under the bill, and contact information for the commissioner in English, Spanish, and any other language commonly used at the work site; the commissioner is responsible for providing these notices to employers.

The bill requires two studies. First, the commissioner must study the impact of allowing employers' contributions to tax-deferred retirement accounts to reduce the living wages they pay on the standard of living of employees affected by that reduction. The study must include a review of living wage requirements in other Maryland jurisdictions and nationally. The commissioner must report the results of the study to the Governor and the General Assembly by December 1, 2007. Second, the Department of Legislative Services (DLS) must conduct a study of the fiscal and economic impacts of this bill on the public and private sectors. DLS is required to consult with the Department of Labor, Licensing, and Regulation (DLLR); the Office of the Attorney General; local governments; and other appropriate units. The bill requires units of State government and local governments to cooperate with DLS. DLS must report its findings by January 1, 2009 to the General Assembly.

Current Law: There is no requirement for a living wage for State contractors. However, public works projects, including school construction, are required to pay prevailing wages if 50% or more of total construction costs are paid by the State, unless the project costs less than $500,000. Several Maryland jurisdictions (Allegany County, Baltimore City) have local prevailing wage requirements for all public works projects.

Chapter 2 of 2006 raised Maryland's minimum wage to $6.15 per hour, compared with the federal minimum wage of $5.15 per hour.

Both chambers of the 2007 U.S. Congress have passed provisions that would increase the federal minimum wage to $7.25 over two years, but other differences in the proposed legislation must still be resolved.

The following State agencies are exempted in whole or in part from most State procurement law, and thus would not be subject to the living wage law, including:

- University System of Maryland;
- Morgan State University;
- St. Mary's College of Maryland;
- Blind Industries and Services of Maryland;
- Maryland State Arts Council;
- Maryland Health and Higher Educational Facilities Authority;
- Department of Business and Economic Development;
- Maryland Food Center Authority;
- Maryland Public Broadcasting Commission;
- Maryland State Planning Council on Developmental Disabilities;
- Maryland Automobile Insurance Fund;
- Maryland Historical Trust;
- Rural Maryland Council;
- Maryland State Lottery Agency;
- Maryland Health Insurance Plan;
- Maryland Energy Administration;
- Maryland Developmental Disabilities Administration;
- Maryland Stadium Authority; and
- State Retirement and Pension System.

Any employee of a contractor who discloses that their employer has failed to abide by the living wage law, or who seeks legal redress against an employer who fails to abide by the law, is protected under State whistleblower protection provisions. Those provisions prevent an employer from taking any personnel action, or refusing to take a personnel action, in retaliation against an employee who discloses that the employer has:

- abused its authority or wasted public funds;
- posed a danger to public health or safety; or
- violated the law.

The whistleblower provisions also protect an employee who seeks legal action to stop the employer's illegal behavior or to remedy any retaliatory actions taken against the employee.

Background: In 1994, Baltimore City became the first locality in the country to enact a living wage requirement for city contractors. Since then, living wage laws have been adopted in at least 120 localities in the U.S, including other large cities such as Detroit, Boston, and Los Angeles. In 2005, Montgomery County and Prince George's County joined Baltimore City as the only jurisdictions in the State to enact a living wage. Washington, DC enacted a living wage bill in 2006, which set the initial living wage at $11.75, subject to annual increases. The current living wage rate is $9.62 in Baltimore City, $11.60 in Montgomery County, and $11.25 in Prince George's County. There are currently no statewide living wage laws, although legislation is pending in eight states.

Based on 2004 U.S. Census figures, per capita income in Maryland ranges from a high of $56,662 in Montgomery County to a low of $21,741 in Somerset County, with a statewide average of $39,790.

In 2005, approximately 28,000 Marylanders earned the minimum wage. However, approximately 9.8% of Marylanders, or 548,000 residents, live below the federal poverty level. Under the new State minimum wage, full-time workers earn $12,792 annually, just above the federal poverty level for a single person and well below the federal poverty level of $20,650 for a family of four. Full-time workers earning a living wage of $11.30 per hour would earn $23,504 annually; those earning $8.50 per hour would earn $17,680 annually.

