

Department of Legislative Services
Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 940
Finance

(Senator Madaleno, *et al.*)

Labor and Employment - Payment of Wages - Minimum Wage and Repeal of Tip Credit

This bill requires employers in the State to pay the greater of the federal minimum wage or a State minimum wage of \$10.10 per hour to employees subject to federal or State minimum wage requirements beginning July 1, 2016, instead of being gradually phased in under current law to \$10.10 per hour by July 1, 2018. The bill provides for subsequent annual increases in the State's minimum wage from July 1, 2017, through July 1, 2020, when the minimum wage is established as \$15.00 per hour. Beginning on July 1, 2022, the minimum wage may increase further as it is indexed to inflation. Also, the bill repeals the tip credit that employers can apply against the direct wages paid to employees classified as tipped employees.

The bill takes effect June 1, 2016.

Fiscal Summary

State Effect: No effect in FY 2016; however, State expenditures (all funds) increase significantly beginning in FY 2017. State expenditures increase, mostly due to additional payroll costs, by at least \$3.6 million in FY 2017 and by \$56.4 million in FY 2021 but likely significantly more to account for wage adjustments to internal salary ladders. Federal fund revenues increase minimally to offset increased wages paid to senior citizen aides employed by the Maryland Department of Aging. Any increase in general fund tax revenues to the State cannot be reliably projected but is expected to be minimal.

Local Effect: Local government expenditures increase significantly beginning in FY 2017 for certain local jurisdictions to pay additional wages to minimum wage government employees. Any increase in local government tax revenues cannot be reliably projected but is expected to be minimal.

Small Business Effect: Meaningful.

Analysis

Bill Summary: The bill specifies that, unless the federal minimum wage is set at a higher rate, the State minimum wage is as follows:

- \$10.10 per hour as of July 1, 2016;
- \$11.90 per hour as of July 1, 2017;
- \$13.25 per hour as of July 1, 2018;
- \$14.25 per hour as of July 1, 2019; and
- \$15.00 per hour as of July 1, 2020.

Beginning on July 1, 2022, and in subsequent fiscal years, the State minimum wage is the rate determined and announced by the Commissioner of Labor and Industry. Generally, the rate will be the prior-year rate plus the average percentage increase, based on the most recent 12-month period, in the Consumer Price Index (CPI) for the Washington-Baltimore metropolitan area (or a successor index that is published by the U.S. Bureau of Labor Statistics (BLS)). An increase in the State minimum wage must be rounded to the nearest cent. However, if the CPI does not change during a given year, or decreases, the minimum wage remains at the same rate as that of the prior year. The commissioner must determine and announce the State minimum wage that will be in effect for the upcoming fiscal year by March 1 of each year beginning on March 1, 2022.

Current Law:

Maryland Wage and Hour Law

The Maryland Wage and Hour Law is the State complement to the federal Fair Labor Standards Act (FLSA) of 1938. State law sets minimum wage standards to provide a maintenance level consistent with the needs of the population. State law specifies that an employee must be paid the greater of the federal minimum wage (which is currently \$7.25 per hour) or \$8.25 per hour. Under Chapter 262 of 2014, the State minimum wage is scheduled to increase on an incremental basis over the next three years to:

- \$8.75 per hour as of July 1, 2016;
- \$9.25 per hour as of July 1, 2017; and
- \$10.10 per hour as of July 1, 2018.

However, an employer may pay an employee a wage that equals 85% of the State minimum wage for the first six months that the employee is employed if the employee is younger than age 20. Additionally, an employer of an amusement or a recreational establishment, including a swimming pool, that meets specified conditions may pay an employee a wage that equals the greater of \$7.25 or 85% of the State minimum wage. Exceptions to the minimum wage requirement also exist for a training wage and a disabled employee of a sheltered workshop.

The Maryland Wage and Hour Law, and minimum wage requirements, do not apply to certain categories of employees, including those defined as administrative, executive, or professional; certain seasonal employees; part-time employees younger than age 16; salesmen and those who work on commission; an employer's immediate family; drive-in theater employees; employees training in a special education program in a public school; employees of an establishment that sells food and drink for on-premises consumption and has an annual gross income of \$400,000 or less; employees employed by an employer who is engaged in canning, freezing, packing, or first processing of perishable or seasonal fresh fruits, vegetables, poultry, or seafood; and certain farm workers.

