

# The Road to Responsible Contracting: Lessons from States and Cities for Ensuring That Federal Contracting Delivers Good Jobs and Quality Services

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## I.

### INTRODUCTION

Contracting by federal government agencies to purchase goods and services totals more than \$500 billion annually and finances millions of jobs across the U.S. economy. Following years of concern about waste by unaccountable federal contractors, the Obama administration has launched a badly needed initiative to modernize the federal procurement system. But as the federal government works to improve oversight and performance by federal contractors, an equally pressing problem needs attention as well: federal contracting finances millions of poverty-wage jobs, and supports employers that violate workplace, tax, and other laws.

These employment practices, in addition to hurting families and communities, undermine the quality of services that government agencies receive, and impose substantial costs on the taxpayers as contractors' employees turn to publicly funded safety net programs for support. Despite longstanding requirements that federal agencies contract only with "responsible" vendors, and growing awareness of the consequences of failing to do so, the past administration put the brakes on efforts to address this problem.

The Obama administration's contracting reform initiative provides an important opportunity to reverse the role that federal procurement has played in creating bad jobs. The administration aims to use federal procurement to address one of the most pressing needs facing the nation: rebuilding a base of middle-class jobs.

The experiences of cities and states over the past decade with a range of "responsible contracting" policies offer a roadmap for how the administration can ensure that federal contracting promotes the creation of good jobs. In short, federal contracting must prioritize businesses that engage in responsible employment practices. This article surveys responsible contracting policies that cities and states across the country have developed and tested, and recommends the following key reforms in the federal contracting system:

1. Institute more rigorous responsibility screening of prospective bidders to ensure that federal contracts are not awarded to employers that are significant or repeat violators of workplace, tax or other laws.
2. Establish a preference in the contractor selection process for employers that provide good jobs, by prioritizing firms that provide living wages, health benefits, and paid sick days.
3. Expand and improve the national contractor misconduct database created under the 2008 National Defense Authorization Act.
4. Strengthen monitoring and enforcement of contractors' compliance with workplace standards.

By incorporating these approaches into the federal contracting system, the government can ensure that contracting delivers the best value for taxpayers by rewarding employers that provide quality jobs.

## II. BACKGROUND

### *A. Federal Contracting is Creating Millions of Substandard Jobs*

#### *1. Wages Are Low, Benefits Are Minimal and Violations Are Common in Much of the Federally Contracted Workforce*

The federally contracted workforce is large and has been growing rapidly. But while federal agency purchasing has become a key source of employment in communities across the country, the federally contracted workforce includes millions of substandard jobs with employers that pay poverty wages, provide meager benefits, and violate workplace, tax and other laws.

The scale of federal contracting more than doubled during the Bush administration, fueled both by the Iraq War and political opposition to growth in the federal workforce.<sup>1</sup> That opposition often led to use of contractors for functions traditionally performed by federal employees – employees who in many cases would have been able to perform those functions more efficiently and with more accountability. The government should therefore reevaluate the scale of past outsourcing and bring back “in house” many functions that today are performed by federal contractors.

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1. See [USAspending.gov](http://www.usaspending.gov/trends?trendreport=default&viewreport=yes&&carryfilters=on&tab=Graph%20View&tab=List%20View&Go_x=21&&formFields=&&tab=List%20View&fiscal_year=2010&carryfilters=on), [http://www.usaspending.gov/trends?trendreport=default&viewreport=yes&&carryfilters=on&tab=Graph%20View&tab=List%20View&Go\\_x=21&&formFields=&&tab=List%20View&fiscal\\_year=2010&carryfilters=on](http://www.usaspending.gov/trends?trendreport=default&viewreport=yes&&carryfilters=on&tab=Graph%20View&tab=List%20View&Go_x=21&&formFields=&&tab=List%20View&fiscal_year=2010&carryfilters=on), (last visited Jan. 11, 2010). Federal contracting spending rose from \$223.1 billion in 2001 to \$541.3 billion in 2008.

However, even once a more appropriate balance between federal employment and outsourcing is restored, the federally contracted workforce will undoubtedly remain large. Federal contracting for goods and services today totals more than \$500 billion.<sup>2</sup> Because the government does not collect data on federal contract workers, estimates of the number of workers employed by federal contractors vary widely. The Economic Policy Institute (EPI) has conservatively estimated that between 2000 and 2006, the number of federal contract workers increased from 1.4 million to 2 million, representing 43 percent of all government employees.<sup>3</sup>

By all indications, a substantial and increasing number of jobs with federal contractors are substandard, paying low wages and providing limited benefits. According to an EPI analysis, nearly 20 percent of all federal contract workers in 2006 earned less than the then federal poverty rate of \$9.91 per hour, and fully 40 percent earned less than a more realistic living wage standard.<sup>4</sup> Moreover, many of these workers do not receive employer-provided health benefits.<sup>5</sup>

The significant growth of federal contracting in low-wage industries over the past eight years contributes to this problem. For example, the Center for American Progress found that spending on federal contracts in four major low-wage industries – utilities and housekeeping, property maintenance and repair, clothing and apparel, and food preparation – nearly doubled between 2000 and 2007.<sup>6</sup>

Similarly, because the federal contracting system does not provide for rigorous screening of potential contractors, federal agencies continue to award contracts to firms that are significant or repeat violators of

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2. *Id.*

3. Kathryn Edwards & Kai Fillion, *Outsourcing Poverty: Federal Contracting Pushes Down Wages and Benefits*, Issue Brief # 250 (Economic Policy Institute, Washington D.C.), Feb. 11, 2009, at 1, available at [http://epi.3cdn.net/10d36747ba0e683ef9\\_hwm6bxwn1.pdf](http://epi.3cdn.net/10d36747ba0e683ef9_hwm6bxwn1.pdf).

4. Economic Policy Inst., Analysis of Federal Contractor Employee Wage Levels (unpublished, on file with the author and the National Employment Law Project). The federal poverty guidelines are widely recognized to be unrealistically low. Therefore, EPI's analysis also calculated the percentage of federally contracted workers who earned less than the Lower Living Standard Income Level (LLSIL), a more realistic income threshold. The LLSIL is an official federal government measure, determined annually by the Secretary of Labor, used to determine income eligibility for training and other programs under the Workforce Investment Act of 1998 (WIA). 29 U.S.C. § 2801(25)(B). The LLSIL varies by geographical region and is generally recognized as an improvement over the federal poverty guidelines, since it uses a "basic family budget" approach for determining income needs. WORKING FOR AMERICA INST., SELF-SUFFICIENCY AND GOOD JOBS, available at <http://www.workingforamerica.org/actionbriefs/word-docs/SelfBrief.doc>. EPI's analysis used the 2006 LLSIL figure for the non-metro South region of the country, which was \$28,750 per year, or \$14.38 per hour assuming a 2,000 hour work year. U.S. Dep't of Labor Employment & Training Admin., Lower Living Standard Income Level (for a family of four persons) by Region (2006), available at <http://www.doleta.gov/lisil/2006/2006table1-2.cfm>.

5. Edwards & Fillion, *supra* note 3, at 3.

6. DAVID MADLAND & MICHAEL PAARLBERG, CTR. FOR AM. PROGRESS ACTION FUND, MAKING CONTRACTING WORK FOR THE UNITED STATES: GOVERNMENT SPENDING MUST LEAD TO GOOD JOBS 4 (2008), available at [http://www.americanprogressaction.org/issues/2008/pdf/contracting\\_reform.pdf](http://www.americanprogressaction.org/issues/2008/pdf/contracting_reform.pdf).

workplace, tax, and other laws. Firms that had repeated violations of labor, employment, and tax laws, and that had overbilled taxpayers for their work, were awarded new federal contracts despite long histories of noncompliance.<sup>7</sup>

## *2. Federal Contractors Providing Substandard Jobs Impose Significant Public Costs on Taxpayers and Undermine the Quality of Services Received by Government Agencies*

When federal contractors provide poverty wages and limited benefits, it imposes significant costs on taxpayers because their employees must rely on public benefits and income supports to make ends meet. Additionally, studies of government contracting show that employers that pay good wages and comply with workplace, tax, and other laws frequently offer quality and reliability advantages over those that do not. But the contract pricing and evaluation process currently used by federal agencies ignores these costs and benefits, thus distorting the selection process.

