

Department of Legislative Services
 Maryland General Assembly
 2008 Session

FISCAL AND POLICY NOTE

House Bill 1304 (Delegate Vaughn, *et al.*)
 Health and Government Operations

Recipients of State Incentives or Financial Assistance - Diversity Initiatives

This bill requires State procurement units to structure procurement procedures to ensure that every State contractor, subcontractor, or other entity that receives a grant, loan, investment, tax exemption, or other incentive or financial assistance of \$100,000 or more has • adopted and implemented diversity initiatives consistent with the State’s minority business enterprise (MBE) program; and • embraced minority business participation in its contracting and vending activities. The requirement applies to the extent that it is not in conflict with other State or federal law. Each affected entity must submit annual reports to the Governor’s Office of Minority Affairs (GOMA) detailing its contracting with MBEs.

Fiscal Summary

State Effect: State expenditures (all funds) could increase by approximately \$4.5 million in FY 2009 to hire at least one procurement officer in every State agency to monitor compliance with the bill’s requirements. Personnel costs across all State agencies are assumed to be split 60% general funds, 20% special funds, and 20% federal funds. Out-year expenditures reflect annualization and inflation. Higher education costs are split 25% general funds and 75% other higher education funds.

(in dollars)	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	2,442,400	3,032,300	3,185,500	3,346,900	3,517,100
SF Expenditure	741,400	920,400	966,900	1,015,900	1,067,600
FF Expenditure	741,400	920,400	966,900	1,015,900	1,067,600
Higher Ed Exp.	623,100	773,600	812,700	853,900	897,300
Net Effect	(\$4,548,300)	(\$5,646,700)	(\$5,932,000)	(\$6,232,600)	(\$6,549,600)

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

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Current Law: The State's MBE program establishes a goal that at least 25% of the total dollar value of each agency's procurement contracts be awarded to MBEs, including 7% to African American-owned businesses and 10% to women-owned businesses. There are no penalties for agencies that fail to reach these targets. Instead, agencies are required to use race-neutral strategies to encourage greater MBE participation in State procurements.

An MBE is a legal entity, other than a joint venture, that is:

- organized to engage in commercial transactions;
- at least 51% owned and controlled by one or more individuals who are socially and economically disadvantaged; and
- managed by, and the daily business operations of which are controlled by, one or more of the socially and economically disadvantaged individuals who own it.

MBEs include not-for-profit entities organized to promote the interests of physically or mentally disabled individuals.

A socially and economically disadvantaged individual is defined as a citizen or legal U.S. resident who is African American, Native American, Asian, Hispanic, physically or mentally disabled, a woman, or otherwise found by the State's MBE certification agency to be socially and economically disadvantaged. The Maryland Department of Transportation is the State's MBE certification agency.

A socially disadvantaged individual is someone who has been subject to racial or ethnic prejudice or cultural bias within American society because of their membership in a group and without regard to individual qualities. An economically disadvantaged individual is someone who is socially disadvantaged whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities compared with those who are not socially disadvantaged. An individual with a personal net worth in excess of \$1.5 million is not considered economically disadvantaged.

The MBE program is scheduled to terminate July 1, 2012.

There are no requirements that State contractors, subcontractors, or other recipients of State funding adopt and implement either diversity initiatives or the State's MBE goals.

Background: Hundreds of businesses and nonprofit organizations in the State receive State contracts or financial assistance. Although an exhaustive list cannot be provided, the following partial listing is illustrative:

- total State procurement spending totaled \$4.6 billion in each of fiscal 2005 and 2006;
- the Department of Business and Economic Development has awarded economic development grants to 150 organizations and loans to 60 organizations;
- the Department of Budget and Management's fiscal 2006 *Tax Expenditures Report* lists dozens of corporate tax deductions available to and claimed by Maryland businesses;
- more than 125 local school construction projects receive State funding through the Public School Construction Program each year;
- the Governor's annual capital budget includes construction grant programs for private hospitals, local community colleges, and private colleges. It also includes funding for about 75 other projects approved by the General Assembly. None of these projects are reflected in the State's procurement expenditures; and
- the State Retirement and Pension System pays more than \$60 million in fees annually to almost 100 investment managers under contract.

Although many recipients of State contracts, grants, and other financial assistance listed above would not reach the \$100,000 threshold specified in the bill, available data suggest that more than half of them would reach the threshold.

State agencies have no mechanism for tracking either the identity or activities of subcontractors or subgrantees. In the case of contracts, compliance with the State's MBE goals is based on contract awards, not actual payments to subcontractors. Experience has shown that the subcontractors named in project bids and proposals often are not the same subcontractors used to complete a contract, and prime contractors are not obligated to report to the State either the identities of or payments made to subcontractors. In the case of grants, the Department of Health and Mental Hygiene makes many social service grants to local governments, which in turn make subgrants to community-based organizations to provide social and health services to local residents. The State has no role in the subgranting process and has no record of the identity of the subgrantees.

Similarly, the State has no mechanism for tracking the identities or activities of public school, college, or hospital construction contractors that receive State funds. Local school systems procure and administer all school construction contracts, and colleges and hospitals that receive construction grants handle those procurements.

State Fiscal Effect: As indicated above, requiring State procurement units to ensure that contractors, subcontractors, and other recipients of State financial assistance implement diversity initiatives represents a significant expansion of the mission and duties of State procurement officers. State agencies would have to institute mechanisms for identifying all the entities that would have to comply with the bill's requirements and for ensuring on a continuing basis that they do comply.

Accordingly, Legislative Services estimates that every procurement unit in the State would initially require, at a minimum, one new full-time equivalent position to identify and monitor affected entities on an ongoing basis to ensure compliance with the bill's provisions. Based on their central role in State procurement, it is assumed several agencies, including all of the State's primary procurement units, would require three additional positions to implement the bill's provisions. These include the departments of General Services, Budget and Management, Transportation, and Business and Economic Development as well as the Comptroller's Office and the University System of Maryland. There are 21 principal agencies in the Executive Branch, 7 constitutional agencies, about 40 independent State agencies (including the Maryland State Department of Education), and 15 public university campuses (including research institutes), all of which have procurement responsibilities. Personnel costs across all State agencies are assumed to be split 60% general funds, 20% special funds, and 20% federal funds. Higher education spending is assumed to be split 25% general funds and 75% higher education funds.

General, special, federal, and higher education fund expenditures could increase by an estimated \$4.5 million in fiscal 2009, which accounts for the bill's October 1, 2008 effective date. This estimate reflects the cost of hiring one regular full-time equivalent procurement officer with an average salary of \$38,594 for most State procurement units and three new positions for six agencies to identify and monitor entities required to institute diversity initiatives and MBE programs. It includes salaries and fringe benefits for 95 new positions, one-time start-up costs, and ongoing operating expenses.

Salaries and Fringe Benefits	\$4,141,416
One-time Start-up Costs	391,875
Ongoing Operating Expenses	<u>14,963</u>
Total FY 2009 State Expenditures	\$4,548,254

Future year expenditures reflect (1) full salaries with 4.4% annual increases and 3% employee turnover; and (2) 2% annual increases in ongoing operating expenses.

Small Business Effect: Small businesses that receive contracts, subcontracts, grants, or other State financial assistance in excess of \$100,000 would be required to institute

diversity initiatives and MBE purchasing goals. They would also be required to submit annual reports to GOMA.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Human Resources, Department of General Services, Governor's Office, Department of Business and Economic Development, Department of Health and Mental Hygiene, Maryland Department of Transportation, Department of Legislative Services

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