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 minimum wage, the employee retains all tips, and the employee customarily receives more than \$30 a month in tips. The tip credit is equal to the State minimum wage, less \$3.63. Thus, the tip credit increases as the minimum wage increases, and the wage paid by employers to tipped employees remains \$3.63, as long as their wages plus tips equal the minimum wage. The State and local governments are not considered employers under the tip credit provisions of the Maryland Wage and Hour Law.

If an employer pays less than the wages required, the employee may bring an action against the employer to recover (1) the difference between the wage paid to the employee and the wage required; (2) an additional amount equal to the difference as liquidated damages; and (3) legal fees. The court must award these differences in wages, damages, and counsel fees if the court determines that an employee is entitled to recovery. However, if an employer shows to the satisfaction of the court that the employer acted in good faith and reasonably believed that the wages paid to the employee were not less than the required wages, then the court must award liquidated damages of an amount less than the difference in wages or no liquidated damages.

A person who violates the State's Wage and Hour Law is guilty of a misdemeanor and on conviction is subject to a fine of up to \$1,000.

Fair Labor Standards Act

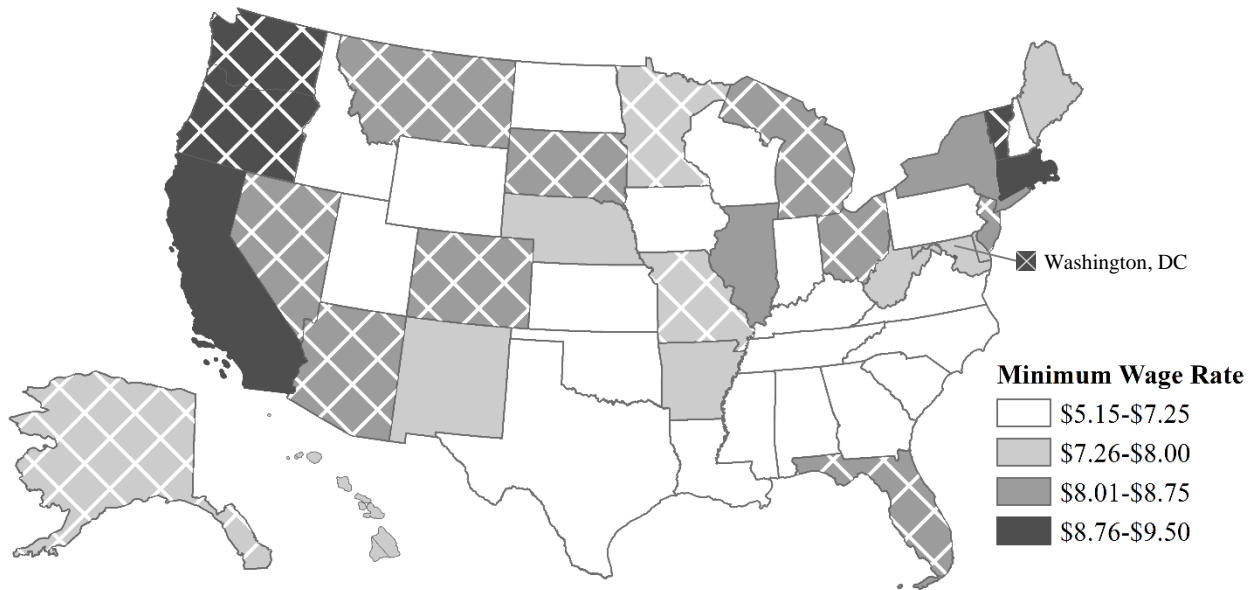
With some exceptions, similar to State law, FLSA requires that workers be paid a minimum hourly wage and that overtime compensation be paid to employees who work more than 40 hours in a week.

Under FLSA, 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 minimum wage, the employee retains all tips, and the employee customarily receives more than \$30 a month in tips. The tip credit is equal to \$5.12 per hour, which is the federal minimum wage less the required cash wage. Thus, the wage paid by employers under FLSA to tipped employees is \$2.13, as long as their wages plus tips equal the minimum wage.

Background: As shown in **Appendix 1**, seven states required employers to pay workers the full state minimum wage before tips in 2015 (Alaska, California, Minnesota, Montana, Nevada, Oregon, and Washington). Employers could pay workers the federal tipped minimum wage of \$2.13 per hour in 17 states. The remaining states, including Maryland, allowed employers to pay tipped employees a minimum wage rate that is higher than the federal tipped minimum wage of \$2.13 per hour but lower than the state's minimum wage.