Recent studies have documented the substantial costs that substandard employment practices impose on the public. These studies measure the direct cost to taxpayers for providing health benefits under Medicaid, the Earned Income Tax Credit, and other benefits and income supports when workers are paid poverty wages and do not receive employer-provided health benefits.

For example, a University of California study found that \$10.1 billion of the \$21.2 billion that federal and state taxpayers spent in 2002 on public assistance programs in California went to families of low-wage workers.<sup>8</sup> The \$10.1 billion included \$3.6 billion in Medicaid costs and \$2.7 billion for the Earned Income Tax Credit.<sup>9</sup> The study's authors estimated that a wage of at least \$14.00 per hour would have reduced the \$10.1 billion cost to \$3.2 billion. Further, employer-provided health benefits for those employees would have reduced the cost by an additional \$2.7 billion.<sup>10</sup> Similar studies have demonstrated corresponding public costs attributable to low-wage employers in New York, Wisconsin and Illinois.<sup>11</sup>

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7. *Id.* at 20.

8. Carol Zabin, Arindrajit Dube & Ken Jacobs, *The Hidden Public Costs of Low-Wage Jobs in California*, in THE STATE OF CALIFORNIA LABOR 3, 13 (2004), available at <http://escholarship.org/uc/item/9hb1k75c>.

9. *Id.*

10. *Id.* at 32.

11. See, e.g., ANNETTE BERNHARDT, ANMOL CHADDHA & SIOBHÁN MCGRATH, NATL. EMP. LAW PROJECT, WHEN WORK DOESN'T PAY: THE PUBLIC COST OF LOW-WAGE JOBS IN NEW YORK STATE (2008), available at <http://www.nelp.org/page/-/EJP/PublicCostReport08.pdf?nocdn=1>; LAURA DRESSER, CTR. ON WIS. STRATEGY, WHEN WORK DOESN'T PAY: THE HIDDEN COSTS OF LOW-WAGE JOBS IN WISCONSIN (2006), available at <http://www.cows.org/pdf/tp-low-wage-jobs.pdf>; NIK THEODORE & MARC DOUSSARD, CTR. FOR URBAN ECON. DEV. AT THE UNIV. OF ILL., THE HIDDEN

The federal government pays the bulk of the costs to the taxpayers identified in these analyses through Medicaid and the Earned Income Tax Credit.<sup>12</sup> These hidden public costs to the federal government partially offset the savings that low-wage contractors may appear to offer federal agencies. However, the contract pricing and evaluation systems currently used by federal agencies do not take these indirect costs into account.

Furthermore, a growing body of research demonstrates that in many industries, contractors that provide good wages and benefits and respect workplace laws deliver higher-quality services for government agencies and the taxpayers. For example, as discussed in greater detail below, studies of local living wage policies have found that better-paid workforces typically see decreased employee turnover (with corresponding savings in re-staffing costs), increased productivity, and improvements in the quality and reliability of contracted services for taxpayers.<sup>13</sup> In a leading case study, the San Francisco International Airport saw annual turnover for security screeners plummet from 94.7 percent to 18.7 percent after it instituted a living wage policy. As a result, employers saved about \$4,275 per employee in turnover costs and reported improvements in employee performance, employee morale and customer service.<sup>14</sup>

Within construction contracting, research indicates that high-road contractors that comply with workplace laws and provide quality training, wages, and benefits typically have better skilled and more productive workforces that produce higher-quality work and save taxpayers money. As early as the 1980s, an audit by the U.S. Department of Housing and Urban Development (HUD) of seventeen HUD sites found a “direct correlation between labor law violations and poor quality construction” on HUD projects, and found that the quality defects on these sites contributed to excessive maintenance costs.<sup>15</sup> The HUD Inspector General concluded

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PUBLIC COST OF LOW-WAGE WORK IN ILLINOIS (2006), available at <http://www.urbaneconomy.org/sites/default/files/HiddenPublicCostMain.pdf>.

12. For Medicaid, federal taxpayers pay between 50 and 77 percent of the cost, depending on the state. In the coming years, the federal government’s share of Medicaid costs will be even greater, as it has been temporarily increased during the recession to provide budget relief to the states. See PENNY THOMPSON, HENRY J. KAISER COMM’N. ON MEDICAID AND THE UNINSURED, MEDICAID’S FEDERAL-STATE PARTNERSHIP: ALTERNATIVES FOR IMPROVING FINANCIAL INTEGRITY 3 (2004), available at <http://www.kff.org/medicaid/upload/Medicaid-s-Federal-State-Partnership-Alternatives-for-Improving-Financial-Integrity.pdf>; HENRY J. KAISER COMM’N. ON MEDICAID AND THE UNINSURED, AMERICAN RECOVERY AND REINVESTMENT ACT (ARRA): MEDICAID AND HEALTH CARE PROVISIONS 1 (2009), available at, <http://www.kff.org/medicaid/upload/7872.pdf>.

13. See *infra* p. 477-80.

14. MICHAEL REICH, PETER HALL, & KEN JACOBS, UNIV. OF CAL., BERKELEY INST. OF INDUS. RELATIONS, LIVING WAGES AND ECONOMIC PERFORMANCE: THE SAN FRANCISCO AIRPORT MODEL 10, 58, 60 (2003), available at [http://www.irl.berkeley.edu/research/livingwage/sfo\\_mar03.pdf](http://www.irl.berkeley.edu/research/livingwage/sfo_mar03.pdf).

15. U.S. DEPT. OF HOUSING AND URBAN DEV., OFFICE OF INSPECTOR GEN., AUDIT REPORT ON MONITORING AND ENFORCING LABOR STANDARDS 13 (1983) (on file with the National Employment Law Project), cited in DALE BELMAN & PAULA VOOS, THE INST. FOR WISCONSIN’S FUTURE,

that “[T]his systematic cheating costs the public treasury hundreds of millions of dollars, reducing workers’ earnings, and driving the honest contractor out of business or underground.”<sup>16</sup>

More recently, a survey of New York City construction contractors by New York’s Fiscal Policy Institute found that contractors with workplace law violations were more than five times as likely to have a low performance rating than contractors with no workplace law violations.<sup>17</sup> Other studies have found that construction workers who receive higher wages and quality training are at least 20 percent more productive than less skilled and lower paid workers.<sup>18</sup> Conversely, a study examining the impact of repealing prevailing wage laws in nine states found that the resulting drop in construction worker wages correlated with significant increases in cost overruns and delays on construction projects, and led to a workforce that was less skilled and less productive.<sup>19</sup>

Despite the recognized quality advantages and offsetting savings generated by better-paid workforces, the federal contracting system does not currently provide any systematic way to factor them into the contract pricing and evaluation process. As a result, such firms remain largely ignored, skewing the selection process towards low road contractors.

