HB 391

Department of Legislative Services
Maryland General Assembly
2005 Session

FISCAL AND POLICY NOTE
Revised

House Bill 391 (Delegate D. Davis, *et al.*)

Economic Matters Finance

Labor and Employment - Minimum Wage - Increase

This bill requires employers to pay the greater of the federal minimum wage or a wage that equals a rate of $6.15 per hour to employees subject to federal or State minimum wage requirements. The bill also alters the tip credit that employers can apply against the direct wages paid to employees classified as tipped employees. The tip credit is equal to 50% of the higher of the federal or State minimum wage. As a result, employers are required to pay tipped employees a wage rate that equals $3.08 per hour.

The bill takes effect January 1, 2006.

Fiscal Summary

State Effect: General fund expenditure increase of approximately $130,000 in FY 2006 due to administrative costs at the Department of Labor, Licensing, and Regulation (DLLR). Future year expenditures reflect annualization and inflation. Potential increase in general fund expenditures for increased contractual services costs. Indeterminate impact on income tax revenues as discussed below.

(in dollars)	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
GF/SF Rev.	+/-	+/-	+/-	+/-	+/-
GF Expenditure	130,000	194,500	206,100	218,600	232,100
Net Effect	($130,000)	($194,500)	($206,100)	($218,600)	($232,100)

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

Local Effect: Potential increase in local expenditures due to increased contracting costs.

Small Business Effect: Meaningful impact as discussed below.

Analysis

Current Law: Maryland adopts federal minimum wage standards. The federal minimum wage is $5.15 per hour for covered employees.

Employees are considered covered by minimum wage standards through either the federal Fair Labor Standards Act (FLSA) of 1938 or Maryland statute. Certain employees are exempted from coverage including commissioned sales employees; farm workers; and executive, administrative, and professional employees who are paid on a salary basis. In addition, various minimum wage exceptions apply in specific circumstances to workers with disabilities, full-time students, student-learners, youth workers, and tipped employees.

The employer of a tipped employee is allowed a "tip credit" that can be applied against the direct wages paid by the employer. The employee can be paid tipping wages so long as the wages plus the tips received equal at least the federal minimum wage, the employee retains all tips, and the employee customarily and regularly receives more than $30 a month in tips. Chapter 1 of 1997 established a tip credit of $2.77 an hour, which is lower than the federal tip credit. As a result, Maryland employers must pay a minimum of $2.38 an hour in tipping wages, which is $0.25 higher than federal law.

The 1996 amendments to FLSA established a subminimum wage of $4.25 an hour for employees under 20 years of age during their first consecutive 90 calendar days of employment with an employer. Due to differences in federal and State coverage, restaurants and similar establishments that gross between $250,000 and $500,000 cannot pay subminimum wages while restaurants grossing over $500,000 have the option of paying subminimum wages.

Background:

Federal Minimum Wage

The federal minimum wage first established in 1938 has been incrementally increased and expanded to cover additional employees through subsequent amendments to FLSA. The last increase in the federal minimum wage was effective September 1, 1997. In the last several years, bills have been introduced in the U.S. Congress proposing to increase the minimum wage, but none has been enacted.

States with Higher Minimum Wage Laws

As shown in **Exhibit 1,** 14 states and the District of Columbia mandate a minimum wage higher than the federal minimum wage of $5.15 an hour ($10,712 annually for a full-time worker).

Exhibit 1
States with Higher than Federal Minimum Wage, 2005

State	Rate	Increases and Indexation
Washington	$7.35	Increases annually by increase in CPI-U*
Oregon	$7.25	Increases annually by increase in CPI-U*
Alaska	$7.15	
Connecticut	$7.10	Automatically increases to 0.5% above federal minimum wage if the federal rate equals or becomes higher than the State minimum
Vermont	$7.00	
California	$6.75	
Massachusetts	$6.75	Automatically increases to $0.10 above federal rate if the federal rate equals or becomes higher than the State minimum
Rhode Island	$6.75	
Washington, DC	$6.60	Automatically increases to $1.00 above federal rate if the federal rate equals or becomes higher than the district minimum
Illinois	$6.50	
Maine	$6.35	
Hawaii	$6.25	
Delaware	$6.15	
Florida	$6.15	Scheduled to be effective May 2005 and indexed to inflation
New York	$6.00	Increases to $6.75 effective January 2006

*Consumer Price Index for all urban consumers.

Source: United States Department of Labor

2004 State Legislative Actions

Florida, New York, the District of Columbia, and Nevada took steps in 2004 to mandate higher minimum wages. Florida voters approved by approximately 70% a November 2004 ballot initiative increasing the minimum wage. In New York, the minimum wage will increase incrementally to $7.15 in the next two years after the state legislature overrode Governor Pataki's veto of the bill in 2004. The District of Columbia Council in November 2004 increased the district's minimum wage from $6.15 to $6.60. In addition, Nevada voters approved by approximately 68% a November 2004 ballot initiative to increase the minimum wage. The increase cannot be implemented before 2007 and must be approved by a second ballot initiative.