In 2015, as shown in **Exhibit 1**, 29 states, including Maryland and the District of Columbia, mandated a minimum wage higher than the federal minimum wage of \$7.25 per hour, with rates ranging from \$0.25 to \$2.25 above the federal rate. Five states had no mandated minimum wage, another two had a minimum wage set lower than the federal minimum wage, and the remaining 14 states used the federal minimum wage. Unless a state had a higher minimum wage rate, the federal minimum wage rate applied. The map also shows the 15 states and the District of Columbia that had, or will have in a future year, indexed the state minimum wage rates to a measure of inflation. As **Exhibit 2** illustrates, in 2015, 6 states used the Consumer Price Index for All Urban Consumers (CPI-U), and 5 states used the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W). Additionally, in the next several years, 4 more states will index the minimum wage to CPI-U, and Minnesota will use a non-CPI measure to index its minimum wage. In addition to Maryland, within the next several years, Connecticut, Hawaii, Massachusetts, Vermont, and the District of Columbia will have minimum wage rates at or above \$10.10.

Exhibit 1
State Minimum Wage Rate in 2015



Note: Cross-hatch pattern indicates states that index the minimum wage to inflation.

Source: U.S. Congressional Research Service; U.S. Department of Labor; National Conference of State Legislatures

Exhibit 2
States with Higher than Federal Minimum Wage, as of 2015

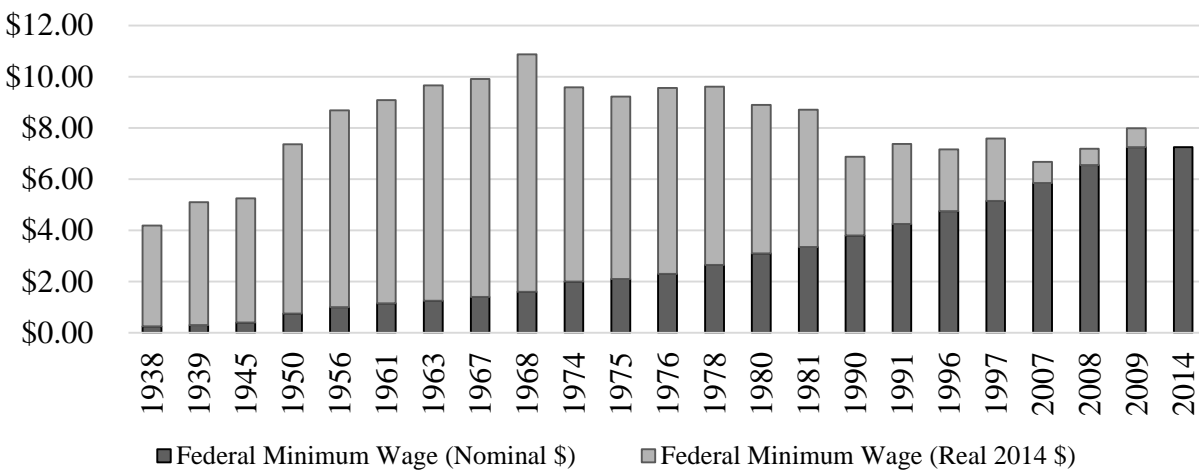
<u>State</u>	<u>Rate</u>	<u>Index</u>	<u>Increases and Indexation</u>
District of Columbia	\$9.50	CPI-U	Phasing up to \$11.50 by July 2016 and then indexed annual increases. Automatically increases to \$1.00 above federal rate if the federal rate equals or becomes higher than the district minimum
Washington	\$9.47	CPI-W	Increases annually based on inflation
Oregon	\$9.25	CPI-U	Increases annually based on inflation
Connecticut	\$9.15		Phasing up to \$10.10 by January 2017. Automatically increases to 0.5% above federal minimum wage if the federal rate equals or becomes higher than the state minimum
Vermont	\$9.15	CPI-U	Phasing up to \$10.50 by January 2018. Increases annually thereafter by inflation, not to exceed 5%
California	\$9.00		Phasing up to \$10.00 by January 2016
Massachusetts	\$9.00		Phasing up to \$11.00 by January 2017. Automatically increases to \$0.10 above federal rate if the federal rate equals or becomes higher than the state minimum
Rhode Island	\$9.00		
New York	\$8.75		Increasing to \$9.00 by January 2016
South Dakota	\$8.50	CPI-U	Increases annually based on inflation
New Jersey	\$8.38	CPI-W	Increases annually based on inflation
Illinois	\$8.25		
Nevada	\$8.25	CPI-U	Increases annually based on inflation
Colorado	\$8.23	CPI-U	Increases or decreases annually based on inflation
Michigan	\$8.15	CPI-U	Phasing up to \$9.25 by January 2018 and then increases annually based on inflation, not to exceed 3.5%
Ohio	\$8.10	CPI-W	Increases annually based on inflation
Arizona	\$8.05	CPI-U	Increases annually based on inflation
Florida	\$8.05	CPI-W	Increases annually based on inflation
Montana	\$8.05	CPI-U	Increases or decreases annually based on inflation
Maryland	\$8.00		Phasing up to \$10.10 by July 2018
Minnesota	\$8.00	non-CPI	Phasing up to \$9.50 by August 2016 for large businesses and then indexed annual increases
Nebraska	\$8.00		Increasing to \$9.00 by January 2016
West Virginia	\$8.00		Increasing to \$8.75 by December 2015
Alaska	\$7.75	CPI-U	Phasing up to \$9.75 by January 2016 and then indexed annual increases
Delaware	\$7.75		Increasing to \$8.25 by June 2015
Hawaii	\$7.75		Phasing up to \$10.10 by January 2018
Missouri	\$7.65	CPI-W	Increases or decreases annually based on inflation
Arkansas	\$7.50		Phasing up to \$8.50 by January 2017
Maine	\$7.50		
New Mexico	\$7.50		