## *B. The Federal Contracting System Does Not Do Enough to Promote Responsible Contractors That Offer the Best Value*

### *1. The Federal Contracting System Is Intended to Promote Purchasing from Responsible Contractors That Offer the Best Value for the*

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PREVAILING WAGE LAWS IN CONSTRUCTION: THE COSTS OF REPEAL TO WISCONSIN 10 (1995), available at [http://www.faircontracting.org/PDFs/prevailing\\_wage/PrevailingWage%20Laws%20in%20Construction,%20Cost%20of%20Repeal%20to%20Wisconsin.pdf](http://www.faircontracting.org/PDFs/prevailing_wage/PrevailingWage%20Laws%20in%20Construction,%20Cost%20of%20Repeal%20to%20Wisconsin.pdf).

16. *Id.* The HUD Inspector General found that that, “Poor workmanship quality, in our opinion, results from the use of inexperienced or unskilled workers and shortcut construction methods . . . Poor quality work led to excessive maintenance costs and increased risk of defaults and foreclosures . . . .” U.S. DEPT. OF HOUSING AND URBAN DEV., OFFICE OF INSPECTOR

17. MOSHE ADLER, FISCAL POLICY INST., PREQUALIFICATION OF CONTRACTORS: THE IMPORTANCE OF RESPONSIBLE CONTRACTING ON PUBLIC WORKS PROJECTS 5 (2003), available at <http://www.columbia.edu/~ma820/prequalification.doc>.

18. FISCAL POLICY INST., THE ECONOMIC DEVELOPMENT BENEFITS OF PREVAILING WAGE 2 (2006) (citing studies), available at <http://www.fiscalpolicy.org/FPI%20Prevailing%20Wage%20Brief%20May%202006.pdf>; see also HARLEY SHAIKEN, CTR. FOR AM. PROGRESS ACTION FUND, THE HIGH ROAD TO A COMPETITIVE ECONOMY: A LABOR LAW STRATEGY 7-8 (2004) (surveying earlier research finding that unionization, by decreasing turnover and increasing wages, increases productivity), available at <http://www.americanprogress.org/kf/unionpaper.pdf>.

19. Peter Philips, Garth Mangum, Norm Waitzman, & Anne Yeagle, Losing Ground: Lessons from the Repeal of Nine “Little Davis-Bacon” Acts 6-7, (Feb. 1995) (Univ. of Utah Econ. Dept. Working Paper.), available at [http://www.faircontracting.org/PDFs/prevailing\\_wage/losingground.pdf](http://www.faircontracting.org/PDFs/prevailing_wage/losingground.pdf). The study also found that injuries increased by 15 percent, wages fell by 22 percent, and construction training fell by 40 percent where state prevailing wage laws were repealed.

*Government, But It Does Not Do So in Practice*

The federal contracting system currently does little to factor into the contractor selection process the advantages for taxpayers and workers alike of employers that provide good jobs. However, authority to do so already exists under the federal procurement statutes. These statutes are intended to promote purchasing from responsible contractors that offer the best value for the government.

Federal contracting statutes and the Federal Acquisition Regulation (FAR) require that the government do business with “responsible” contractors.<sup>20</sup> Only employers with “a satisfactory record of integrity and business ethics” (among other factors) – a standard that should encompass an employer’s record of compliance with workplace, tax and other laws – may be deemed “responsible.”<sup>21</sup> Contracting agencies have broad authority to take into account a range of other factors in defining responsibility.<sup>22</sup> And for some categories of construction contracts, federal agencies are already authorized to use “prequalification,” a key responsibility approach that, as discussed below, allows agencies to limit competition to a list of approved bidders that have shown they meet certain basic eligibility criteria.<sup>23</sup>

In practice, however, the government does a poor job of ensuring that it does business only with responsible firms. The government has never systematically collected information about prospective contractors’ compliance with workplace, tax, and other laws. Only very general information about the firms that are awarded government contracts is available to the public and there has been no central government database with federal contractor responsibility information. Moreover, as the U.S. Government Accountability Office (GAO) found in 2005, federal agencies do not even have access to accurate listings of contractors that have been previously debarred or suspended making it difficult to ensure that they do not award new contracts to such firms.<sup>24</sup> As a result, the government continues to award billions of dollars in contracts to firms with histories of fraud, workplace violations, and criminal misconduct.<sup>25</sup> A 2009 GAO study reported little improvement, finding that businesses that had been suspended or debarred for “egregious offenses ranging from national

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20. 41 U.S.C. § 403(7) (2006); 48 C.F.R. § 9.103 (2010).

21. 41 U.S.C. § 403(7); 48 C.F.R. § 9.104-1.

22. 48 C.F.R. § 9.104-1.

23. 48 C.F.R. § 236.272 (2010).

24. U.S. GOV’T. ACCOUNTABILITY OFFICE, GAO-05-479, FEDERAL PROCUREMENT: ADDITIONAL DATA REPORTING COULD IMPROVE THE SUSPENSION AND DEBARMENT PROCESS 6 (2005), available at <http://www.gao.gov/new.items/d05479.pdf>.

25. Madland & Paarlberg, *supra* note 6, at 20.



security violations to tax fraud [continued to] improperly receiv[e] federal contracts.”<sup>26</sup>

The National Defense Authorization Act of 2008, which mandated the creation of a federal contractor responsibility database, represents an important first step toward addressing this problem.<sup>27</sup> The legislation authorizing this database requires all contractors awarded federal contracts or grants over \$500,000 to disclose a wide range of past violations – including criminal convictions and findings of liability, as well as past suspensions, debarments, and non-responsibility determinations.<sup>28</sup>

However, this new database, the Federal Awardee Performance and Integrity Information System (FAPIIS),<sup>29</sup> needs significant improvements in order to provide federal agencies with all of the information they will need to institute more rigorous contractor responsibility review. First, the database should be expanded to include all violations of federal statutes, especially those relating to the workplace, and to include pending litigation and settlements. Second, the government should act quickly to make this database public so that taxpayers and stakeholders can scrutinize the compliance histories of firms receiving taxpayer funds and submit information about violations that contractors have erroneously failed to disclose.<sup>30</sup> Third, the database should include information on the performance of contractors on federally-assisted state contracts, which the authorizing legislation instructs the government to do “to the maximum extent practicable.”<sup>31</sup> As the government taskforce that recommended the creation of the database noted, contractor fraud, law-breaking and non-responsibility is of equal concern for state and local governments, as “[m]obility permits fraudulent contractors and service providers to move

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26. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-174, EXCLUDED PARTIES LIST SYSTEM: SUSPENDED AND DEBARRED BUSINESSES AND INDIVIDUALS IMPROPERLY RECEIVE FEDERAL FUNDS 1 (2009), available at <http://www.gao.gov/new.items/d09174.pdf>.

27. Pub. L. 110-417 § 872, 122 Stat. 4356 (2008); see also PROJECT ON GOVERNMENT OVERSIGHT, MYTHS ABOUT A FEDERAL CONTRACTOR RESPONSIBILITY DATABASE (2008), available at <http://pogoarchives.org/m/co/fcmd/database-myths.pdf>.

28. Pub. L. No. 110-417 § 872(c).

29. The FAPIIS database is available to federal acquisition professionals at <http://www.ppirs.gov/fapiis.html>.

30. An amendment to a 2010 supplemental appropriations bill, signed into law in August 2010, requires the General Services Administration to make most of the FAPIIS information available to the public. Pub. L. No. 111-212 § 3010 (providing that “the Administrator shall post all such information, excluding past performance reviews, on a publicly available Internet website”). As of January 2011, the website had not yet been developed.