Short-term Costs

Numerous studies examining the early implementation of local living wage ordinances in different localities conclude that, on a nominal basis, contract costs increase by less than the rate of inflation. In 2001, several studies found that contract costs increased between 0.003 to 0.079% of the jurisdiction's total budget. In Baltimore City, a 1999 Johns Hopkins University study found that for the 26 living wage contracts that could be compared before and after the living wage law was implemented, contract costs increased by 1.2%. Montgomery County's procurement office reports that it has not experienced any significant increase to its contract costs in the two years since the enactment of the county's living wage law.

The research studies attribute the minimal increases in contract costs to several factors. A consistent finding has been increased retention among employees earning the living wage, which reduces recruitment and training costs for employers. Several studies have found evidence of increased worker productivity and employer absorption of some costs due to the pressure of competitive contract bidding. Another possible explanation for these findings is that they are incomplete. Almost all of the available research on the effects of living wages has examined cost effects within one to three years of the legislation's enactment in a particular jurisdiction. Thus, they capture only a small portion of affected contracts because the living wage requirements apply only to new contracts awarded after the living wage takes effect. Also, anecdotal evidence from several studies suggests that some employers did not comply with the living wage requirement and that enforcement of the requirement was lax. This was true in the 1999 study of Baltimore City, but Montgomery County reports no complaints about employer noncompliance.

A significant shortcoming of these studies is that they cannot say what would have happened to contract costs in the absence of the living wage legislation. Given that contract costs increased only marginally, and often declined in real terms, it is conceivable that they would have declined by even greater margins if contractors did not have to pay higher living wages. In these instances, there could be an opportunity cost associated with living wages that has not been measured.

Long-term Costs

Long-term costs associated with living wage requirements could be larger or smaller than the initial costs highlighted in the current research. Among the reasons they could be higher are:

- more labor intensive contracts could be affected over time. Most living wage research shows that contract cost increases were larger for labor intensive services, such as janitorial services, than for other service contracts. In some cases, the cost increases were as high as 16%;

- wage spillover effects could push wages higher in nonaffected jobs. One study found that employees whose income was originally higher than the mandated living wage bargained for significant wage increases to maintain the traditional wage gap between them and low-wage co-workers; and

- enhanced awareness and enforcement of the living wage provisions could reduce noncompliance among employers.

However, the long-term effects could be muted by two factors:

- reduced public assistance payments under Temporary Assistance for Needy Families, Medicaid, food stamps, and other programs as families earning the living wage emerge from poverty status; and

- the bill's provision for annual adjustments to the living wage based on the CPI-U in the Washington/Baltimore region. **Exhibit 1** shows that for the past seven years for which data are available, the CPI-U for the region has grown substantially slower than average annual pay in Maryland. If that trend continues, the living wage may cause wages for affected employees to grow at a slower pace than they normally would.

Exhibit 1
Annual Growth Rates for CPI-U and Average Maryland Pay

	CPI-U (DC/Baltimore)	Average Annual Pay (Maryland)
2004	2.8%	4.7%
2003	2.8	3.3
2002	2.4	3.0
2001	2.6	5.1
2000	3.3	5.5
1999	2.1	3.5
1998	1.3	4.9

Source: U.S. Bureau of Labor Statistics

State Revenues: Based on similar liquidated damages provisions in the prevailing wage law, DLLR estimates that it would collect approximately $90,000 per year, although fiscal 2008 collections would likely be minimal.

State income tax revenues could increase as incomes rise for affected employees, while at the same time tax receipts could drop as some individuals receive larger tax refunds under the State's earned income tax credit program. The Comptroller's Office reports that the net effect of these changes on State tax revenues is likely to be negligible.

State Expenditures: This bill could result in moderate to minimal increases in State expenditures, all funds, stemming from increased contract costs and administrative expenses.