Source: U.S. Congressional Research Service; U.S. Department of Labor; National Conference of State Legislatures

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 in July 2009. **Exhibit 3** shows the nominal and real values for each time the minimum wage was changed, expressed in terms of July 2014 dollars. The real value reflects the purchasing power of the minimum wage, taking inflation into consideration. When Maryland established a minimum wage rate of \$6.15 in January 2006, the real value of the minimum wage then was \$7.54, in 2014 dollars.

Exhibit 3
Federal Minimum Wage in Real and Nominal Dollars
1938-2014



Source: U.S. Congressional Research Service; U.S. Bureau of Labor Statistics

Local Jurisdiction Labor Laws

Montgomery County and Prince George's County passed local minimum wage laws in 2013 – Montgomery County Bill 27-13 and Prince George's County Bill CB-94-2013. Both bills phase in minimum wage increases over four years. The bills increase the minimum wage to \$8.40 per hour beginning October 1, 2014; \$9.55 per hour beginning October 1, 2015; \$10.75 per hour beginning October 1, 2016; and \$11.50 per hour beginning October 1, 2017. The county minimum wage for Montgomery and Prince George's counties do not apply to an employee who is exempt from the minimum wage requirements of the Maryland Wage and Hour Law or the federal FLSA or to an employee who is younger than age 19 and is employed no more than 20 hours in a week.

Baltimore City enacted a city minimum wage rate in 1964, which was challenged in the State Court of Appeals in *Mayor of Baltimore v. Sitnick*, 254 Md. 303, 255 A.2d 376 (1969). The court found that the State's minimum wage rate did not preempt Baltimore's minimum wage law since Baltimore's law supplemented the State law by setting a higher rate. Baltimore still has its own minimum wage statute with an enforcement commission, which currently enforces the State minimum wage rate in the city.

Characteristics of Minimum Wage Workers

BLS and the U.S. Census Bureau conduct the Current Population Survey (CPS), which includes tabulating characteristics on minimum wage earners. In 2013, 3.3 million workers nationwide were paid wages at or below the federal minimum wage, representing 4.3% of all hourly paid workers.

According to CPS, minimum wage workers tend to be young. About one-half of all workers earning minimum wage or less were younger than 25, and about 20% of teenagers earning an hourly wage were paid the minimum wage or less. Among hourly wage workers without a high school diploma, approximately 10% earned the federal minimum wage or less. About 10% of part-time workers earning an hourly wage were paid the federal minimum wage or less, compared with about 2% of full-time workers.

BLS reports 66,000 workers in Maryland earned wages equal to or less than the federal minimum wage in 2013. In 2012, of those earning minimum wage or less, 61% were women. In the last decade, the percent of workers in Maryland earning at or below federal minimum wage has increased from 2.1% in 2003 to 5% in 2012, while, over the same time, median hourly earnings overall have risen from \$12.08 to \$14.17.

Minimum Wage Effects on the Economy

There is much debate on how raising the minimum wage affects the economy. Positive impacts on the economy may include (1) increases in personal income; (2) decreases in employee turnover; (3) increases in local consumption; (4) higher labor force participation rates; (5) decreases in social welfare costs; and (6) higher levels of technological development, investment, and productivity.