31. Pub. L. No. 110-417 § 872(c)(7), (providing that the “[t]o the maximum extent practical, [the database should include] information similar to [the information required of federal contractors] in connection with the award or performance of a contract or grant with a State government”).

between levels of government and across jurisdictions with little fear of detection.”<sup>32</sup>

Apart from more effective responsibility screening of contractors with poor records of legal compliance, under the federal procurement system, contractor selections are to be based on an evaluation of which contractor would offer the “best value” for the government and the taxpayers.<sup>33</sup> Under these statutes, agencies are instructed to balance bid price with other relevant cost and non-cost factors including business history, staff reliability and expertise, and cost considerations that may not be reflected in the bid.<sup>34</sup> In fact, a 1994 presidential executive order directs agencies to “place more emphasis on past contractor performance, and promote best value rather than simply low cost in selecting sources for supplies and services.”<sup>35</sup>

As part of their best value assessment, agencies may consider quality and reliability factors. These may include bidders’ history of complying with workplace laws, or whether bidders provide wages and benefits sufficient to attract and retain a stable, qualified workforce. And agencies may similarly take into account the indirect and hidden costs resulting from low wages when assessing best value.

Some agencies have begun to do this by including prospective contractors’ compliance with workplace and safety standards as evaluation factors<sup>36</sup> or by recognizing that provision of fringe benefits generally improves staff retention.<sup>37</sup> However, agencies have not broadly or systematically included such considerations in the evaluation process. Nor have agencies established systems to facilitate efficient gathering and evaluation of such information by procurement staff. As a result, many agencies’ contracting decisions are still based chiefly on price. And especially in labor intensive, low-wage industries, low price closely correlates with low wages and benefits for employees.

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32. NAT’L PROCUREMENT TASKFORCE LEGISLATION COMM., PROCUREMENT FRAUD: LEGISLATIVE AND REGULATORY REFORM PROPOSALS 18 (2008), available at <http://pogoarchives.org/m/co/npftflc-white-paper-20080609.pdf>.

33. For example, under the competitive negotiated acquisition procurement approach, agencies are instructed that “[t]he objective of source selection is to select the proposal that represents the best value.” See 48 C.F.R. § 15.302 (2010).

34. 48 C.F.R. § 15.304 (2010); 41 U.S.C. § 253b (2006).

35. Exec. Order No. 12,931 (1994).

36. See, e.g. *Morgan-Keller, Inc.*, B-298076.2, 2006 WL 2136651 (Comp. Gen. Aug. 1, 2006).

37. For example, in *Comprehensive Health Services, Inc.*, B-285048.3, 2001 WL 66633 (Comp. Gen. Jan. 22, 2001), the Department of Veterans Affairs, seeking bidders to provide employee health services, issued a request for proposal where past performance and technical factors combined were worth significantly more than price in the award decision. A protest was filed by an unsuccessful bidder whose price was lower than the successful bidder. In denying the protest, the Comptroller General noted that the protestor’s bid offered fewer fringe benefits, which increased the risk of losing current employees, and found nothing unreasonable in the agency’s insistence on qualified staff.

Because the federal contracting process is meant to prioritize purchasing from responsible vendors that offer best value for the government and taxpayers, new statutory authority is not required to adopt new safeguards to promote these goals more effectively.

## 2. Existing Labor Standards Are Not Enough

Existing federal contracting rules do include important labor standards. But these standards by themselves are not enough to ensure that the advantages offered by contractors that provide quality jobs are factored into the selection process. The current system should be supplemented with responsible contracting reforms to ensure that high road employers receive priority in the federal contracting process.

The Davis-Bacon Act requires payment of prevailing wages and benefits to employees performing construction-related work on federally funded projects.<sup>38</sup> The Service Contract Act requires the same for federally contracted service workers such as janitors, security guards and cafeteria workers.<sup>39</sup> The purpose of these prevailing wage laws is to ensure that federally financed purchasing does not drive down wages and benefits in the private sector.<sup>40</sup> Accordingly, these laws require contractors on federally funded projects to provide wages and benefits that mirror those paid by other employers in their locality and industry, as determined by U.S. Department of Labor (DOL) wage surveys. As a result, the wages and benefits guaranteed under these prevailing wage laws vary widely. In industries that are largely low-wage and in regions of the country where there is little union presence, the prevailing wage can be barely above the current federal minimum wage of \$7.25 per hour – for example, \$8.19 for a laundry worker in Tallahassee, Florida, or \$8.38 for a dishwasher in Dallas, Texas.<sup>41</sup>

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38. 40 U.S.C. § 3142(b) (2006).

39. 41 U.S.C. § 351(a) (2006). A third federal prevailing wage law, the Walsh-Healey Public Contracts Act, provides for payment of prevailing wages to workers employed under federal contracts for the purchase of certain goods. 41 U.S.C. § 35(a) (2006). However, since 1963, when the D.C. Circuit Court of Appeals in *Wirtz v. Baldor Electric Co.*, 337 F.2d 518 (D.C. Cir. 1963) established procedural requirements which blocked U.S. Department of Labor wage determinations under Walsh-Healey, the agency has been unable to implement the act, leaving these workers without meaningful prevailing wage protection.

40. As Solicitor of Labor Charles Donahue testified, “There is the possibility also that under the pressure of bid competition an ordinarily fair contractor may reduce the wages of employees in order to improve the chances that his bid will be accepted. This action, of course, would further depress wage rates. When, as at present, a low bid award policy on service contracts is coupled with a policy of no labor standards protection, the trend may well be in certain areas for wage rates to spiral downward.” *Service Contract Act of 1965: Hearing on H.R. 10238 Before the Special Subcomm. on Labor of the H. Comm. on Education and Labor*, 89th Cong. 5 (1965).

41. U.S. Department of Labor Wage Determinations, <http://www.wdol.gov>. (last visited January 23, 2011). This website provides access to regional wage determinations under the Service Contract Act.

Reforming the DOL's methodology for determining prevailing wages, which was weakened by the Reagan Administration in the early 1980s, can help ensure more adequate wages under federal contracts. But even with such improvements, the prevailing wage laws are just one tool for promoting responsible employment practices on federally funded projects. Because prevailing wage laws mirror local industry standards, they will never consistently guarantee living wages and adequate benefits in all regions and occupations. Moreover, they do not address contractors' records of violating workplace, tax, and other laws. They should therefore be supplemented with responsible contracting reforms to ensure that federal spending creates good jobs for communities and provides quality services for the taxpayers.

### *3. Past Initiatives to Promote Responsible Contracting Were Halted by the Bush Administration*

The federal contracting system's failure to promote purchasing from responsible contractors has been recognized for many years. During the Clinton administration, the Federal Acquisition Regulation Council explored options for more effectively promoting responsible employers in the federal contracting process. Regulations to begin that process by requiring more rigorous responsibility review were published in December of 2000.<sup>42</sup> However, the Bush administration halted those reforms in 2001<sup>43</sup> and took no action in the following years to address the problem. This retreat from reform together with the unprecedented growth in federal contracting during the Bush years has exacerbated the extent to which federal spending supports low-road employers that deliver poor value for the taxpayers and substandard jobs for their workforces.

## III.

### LESSONS FROM THE STATES AND CITIES: RESPONSIBLE CONTRACTING REFORMS DELIVER GOOD JOBS AND QUALITY SERVICES

As the Obama administration undertakes reform of the federal contracting process to improve accountability and results, the experiences of states and cities with responsible contracting policies offer key lessons. Over the past decade or more, state and local governments have developed a range of new responsible contracting policies. The goal of these policies has been to promote public purchasing from employers that create quality

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The website's User Guide, available at <http://www.wdol.gov/usrguide/index.aspx>, provides instructions on how to access specific wage determinations.

42. 65 Fed. Reg. 80,256 (2000).

43. 66 Fed. Reg. 66,986 (2001) (rescinding the December 2000 regulations).

jobs, minimize hidden public costs, and deliver more reliable services to the taxpayers. These successful experiences point the way for federal reform.