Contract Cost Increases

Most analyses agree that service contracting is the contract type most likely to be affected by living wage requirements. The Department of General Services (DGS) is the procurement control agency for facilities maintenance contracts, while the Department of Budget and Management (DBM) is the control agency for all other service contracts. Neither DGS nor DBM can provide aggregate wage data for the service contracts they procure. However, the following contracts are among the largest service contracts that would likely be affected by the living wage mandate:

- community-based services for individuals with developmental disabilities, by the Developmental Disabilities Administration ($602 million in fiscal 2007);
- maintenance contracts (*e.g.*, garbage removal, landscaping, janitorial services; systems' maintenance) for all State facilities ($28.4 million in fiscal 2006); and
- food service contracts for all Department of Public Safety and Correctional Services and Department of Health and Mental Hygiene institutions ($15.2 million in fiscal 2007).

Community-based service contracts by the Developmental Disabilities Administration (DDA), by far the single largest item on the list, would seem not to be affected by the living wage provisions, for two reasons. First, approximately 90% of the DDA contractors are nonprofit organizations, which are exempt from the living wage requirement. Second, the average direct service employee under those contracts already earns almost $12 an hour, more than the proposed living wage rates.

DDA notes, however, that its contractors already have trouble recruiting staff at the current $12 wage rate because the work is difficult and often unpleasant. The contractors worry that if more jobs become available that pay a similar wage and are less stressful, they would have to raise their wages even higher to keep attracting new employees. In response, DDA would have to raise its standard reimbursement rates, which apply uniformly to all non- and for-profit service providers. In the short term, the number of jobs likely to be affected by the living wage will not be large enough to create the wage pressure that concerns DDA, but in the long term, as discussed earlier, there could be wage spillover effects.

Most research indicates that, in the short term, a living wage requirement increases total contract costs by 0 to 2% in nominal terms. DLS believes a reasonable assumption is that State contract costs could increase by no more than 1%. In the short term, State expenditures could increase by approximately $436,000 annually for maintenance and food service contracts. The total impact will be realized incrementally as contracts are re-bid. The increase is assumed to be divided 60% general funds, 20% special funds, and

20% federal funds. It is less, however, than the annual rate of inflation, and thus may be largely absorbed within automatic contract increases, as is often the case with local living wage laws.

In the long term, wage spillover effects could impact the costs of DDA and other services provided by nonprofit organizations. The fiscal impact of this cannot be reliably estimated. To the extent that the wage spillover effects are smaller than inflation growth, there would be no significant annual contract cost increases.

Administrative Costs

General fund expenditures by DLLR could increase by an estimated $114,780 in fiscal 2008, which accounts for the bill's October 1, 2007 effective date. This estimate reflects the cost of hiring one administrator to oversee DLLR's enforcement effort, one wage and hour investigator to investigate complaints of living wage violations, and one clerical staff person. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Salaries and Fringe Benefits	$97,951
Operating Expenses	16,829
Total FY 2008 State Expenditures	**$114,780**

Future year expenditures reflect: (1) full salaries with 4.5% annual increases and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses. Assuming that it would receive up to 1,000 living wage complaints each year, and that each investigator can complete 500 investigations each year, DLLR requested two wage and hour investigators. However, given that local jurisdictions report few complaints of noncompliance, and that DLLR received only 229 complaints of noncompliance with the prevailing wage requirements in fiscal 2006, DLS believes only one wage and hour investigator is necessary.

DLS advises that it will likely be able to conduct the mandated study with existing resources, depending on the number of other required reports mandated during the 2007 session. Staff resources could be diverted from other responsibilities.

Small Business Effect: Large firms are more able than small firms to absorb the cost of increased wages without passing on the full cost to the State because small businesses are less able to take advantage of economies of scale to reduce costs. Often, small firms do not have a large enough client base over which to spread the increased costs. Therefore, the living wage could put them at a competitive disadvantage in bidding for State contracts.

Additional Information

Prior Introductions: SB 621 of 2004 passed the House and the Senate, but was vetoed by the Governor for policy reasons.

Cross File: None.

Information Source(s): Maryland Chamber of Commerce; Department of General Services; Board of Public Works; Comptroller's Office; University System of Maryland; Department of Labor, Licensing, and Regulation; Department of Budget and Management; Department of Public Safety and Correctional Services; Montgomery County; Progressive Maryland; *Industrial Relations*; Brennan Center for Justice; Economic Policy Institute; Department of Legislative Services

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Analysis by: Michael C. Rubenstein

Direct Inquiries to:
(410) 946-5510
(301) 970-5510