However, on the downside, raising the minimum wage may (1) decrease demand for labor; (2) increase inflation from employers passing higher employee costs onto the consumer; (3) cause wage compression; (4) reduce local competitiveness; and (5) have 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 may be offset by a reduction in hours worked or increased unemployment.

State Revenues: General fund tax revenues increase minimally from increasing the State’s minimum wage beginning in fiscal 2017. Individuals earning minimum wage likely have low, if any, State income tax liability so raising the minimum wage only has a minimal effect on State income tax revenues. Any increase in personal income tax revenue is likely offset from diminished revenues from businesses with higher payroll expenses. Given that raising the minimum wage boosts the purchasing power of minimum wage workers and generates new consumer spending, general fund sales tax revenues increase minimally.

The Department of Labor, Licensing, and Regulation (DLLR) does not anticipate investigating a significant increase in violations of the State’s Wage and Hour Law under the bill, so general fund revenues are not materially affected.

State Expenditures: State expenditures (all funds) increase significantly as a result of incrementally raising the State minimum wage to \$15.00 per hour by fiscal 2021; **Exhibit 4** displays some of the additional wages that must be paid to State employees in fiscal 2017 through 2021 under the bill.

Exhibit 4
Effect of Phasing in a \$15.00 Minimum Wage on State Employees
Fiscal 2017-2021

<u>Additional Staffing Costs</u>	<u>FY 2017</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>
Senior citizen aides	\$273,208	\$543,764	\$752,960	\$907,920	\$1,024,140
MDOT Employees	0	41,340	720,720	1,644,396	2,665,208
St. Mary’s College employees	190,361	373,673	444,177	585,185	690,942
Hourly/contractual employees within SPMS	2,657,362	13,343,540	23,729,581	32,481,065	39,509,002
Salaried employees within SPMS	0	160,026	1,060,819	2,686,880	4,718,944
USM employees	455,378	2,241,284	4,287,628	6,236,663	7,767,017
Increase in Expenditures	\$3,576,309	\$16,703,627	\$30,995,885	\$44,542,109	\$56,375,253
Federal Fund Revenues	273,208	543,764	752,960	907,920	1,024,140
Net Increase in Expenditures	\$3,303,101	\$16,159,863	\$30,242,925	\$43,634,189	\$55,351,113

MDOT: Maryland Department of Transportation
 SPMS: State Personnel Management System
 USM: University System of Maryland

Source: Department of Legislative Services

Current law has the minimum wage rate increasing to \$8.75 in fiscal 2017, so State expenditures increase by \$3.6 million in fiscal 2017, which is the difference between \$8.75 and a \$10.10 wage rate. Expenditures in future years are calculated based on the difference between the scheduled minimum wage rates under current law versus the rates under the bill, so by fiscal 2021, State expenditures increase by \$56.4 million. These costs do not take into account any wage adjustments to internal salary ladders. The State may increase wages for an employee who currently earns just above \$10.10 per hour in fiscal 2017 or just above \$15.00 per hour in fiscal 2021 and has more job responsibilities than a minimum wage employee. Any such wage adjustments further increase the State's expenditures, potentially significantly.

DLLR can implement and enforce the bill with existing resources, assuming DLLR maintains its current level of contractual employees, several of whom were hired to address the increased volume of enforcement activity prompted by the enactment of Chapter 262 of 2014.

Local Fiscal Effect: Expenditures could increase significantly by fiscal 2021 for some local governments to pay employees (typically part-time or contractual employees) the minimum wage rates specified in the bill. For example, Dorchester County currently has only four employees earning less than \$10.10 per hour, but it has 70 employees making less than \$15.00 per hour. Thus, the county estimates expenditures increasing by \$253,155 by fiscal 2021.

Montgomery and Prince George's counties each established a county minimum wage of \$8.40 per hour that phases up to \$9.55 per hour in October 2015 and up to \$11.50 per hour in October 2016, so the bill only has a minimal impact to Montgomery and Prince George's counties in fiscal 2017. However, by fiscal 2021, Montgomery County estimates a \$1.5 million increase in expenditures for increased payroll expenses at Maryland County public schools.

The Maryland Municipal League advises that increasing the minimum wage significantly impacts cities and towns that employ part-time and seasonal workers who are paid below the minimum wage rates specified in the bill.

Small Business Effect: Small businesses in the State that employ minimum wage or low wage workers experience significant increases in their labor costs due to the bill. The impact is even greater for small businesses that employ tipped employees.