Below are highlights of some of the key responsible contracting strategies that cities and states are finding effective in reorienting their public contracting programs to promote high road employment practices and deliver better services for the taxpayers:

**Table: Key State and Local Responsible Contracting Strategies**

Strategy	Description	Advantages for Government and Taxpayers	Advantages for Workers
Responsibility Standards and Review	<p>Screen out repeat violators of workplace, tax and other laws. Specifically:</p> <p>Make responsibility review the first step in the bidder evaluation process, where appropriate through a “prequalification” phase</p> <p>Use a standardized responsibility questionnaire and quantified point system</p> <p>Publish the names of firms seeking to bid or prequalify, in order to allow the public to report relevant information</p>	<p>Higher quality and more reliable services</p> <p>Increased competition among responsible contractors</p> <p>Reduced project delays and costs overruns</p> <p>Reduced monitoring, compliance and litigation costs</p> <p>Stronger incentives for compliance</p>	Better jobs
Living Wages	Favor contractors that pay living wages	<p>Reduced staff turnover and recruitment costs</p> <p>Higher quality and more reliable services</p> <p>A means for factoring the public costs of low wages into contractor selection</p>	Better wages

Health Benefits	Favor contractors that provide quality, affordable health benefits	Reduced staff turnover and recruitment costs Higher quality and more reliable services A means for factoring the public costs of uninsured workers into contractor selection	Quality, affordable health benefits
Paid Sick Days	Favor contractors that provide paid sick days	Reduced staff turnover and recruitment costs Higher quality and more reliable services Savings from reduced on-the-job sickness	Paid sick days Reduced risk of workplace illness
Proper Employee Classification	Certification by contractors that all workers are properly classified and are covered by workers compensation and unemployment insurance	Leveled playing field for all contractors Improved tax compliance resulting in increased state and federal revenue Savings from reducing the ranks of the uninsured	Workers' compensation and unemployment insurance coverage for injured and unemployed workers

### *A. Responsibility Standards and Review*

The most basic contracting reform that cities and states have instituted has been more rigorous review of prospective contractors' history of violations of workplace, tax, and other laws. Like the federal system, most state and local public contracting laws instruct government agencies to purchase only from responsible contractors. But until recently, most public bodies did not have systems for ensuring thorough review of potential contractors' records of legal compliance. The cities and states that have adopted such systems have found that they offer key advantages for the government, workers, and contractors alike.

The move towards more rigorous responsibility screening has reflected a growing recognition that employers with poor compliance records constitute bad business risks that provide unreliable services and present hazards for both workers and taxpayers. An investigation into the construction program of Florida's Miami-Dade County Public School

District is illustrative. Seventy-seven recently-built schools in the county were found to have water leaks, and nearly forty had developed mold and mildew. In at least fourteen cases, county engineers determined that shoddy construction was directly at fault.<sup>44</sup> The district also had to pay more than \$7.8 million to finish abandoned projects even after contractors had been paid in full.<sup>45</sup> An audit found that a key practice contributing to these results was the district's failure to evaluate contractors adequately before they were retained, giving "more than \$228 million in repeat business to at least twenty-one contractors that had delayed jobs, turned in bad work, or failed to finish projects."<sup>46</sup>

Similar experiences can be found in jurisdictions across the country. As noted earlier, a past HUD audit found a direct correlation between workplace law violations and poor construction. And a survey in New York City found that contractors with workplace law violations were more than five times as likely to have a low performance rating than contractors with clean records of workplace law compliance.<sup>47</sup>

In response to these problems, state and local agencies have adopted more rigorous systems for assessing contractor responsibility and screening out firms with poor compliance records. The key components of these reforms have included: (1) making responsibility review the first step in the bidder evaluation process, not the last, often by establishing a preliminary "prequalification" phase; (2) using a model questionnaire and quantified point system for weighing responsibility factors; and (3) requiring disclosure of firms seeking to bid or prequalify to bid, in order to allow the public to provide information relevant to their record of responsibility.

In the past, many public agencies conducted responsibility reviews only as the last step in the contractor selection process, after proposals had been submitted and evaluated, and in some cases, after a presumptive finalist had been chosen. Conducting review at the end discourages rigorous scrutiny. Typically by that point an agency has decided that the finalist is the best candidate and accordingly is reluctant to deem it

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44. MARCOS FELDMAN, RESEARCH INST. ON SOC. AND ECON. POLICY AT FLORIDA INT'L. UNIV., *BEST VALUE IN PUBLICLY FUNDED PROJECTS: CONTRACTOR SELECTION IN TWO COUNTY GOB PROJECTS 6* (2006), available at [http://www.risep-fiu.org/wp-content/uploads/2009/04/best\\_value\\_in\\_publicly\\_funded\\_projects.pdf](http://www.risep-fiu.org/wp-content/uploads/2009/04/best_value_in_publicly_funded_projects.pdf) (citing Debbie Cenziper, *Water Leaks Plague Schools*, MIAMI HERALD, Apr. 13, 2003, at 1B).

45. *Id.* (citing Charles Savage, *State Audit Shreds Dade Schools*, MIAMI HERALD, June 29, 2002, at A1).

46. *Id.* (quoting Cenziper, *supra* note 44). See also WILLIAM O. MONROE, STATE OF FLORIDA AUDITOR GENERAL, OPERATIONAL AUDIT OF CAPITAL CONSTRUCTION ACTIVITIES FOR MIAMI-DADE COUNTY DISTRICT SCHOOL BOARD, JULY 1, 2000 THROUGH APR. 30, 2002, REPORT NO. 03-026 (2002) (recommending that the school district "enhance its contractor prequalification procedures to ensure that appropriate consideration is given to past performance of contractors."), available at [http://www.myflorida.com/audgen/pages/pdf\\_files/03-026.pdf](http://www.myflorida.com/audgen/pages/pdf_files/03-026.pdf).

47. See *supra* note 17.

ineligible. Moreover, the finalist firm will frequently have invested substantial resources in preparing its bid, making it more likely to contest or litigate a finding of irresponsibility. These factors, and the reality that a finding of non-responsibility at the end of the process can result in substantial delay, all serve to discourage rigorous responsibility review.

Making the responsibility evaluation the first step in the process rather than the last removes these disincentives to screen thoroughly. The most common approach that states and cities have used to do this has been establishing a preliminary “prequalification” phase through which firms apply for eligibility to bid on contracts with a public agency. During prequalification, firms are evaluated to determine whether they meet the agency’s responsibility standards before they are placed on its approved bidders list.

Responsibility review is generally based on a variety of factors – including the company’s record of legal compliance, financial stability, experience, and references – that are weighed together in order to evaluate the candidate firm. The best responsible contracting systems use model questionnaires and publicly announced weighting formulas, developed with input from all relevant stakeholders, to put prospective bidders on notice of the process and provide a fair means of evaluating individual firms’ information.

One of the first states to adopt this type of responsible contracting reform was California, which in 1999 began promoting improved responsibility review and prequalification for public works projects contracted by state agencies.<sup>48</sup> The California Department of Industrial Relations (DIR) developed a model questionnaire used by many of the state’s agencies, which inquires into applicant firms’ violations of laws and regulations, history of suspensions and debarments, past contract performance, financial history, and capitalization.<sup>49</sup> Although questionnaire responses and financial statements submitted by contractors are not open to public inspection, the names of contractors applying for prequalification status are a matter of public record, allowing the public to supplement the process by providing relevant information that applicants may have failed to volunteer.

In addition to the questionnaire, California agencies electing to use prequalification are instructed to use a uniform and objective system for rating bidders. This system is typically based on a composite numerical score derived from the candidate’s answers on the questionnaire and its

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48. CAL. PUB. CONT. CODE § 20101 (2004).