On the other hand, proposals to increase minimum wages, including those in states that already mandate higher-than-federal minimum wages, failed in 13 states.

Characteristics of Minimum Wage Workers: 2003

The U.S. Department of Labor conducts the Current Population Survey (CPS), which includes tabulating characteristics on minimum wage earners. In 2003, 2.1 million workers nationwide were paid wages below or at minimum wage, representing 2.9% of all hourly-paid workers and 1.3% of all wage and salary workers. In both relative and absolute terms, the number of minimum wage earners has declined in the last 25 years. In 1981, for example, there were 7.8 million minimum wage earners or 15.1% of all hourly-paid workers.

Minimum wage workers tend to be young. Slightly more than half of all workers earning minimum wage or less were younger than 25, and about one-fourth were 16 to 19. Women comprise approximately two-thirds of all minimum wage earners 16 and older. Approximately 62% are part-time workers, and 61.7% have never been married. Ethnically, minimum wage workers – some are classified in more than one category – are: White (83.1%), Hispanic (14.7%), Black (11.9%), and Asian (2.4%). More than two-thirds of minimum wage earners were in service-type industries, mostly in food service jobs. Further, three-fifths of all minimum wage workers were employed in leisure and hospitality.

Approximately 1.3 million Maryland workers were paid hourly wages in 2003 – 28,000, or approximately 2.1% of hourly workers, earned wages at or below minimum wage. By comparison, there are approximately 439,000 Marylanders estimated to have incomes below the poverty level.

Debate over Increasing the Minimum Wage

Proponents of increasing the minimum wage believe that increasing the minimum wage: (1) will help low-income individuals; (2) will have a "ripple effect," increasing wages for workers above the minimum wage; (3) is needed because the real value of the minimum wage continues to fall; and (4) will not harm businesses because higher wages will increase worker productivity through increased retention rates.

Opponents of increasing the minimum wage believe it: (1) is poorly targeted in that many minimum wage workers are from higher income households; (2) has undesirable effects on the economy such as increasing inflation; (3) is not needed because the decreased real value of the minimum wage has been offset by an increase in federal and State earned income tax credits; and (4) has disemployment effects. The disemployment effects happen when businesses hire fewer low-wage workers in response to an increase in the minimum wage. Benefits to low-wage workers from increased wages are offset by a reduction in hours worked or increased unemployment.

State Revenues: State revenues would not be directly affected by the bill. An increase in the minimum wage would likely shift income (and tax liability) from businesses to minimum wage earners. The net effect on State revenue depends on the change in the effective rate of taxation which cannot be reliably estimated.

For every hour worked by minimum wage earners, theoretically State revenues would increase. To the extent that adult minimum wage earners are part of middle- and upper-income households, personal income tax revenue would likely increase. However, increased wages for other households might not lead to increased personal tax revenues for three reasons.

First, the State Earned Income Tax Credit (EIC) could offset any expected increase in tax liability. Minimum wage earners who are part of low-income households typically have large amounts of nonrefundable State EIC that are not utilized; therefore, any change in tax liability would be due to changes in the refundable EIC. The maximum refundable EIC of $860 in tax year 2004 is earned by households with income between $10,750 and $14,450. The impact on State income tax revenue, if any, depends on whether a household is below this maximum, in between, or above it. Consider the effect of a $1 increase in minimum wage on a full-time worker with labor-only income and two dependents. Total annual income would increase from $10,712 to $12,792 – increasing the individual's tax refund from $858 to $860.

Second, State income tax revenues from young, seasonal minimum wage earners would not likely increase since they often earn less than the minimum threshold filings and can file for an exemption from having taxes withheld.

Third, although certain individuals would have increased labor earnings and potentially more tax liability, if there are disemployment effects total wages earned (and total taxes paid) by affected individuals could decrease.

State Expenditures: The mandated increase in the minimum wage proposed by the bill does not apply to the State and would not require an increase in the State's labor costs.

Even though the bill does not mandate that the State increase its minimum wage paid to employees, the higher minimum wage could be adopted as a matter of policy. The State has a minimal number of permanent employees who would be affected. The Department of Budget and Management (DBM) advises that the State, including the University System of Maryland, has several thousand contractual employees who earn less than $6.15 per hour. DBM estimates that State labor costs would increase by approximately $2.0 million annually if these contractual workers were paid a minimum wage of $6.15 per hour.