BLS reports there were 43,090 waiters and waitresses in the State in 2013, earning median hourly wages of \$8.71. By eliminating the tip credit and raising the State minimum wage, an employer must pay a tipped employee an hourly wage rate of \$10.10 instead of \$3.63 in

fiscal 2017. Thus, an employer that currently pays a tipped employee \$3.63 per hour must pay each tipped employee an additional:

- \$6.47 per hour as of July 1, 2016;
- \$8.27 per hour as of July 1, 2017;
- \$9.62 per hour as of July 1, 2018;
- \$10.62 per hour as of July 1, 2019; and
- \$11.37 per hour as of July 1, 2020.

To the extent that higher wages increase worker productivity, businesses would be less affected by the provisions of the bill. Additionally, minimum wage workers tend to have a low saving rate, so increasing their wages could lead to additional consumer spending for small businesses.

Additional Information

Prior Introductions: None.

Cross File: HB 1372 (Delegate Waldstreicher, *et al.* – Economic Matters) is designated as a cross file; however, the title of the bill is different.

Information Source(s): Baltimore, Dorchester, Garrett, and Montgomery counties; Maryland Association of Counties; cities of Frederick and Havre de Grace; Maryland Municipal League; Judiciary (Administrative Office of the Courts); University System of Maryland; Morgan State University; St. Mary’s College of Maryland; Department of Budget and Management; Department of Labor, Licensing, and Regulation; Maryland Department of Transportation; U.S. Bureau of Labor Statistics; U.S. Census Bureau; U.S. Congressional Research Service; U.S. Department of Labor; National Conference of State Legislatures; Department of Legislative Services

Fiscal Note History: First Reader - March 4, 2016
min/mcr

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Appendix 1 – State Minimum Wage Rates for Tipped Employees, as of 2015

<u>State</u>	<u>Combined Cash & Tip Rate</u>	<u>Tip Credit</u>	<u>Cash Wage</u>
Federal	\$7.25	\$5.12	\$2.13
Alabama*	7.25		2.13
Alaska	8.75		8.75
Arizona	8.05	\$3.00	5.05
Arkansas	7.50	\$4.87	2.63
California	9.00		9.00
Colorado	8.23	\$3.02	5.21
Connecticut	9.15	34.80%	5.78
Delaware	7.75	\$5.52	2.23
District of Columbia	9.50	\$6.73	2.77
Florida	8.05	\$3.02	5.03
Georgia	5.15		2.13
Hawaii	7.75	\$0.50	7.25
Idaho	7.25	\$3.90	3.35
Illinois	8.25	40%	4.95
Indiana	7.25	\$5.12	2.13
Iowa	7.25	\$2.90	4.35
Kansas	7.25	\$5.12	2.13
Kentucky	7.25	\$5.12	2.13
Louisiana*	7.25		2.13
Maine	7.50	50%	3.75
Maryland	\$8.00	\$4.37	\$3.63
Massachusetts	9.00	\$6.00	3.00
Michigan	8.15	\$5.05	3.10
Minnesota	8.00		8.00
Mississippi*	7.25		2.13
Missouri	7.65	50%	3.82
Montana	8.05		8.05
Nebraska	8.00	\$5.87	2.13
Nevada	8.25		8.25
New Hampshire	7.25	55%	45%
New Jersey	8.38	\$6.25	\$2.13
New Mexico	7.50	\$5.37	2.13
New York	8.75	\$3.75	5.00
North Carolina	7.25	\$5.12	2.13
North Dakota	\$7.25	33%	\$4.86

<u>State</u>	<u>Combined Cash & Tip Rate</u>	<u>Tip Credit</u>	<u>Cash Wage</u>
Ohio	8.10	\$4.05	4.05
Oklahoma	7.25	\$3.63	3.63
Oregon	9.25		9.25
Pennsylvania	7.25	\$4.42	2.83
Rhode Island	9.00	\$6.11	2.89
South Carolina*	7.25		2.13
South Dakota	8.50	50%	4.25
Tennessee*	7.25		2.13
Texas	7.25	\$5.12	2.13
Utah	7.25	\$5.12	2.13
Vermont	9.15	50%	4.58
Virginia	7.25	\$5.12	2.13
Washington	9.47		9.47
West Virginia	8.00	70%	2.40
Wisconsin	7.25	\$4.92	2.33
Wyoming	5.15	\$3.02	2.13

*No state minimum wage law; subject to the Fair Labor Standards Act.

Source: U.S. Department of Labor