49. CAL. DEPT. OF INDUS. RELATIONS, PREQUALIFICATION OF CONTRACTORS SEEKING TO BID ON PUBLIC WORKS PROJECTS: THE 1999 STATE LEGISLATION AND THE MODEL FORMS CREATED BY THE DEPARTMENT OF INDUSTRIAL RELATIONS, *available at* [http://www.dir.ca.gov/od\\_pub/prequal/PubWksPreQualModel.doc](http://www.dir.ca.gov/od_pub/prequal/PubWksPreQualModel.doc).



disclosed financial statements. The DIR provides agencies with a model scoring system, which evaluates potential bidders on a point system and recommends a “passing score.”<sup>50</sup>

For example, a passing score on a bidder’s “compliance with occupational safety and health laws, workers’ compensation and other labor legislation” is 38 points out of a possible score of 53 points. Participation in a state-approved apprenticeship program yields five points, while bidders that do not maintain apprenticeship programs receive zero points. A bidder with four or more Davis-Bacon violations receives zero points, one with three violations receives three points, and one with two or fewer violations receives five points.<sup>51</sup> Thus, the better a bidder’s history of workplace law compliance, the better its prequalification score.

Enhanced contractor responsibility review using a quantified point system and prequalification has become an increasingly common practice in recent years. In 2004, Massachusetts adopted a similar system that requires firms to achieve a threshold prequalification score before they are eligible to bid on public works projects.<sup>52</sup> This prequalification system is mandatory for public works projects over \$10 million, and optional for those between \$100,000 and \$10 million. Points are allocated based on an evaluation of the following prequalification criteria: management experience (50 points); references (30 points); and capacity to complete (20 points).<sup>53</sup> Management experience includes consideration of the firm’s safety record, past legal proceedings (including compliance with workplace, tax, and other laws), past terminations, and compliance with equal employment opportunity goals.<sup>54</sup> To prequalify, contractors must first satisfy certain mandatory requirements. Contractors must then receive a score of at least half of the available points in each category, and receive at least 70 points overall.<sup>55</sup>

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50. *Id.*

51. *Id.* at 30. This scoring formula applies for bidders with gross revenues less than \$50 million. For those with gross revenues above \$50 million, a bidder with up to four Davis-Bacon violations may still receive five points.

52. MASS. GEN. LAWS ch. 149, § 44D 3 (2008); 810 MASS. CODE REGS. §§ 9.00-911 (2005).

53. 810 MASS. CODE REGS. § 9.05(4) (2005) (listing prequalification criteria and subfactors); COMMONWEALTH OF MASS. EXEC. OFFICE FOR ADMIN. AND FIN. DIV. OF CAPITAL ASSET MGMT., APPLICATION FOR PRIME/GENERAL CONTRACTOR CERTIFICATE OF ELIGIBILITY 35, available at [http://www.mass.gov/Eoaf/docs/dcam/dlforms/certification/prime\\_general\\_contractor\\_application\\_1\\_20\\_09.doc](http://www.mass.gov/Eoaf/docs/dcam/dlforms/certification/prime_general_contractor_application_1_20_09.doc) (asking prequalification candidates to disclose whether, within the past five years, they have been involved in litigation relating to “a violation of any state or federal law regulating hours of labor, unemployment compensation, minimum wages, prevailing wages, overtime pay, equal pay, child labor or workers’ compensation”), [http://www.mass.gov/Eoaf/docs/dcam/dlforms/certification/prime\\_general\\_contractor\\_application\\_1\\_20\\_09.doc](http://www.mass.gov/Eoaf/docs/dcam/dlforms/certification/prime_general_contractor_application_1_20_09.doc).

54. 810 MASS. CODE REGS. § 9.05(4)(b)1 (2005)

55. 810 MASS. CODE REGS. § 9.08(9) (2005).

Connecticut also adopted improved responsibility review in 2004 with the implementation of a prequalification system for bidders on public works projects larger than \$500,000.<sup>56</sup> Connecticut's system evaluates prospective bidders based on their integrity, work history, experience, financial condition, and record of legal compliance.<sup>57</sup> The Illinois Department of Transportation uses a similar system to evaluate prospective bidders' capacity to perform the contract based on a range of factors that includes past compliance with labor and equal employment opportunity laws.<sup>58</sup> And the Ohio School Facilities Commission has adopted model responsibility criteria that local school boards are encouraged to use for school construction contracting. The policy requires certifications by contractors that they meet certain minimum workplace standards and have not been penalized or debarred for minimum wage or prevailing wage law violations.<sup>59</sup>

The same approach has increasingly been used at the municipal level. The city of Oregon, Ohio, for example, requires potential bidders to disclose past legal violations or litigation, especially concerning workplace laws, as part of prequalifying to bid on municipal public works projects.<sup>60</sup> Los Angeles adopted a comprehensive "responsible contractor policy" in 2000. Like the state policies discussed, it directs city agencies to review potential bidders' history of labor, employment, environmental, and workplace safety violations,<sup>61</sup> and uses a detailed questionnaire asking bidders to disclose and explain past and pending litigation, past contract suspensions, and outstanding judgments.<sup>62</sup> Full transparency is a key feature of the Los Angeles policy, which makes bidders' responses to the questionnaire subject to public review.<sup>63</sup>

As Russell Strazzella, a chief construction inspector for the Los Angeles Bureau of Contract Administration, explained:

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56. CONN. GEN. STAT. ANN. §§ 4a-100(c)(5), (f) (2003).

57. *Id.*; see also CONN. GEN. STAT. ANN. §§ 31-57a, 31-57b (2003); *Contractor Prequalification FAQ's*, STATE OF CONN. DEPT. OF ADMIN. SVCS. (2010), available at [http://www.das.state.ct.us/Business\\_Svs/PreQual/Prequal\\_FAQ.asp](http://www.das.state.ct.us/Business_Svs/PreQual/Prequal_FAQ.asp).

58. ILL. ADMIN. CODE tit. 44, § 650.240 (2006).

59. OHIO SCH. FACILITIES COMM'N., RESOLUTION 07-98, ATTACHMENT A, available at <http://www.osfc.state.oh.us/LinkClick.aspx?fileticket=DnuI5vfrOdk%3d&tabid=146>.

60. OREGON, OHIO MUN. CODE ch. 180, § 180.01 (2002), available at <http://www.oregonohio.org/images/stories/docs/engineering/bestbidcriteriacode.pdf>.

61. LOS ANGELES, CAL., ADMIN. CODE ch. 1, div. 10, art. 14, §§ 10.40-10.40.9 (2000), available at <http://bca.lacity.org/site/pdf/cro/CRO%20Contractor%20Responsibility%20Ordinance.pdf>.

62. CITY OF LOS ANGELES, CONSTRUCTION CONTRACTOR RESPONSIBILITY QUESTIONNAIRE (2008), available at <http://bca.lacity.org/site/pdf/cro/CROQ%20Construction.pdf>; CITY OF LOS ANGELES, SERVICES CONTRACTOR RESPONSIBILITY QUESTIONNAIRE, available at <http://bca.lacity.org/site/pdf/cro/CROQ%20Service.pdf>.

63. LOS ANGELES, CAL., ADMIN. CODE ch. 1, div. 10, art. 14, § 10.40(c) (2000), available at <http://bca.lacity.org/site/pdf/cro/CRO%20Contractor%20Responsibility%20Ordinance.pdf>.

[Front end responsibility screening] is more effective and more beneficial to the public than a reactionary system. When you get a bad contractor on the back end, they've already done the damage, and then it's a costly process of kicking them out. On the other hand, if you have a very strong prequalification system that can be vigorously enforced and a uniform system of rating bidders that is published – so everyone knows where they stand before they compete – then you get a level playing field and a pool of good contractors.