DLLR advises that complaints regarding the minimum wage are currently referred to the U.S. Department of Labor and that these complaints could not be forwarded if Maryland mandates a higher-than-federal minimum wage. DLLR estimates general fund expenditures would increase by approximately $285,400 in fiscal 2006 due to the costs of hiring three wage and hour investigators, one support staff, one assistant attorney, and a part-time administrator. DLLR advises that this estimate is based on receiving 1,050 wage complaints annually.

Legislative Services estimates that general fund expenditures would increase by approximately $129,976 in fiscal 2006 due to the bill's effective date and the hiring of two wage and hour investigators, one support staff, one part-time assistant attorney, and one part-time administrator. This estimate is based on the experience of the State of Washington. The Washington Department of Labor and Industries advises that it typically receives between 300 and 500 minimum wage complaints annually. It is estimated that the amount of complaints DLLR would receive annually would not exceed complaints in Washington, given that state's greater population and higher minimum wage than proposed under the bill. The following estimate includes salaries, fringe benefits, one-time start-up costs, communications, travel expenses, and other ongoing operating expenses. It is assumed that the Governor's budget plan, which reduces positions at DLLR, would be enacted; therefore, sufficient equipment would be available for the employees needed under the bill.

Salaries and Fringe Benefits	$86,306
Communications	30,000
Travel	3,250
Office Space	3,750
Printing Minimum Wage Posters	5,500
Other Operating Expenses	1,170
Total FY 2006 Expenditures	**$129,976**

Future years reflect: (1) full salaries with 4.6% annual increases and 3% employee turnover; and (2) 1% annual increases in ongoing operating expenses.

State contracting costs could increase. Part of the increase in wages would be borne by contracting businesses, while some costs would likely be shifted forward to the State. In fiscal 2004, the State appropriated $889 million (including $338.1 million in federal funds) for service contracts. Approximately 80% was for purchase-of-care services and the remaining amount encompassed food and janitorial services, grounds maintenance, housekeeping, and garbage removal.

State capital expenditures would not likely increase significantly, given: (1) the low incidence of minimum wage rates in construction jobs; and (2) the coverage currently afforded by the Prevailing Wage Law.

Local Effect: Local governments are not covered by the bill and thus would not have to pay the higher minimum wage. However, to the extent that local governments contract with companies that pay less than the proposed minimum wage, local government contracting costs would increase. The indirect effects of increasing the minimum wage on local revenues cannot be reliably estimated.

Small Business Effect: Small businesses that employ low-wage individuals would be impacted by the bill through increased wage payments and mandatory payroll taxes such as Social Security taxes and unemployment insurance taxes. Even if part of this cost were shifted forward to consumers through higher prices, these businesses could be impacted by decreased sales. To the extent that increased wages increases worker productivity, businesses would be less affected by the provisions of the bill.

Exhibit 2 lists the average numbers of Maryland workers that were paid up to $6.15 per hour in 2003 and 2004.

Exhibit 2
Average Number of Marylanders Earning up to $6.15 per Hour
2003 – 2004

	Less Than $4.25	$4.26 – $5.14	$5.15	$5.16 – $5.64	$5.65 – $6.14	Total
Maryland Workers	13,500	7,500	5,000	12,500	30,500	69,000

Source: Bureau of Labor Statistics

Not all these individuals would receive an increase in wages. Some are not covered by the FLSA or State law or work for a unit of government. The Department of Legislative Services estimates that approximately 55,300 workers would receive an increase in wages (in any amount) directly as a result of this bill. Further, it is estimated that based on analysis of CPS data that the total increase in wages paid to these individuals would be approximately $56 million or an average of $1,020 per worker annually. Wages and mandatory payroll taxes paid by Maryland businesses as a result of the bill would increase by approximately $61 million annually. Increased labor costs and taxes can be typically deducted by businesses. The reduction in costs to a business, if any, depends on the effective tax rate of the business and if the business is operating at a profit. Legislative Services advises this cannot be reliably estimated at this time.

As mentioned previously, a majority of minimum wage workers nationally are employed in the service industry, particularly in leisure and hospitality. Approximately 15% of workers nationwide in the leisure and hospitality industry were paid wages at or below minimum wage in 2004. The highest incidence of minimum wage workers in this industry was approximately 19% at food services and drinking establishments. According to the U.S. Census Bureau, in 2001 7,139 Maryland firms in the accommodation and food services industry classification employed 168,647 individuals with total payroll of approximately $2.23 billion. Of these businesses, 6,488 were small businesses that employed 60,000 individuals with total payroll of approximately $792.7 million.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Bureau of Labor Statistics; National Conference of State Legislatures; U.S. Department of Labor; Congressional Budget Office; Washington Department of Labor and Industries; University System of Maryland; Department of Labor, Licensing, and Regulation; Department of Budget and Management; Department of Legislative Services

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