As a result of these reforms, the combination of improved responsibility screening and prequalification have come to be viewed in the public contracting field as a best practice and a key management strategy. As Daniel McMillan and Erich Luschei wrote in *Construction Lawyer*:

Public owners in numerous states now view prequalification as a useful, if not essential, element to ensure successful completion of construction projects. Public officials today often point to newly adopted prequalification programs to assure the public that problems encountered on prior projects will not be repeated, including problems of poor workmanship, delays, and cost overruns.<sup>64</sup>

In fact, many contractors themselves prefer prequalification, and procurement professionals have found that it can improve competition by encouraging a greater number of qualified bidders to submit proposals. According to Carol Isen, Director of Labor Relations for the San Francisco Public Utilities Commission's Infrastructure Division, enacting a prequalification requirement for that agency was partly a response to concerns voiced by the construction industry. "In order to encourage bidders possessing the requisite experience to spend the resources necessary to prepare bids for a large public works construction project," she explained, "eliminating the prospect of irresponsible low bids from contractors whose qualifications to perform the work have not been examined by the owner is paramount."<sup>65</sup>

### B. Living Wages

Another major focus of local and state responsible contracting policy has been promoting public purchasing from firms that pay their employees a living wage. State and local governments have recognized that high road employers that pay living wages not only create the types of good jobs that communities need, but also have more stable workforces that deliver better results for the taxpayers and minimize the hidden public costs of low wages. As described in this section, studies of the effects of local living

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64. Daniel D. McMillan and Erich R. Luschei, *Prequalification of Contractors by State and Local Agencies*, CONSTR. LAWYER, Spring 2007, at 21, 22.

65. Email from Carol Isen, Director of Labor Relations for the San Francisco Public Utilities Commission, to author (Mar. 10, 2009, 16:25 EST) (on file with the National Employment Law Project).

wage policies have confirmed these results, finding that higher wages have led to decreased employee turnover and increased productivity, improving the quality and reliability of contracted services.<sup>66</sup>

More than 140 cities and one state, Maryland, have adopted living wage laws for their contracting programs over the past fifteen years.<sup>67</sup> Such laws generally mandate a wage floor above the state or federal minimum wage for businesses that receive contracts – and in some cases, economic development subsidies – from state or local governments.

Typically the wage floor is based on the hourly wage that a full-time worker would need to support her family at some multiple of the Federal Poverty Guidelines. Representative of this approach is St. Louis, which defines its living wage as 130 percent of the Federal Poverty Guidelines for a family of three,<sup>68</sup> translating to \$14.57 per hour as of 2009.<sup>69</sup>

A central policy goal for cities and states in adopting living wage standards for procurement has been ensuring that taxpayer dollars create better quality jobs for communities. But governments have also found that living wage benchmarks have improved the contracting process by both reducing the hidden public costs of the procurement system and shifting purchasing towards more reliable high road contractors.

For example, when Maryland became the first state to enact a living wage law for service contractors in 2007, it did so partly to respond to the rising costs for taxpayers resulting from low-wage jobs in the state and the distorting effect those costs were having on the state's procurement system. "Before the passage of the living wage law, we effectively had a policy of subsidizing low-road employers. This distorted the state's contracting and budgeting processes," explained Maryland Delegate Tom Hucker, the measure's sponsor. "Now under the living wage system, contract bids and prices more accurately reflect the true price to taxpayers of the services being purchased."

In addition to reducing the hidden costs of low-wage employment, municipalities have found that shifting their purchasing to living wage contractors has often improved the quality and reliability of contracted services. A substantial body of research demonstrates that higher wages

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66. See *infra* notes 67-83 and accompanying text.

67. Local and state living wage laws have sometimes been enacted to supplement existing state prevailing wage laws. Living wage laws sometimes fill in gaps in coverage under prevailing wage laws, or establish a more adequate minimum wage floor in occupations where the prevailing wage is very low. For a list of state prevailing wage laws, see *Dollar Threshold Amount for Contract Coverage*, UNITED STATES DEPT. OF LABOR WAGE AND HOUR DIV. (December 2009), <http://www.dol.gov/whd/state/dollar.htm>.

68. ST. LOUIS, MO. ORDINANCE NO. 65597 §3(B) (2002), available at <http://www.mwdbe.org/livingwage/LivWageOrd.pdf>.

69. CITY OF ST. LOUIS, LIVING WAGE ADJUSTMENT BULLETIN (2009), available at <http://www.mwdbe.org/livingwage/LvgWgAdjustment09.pdf>.

substantially reduce employee turnover, yielding a more stable workforce and reducing new employee recruitment and training costs.

For example, the San Francisco International Airport found that annual turnover among security screeners fell from 94.7 percent to 18.7 percent when their hourly wage rose from \$6.45 to \$10.00 an hour under a living wage policy.<sup>70</sup> With each new hire costing approximately \$4,275, the reduced turnover saved airport employers a total of \$6.6 million each year in re-staffing costs, a savings that offset a substantial portion of the higher wages.<sup>71</sup> Similarly, a study of home care workers in San Francisco found that turnover fell by 57 percent following implementation of a living wage policy.<sup>72</sup> And a study of the Los Angeles living wage law found that staff turnover rates at firms affected by the law averaged 17 percent lower than at firms that were not,<sup>73</sup> and that the decrease in turnover offset 16 percent of the cost of the higher wages.<sup>74</sup>

The savings for contractors, and ultimately for the taxpayers, from reduced turnover can be significant. A widely cited study conservatively estimates that cost of refilling a position averages about 25 percent of the employee's annual compensation.<sup>75</sup>

Research on the effects of living wage policies has also found that they generally improve worker performance, productivity and morale. For example, 35 percent of San Francisco International Airport employers affected by the living wage policy reported improvements in their employees' work performance, 47 percent reported better employee morale, 44 percent reported fewer disciplinary issues, and 45 percent reported that customer service had improved.<sup>76</sup> In each case, only a very small percentage reported any worsening of these factors.<sup>77</sup> In Boston, firms

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70. REICH, HALL & JACOBS, *supra* note 14, at 10.

71. *Id.* at 10, 58.

72. Candace Howes, *Living Wages and the Retention of Homecare Workers in San Francisco*, 44 INDUSTRIAL RELATIONS, 139, 140 (2005).

73. DAVID FAIRRISS, DAVID RUNSTEN, CAROLINA BRIONES & JESSICA GOODHEART, LOS ANGELES ALLIANCE FOR A NEW ECONOMY, EXAMINING THE EVIDENCE: THE IMPACT OF THE LOS ANGELES LIVING WAGE ORDINANCE ON WORKERS AND BUSINESSES 106 (2005), available at [http://irle.ucla.edu/research/pdfs/LivingWage\\_fullreport.pdf](http://irle.ucla.edu/research/pdfs/LivingWage_fullreport.pdf).

74. *Id.* at 109.

75. EMPLOYMENT POLICY FOUNDATION, EMPLOYEE TURNOVER: A CRITICAL HUMAN RESOURCE BENCHMARK (2002), cited in DORIE SEAVEY, INST. FOR THE FUTURE OF AGING SVCS., THE COST OF FRONTLINE TURNOVER IN LONG-TERM CARE 9 (2004), available at <http://www.bjbc.org/content/docs/tocostreport.pdf>; VICKY LOVELL, INST. FOR WOMEN'S POLICY RESEARCH, VALUING GOOD HEALTH: AN ESTIMATE OF COSTS AND SAVINGS FOR THE HEALTHY FAMILIES ACT 9 (2005), available at <http://www.iwpr.org/pdf/B248.pdf>.

76. REICH, HALL & JACOBS, *supra* note 14, at 60.

77. *Id.*

affected by the city's living wage policy also reported improved morale and increased work effort among their employees.<sup>78</sup>

Studies of living wage policies have generally shown only a modest impact on costs, if any. In Baltimore, which passed the first living wage ordinance in the country in 1994, researchers compared pre and post-living wage contracts and found that contract costs for the city rose just 1.2 percent, which was lower than the rate of inflation.<sup>79</sup> And a survey of 20 cities that had passed living wage ordinances found that in most municipalities, contract costs increased by less than one-tenth of 1 percent of the overall city operating budget.<sup>80</sup>

Finally, by increasing the ability of firms that pay their workers more than the minimum wage to compete for public service contracts, living wage laws can make the procurement process more competitive overall. In a 2008 assessment of Maryland's living wage law after its first year in operation, almost half of bidders interviewed reported that the living wage requirement encouraged them to bid on state contracts because it meant that contractors that paid very low wages would not automatically be able to underbid them.<sup>81</sup> Maryland found that the number of bidders for state service contracts increased from an average of 3.7 bidders to 4.7 bidders once its living wage policy took effect.<sup>82</sup> As one current contractor explained, "I would rather our employees work with a good wage. If a living wage is not mandated, the bids are a race to the bottom. That's not the relationship that we want to have with our employees. [The living wage] puts all bidders on the same footing."<sup>83</sup>

### C. Health Benefits

Responsible contracting reforms at the city and state level can also mitigate the public strain caused by employers that do not provide health benefits. Many localities have found that contractors that do not provide quality, affordable health benefits to their workforces impose a substantial burden on the public health care system, as their uninsured workers turn to

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78. MARK D. BRENNER & STEPHANIE LUCE, UNIV. OF MASS. POLITICAL ECON. RESEARCH INST., *LIVING WAGE LAWS IN PRACTICE: THE BOSTON, NEW HAVEN AND HARTFORD EXPERIENCES* (2005), available at [http://www.peri.umass.edu/fileadmin/pdf/research\\_brief/RR8.pdf](http://www.peri.umass.edu/fileadmin/pdf/research_brief/RR8.pdf).

79. Christopher Niedt, Gret Ruiters, Dana Wise & Erica Schoenberger, *The Effects of the Living Wage in Baltimore 5* (Economic Policy Institute, Working Paper No. 119, 1999), available at [http://epi.3cdn.net/63b7cb4cbcf2f33b2d\\_w9m6bnks7.pdf](http://epi.3cdn.net/63b7cb4cbcf2f33b2d_w9m6bnks7.pdf).

80. ANDREW J. ELMORE, BRENNAN CTR. FOR JUSTICE, *LIVING WAGE LAWS & COMMUNITIES: SMARTER ECONOMIC DEVELOPMENT, LOWER THAN EXPECTED COSTS 2-4* (2003), available at [http://nelp.3cdn.net/4fdbdbf70be73ca80f\\_6tm6b5suw.pdf](http://nelp.3cdn.net/4fdbdbf70be73ca80f_6tm6b5suw.pdf).

81. DEPARTMENT OF LEGISLATIVE SERVICES, *IMPACT OF THE MARYLAND LIVING WAGE 10* (Dec. 2008), available at <http://www.chamberactionnetwork.com/documents/LivingWage.pdf>.

82. *Id.*

83. *Id.*

emergency rooms and the Medicaid program for care. To address this problem, a growing number of cities and states have reformed their contracting systems to account for these public costs during the contract pricing and award process.

These reforms have taken a variety of approaches. El Paso, Texas gives contractors that provide their employees with health benefits a preference in the contracting process by making provision of health care a positive evaluation factor – along with price, reputation, technical qualifications, and past performance – that is weighed by city agencies in making their contract award decisions.

Former El Paso Mayor Raymond Caballero, who instituted the policy, reports that while the price of bids that the city receives from contractors that provide health benefits may tend to be a little higher, the net impact on the taxpayer is about the same because of offsetting public health care system savings.<sup>84</sup> Houston and San Francisco have used a related approach for addressing the indirect public costs of contractors' health care practices. They require contractors to either provide health benefits to their employees, or pay into a fund to offset the cost of services for uninsured workers. San Francisco's Health Care Accountability Ordinance (HCAO), which has been in effect since 2001, requires city service contractors to either provide health benefits to their employees or make payments of \$2.00 per employee per hour worked to the city, which then appropriates the money to the Department of Public Health (DPH) in order to partially offset the costs of services for uninsured workers.<sup>85</sup> As of December 2008, the DPH had collected nearly \$2.5 million to offset such costs from contractors that did not provide health coverage.<sup>86</sup> Similarly, under Houston's "Pay or Play" (POP) program, contractors must offer health care benefits to covered employees ("play") or contribute \$1.00 per hour worked by these employees to offset the costs of providing health care to uninsured Houston

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84. Telephone Interview with Raymond Caballero, former mayor, City of El Paso September 2008 (on file with the National Employment Law Project). See also Jim Yardley, *A City Struggles to Provide Health Care Pledged by U.S.*, NEW YORK TIMES, Aug. 7, 2001, at A1 (reporting that Mayor Caballero was "pushing to change municipal contracting practices in favor of companies that provide private insurance for their employees"), available at <http://query.nytimes.com/gst/fullpage.html?res=9C06E0D61E3CF934A3575BC0A9679C8B63&sec=&spon=&pagewanted=all>. According to El Paso City Representative Susie Byrd, where an employer is providing health benefits and saving the public health care system money, it is appropriate to factor in those costs into the contracting process by giving those employers a preference in the bidder selection process. Interview with El Paso City Representative Susie Byrd (on file with the National Employment Law Project).

85. SAN FRANCISCO, CAL. ADMIN CODE ch. 12Q §§ 3a, 3c (2006), available at <http://www.municode.com/content/4201/14131/HTML/ch012q.html>. In 2007, San Francisco enacted a related ordinance that effectively broadened this policy beyond city contractors to apply to all larger employers in the city. SAN FRANCISCO, CAL. ADMIN CODE ch. 14, available at <http://www.municode.com/content/4201/14131/HTML/ch014.html>.

86. Analysis by the City of San Francisco Office of Labor Standards Enforcement (on file with the National Employment Law Project).

residents (“pay”). A contractor that decides to “play” must contribute a minimum of \$150 toward the employee’s monthly health benefits premium, and the employee cannot be required to pay more than half of the monthly cost.<sup>87</sup> As explained in Houston Mayor Bill White’s executive order and the city ordinance establishing the POP program, contractors that did not provide health insurance benefits increased the ranks of uninsured Houston residents and contributed to escalating costs facing public health care programs.<sup>88</sup> In response, the POP program aimed to level the playing field for responsible bidders that already provided health benefits to their employees.<sup>89</sup>

Orlando requires bidders seeking construction contracts of \$100,000 or more to provide their workers with health benefits or increase hourly wages by 20 percent.<sup>90</sup> According to Orlando’s public works director, this policy is especially important in times of high unemployment, where employers may be less likely to provide health benefits because the pool of prospective job seekers is large.<sup>91</sup>

Other cities and states have created incentives for contractors to provide health benefits as part of living wage policies. Maryland, for example, under its state living wage law for service contractors, provides a credit towards the required living wage for the prorated hourly value of contractors’ health care contributions.<sup>92</sup>

The Maryland law follows the approach used by most of the more than 140 cities that have enacted municipal living wage laws. These city ordinances typically require contractors that do not provide health benefits to pay their employees an additional hourly wage supplement to help them purchase health insurance. The supplement also ensures that contractors that provide benefits are not placed at a disadvantage.

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87. HOUSTON, TEX. EXEC. ORDER NO. 1-7 (2009), available at <http://www.houstontx.gov/aacc/1-7.pdf>.

88. *Id.*

89. *Id.* (providing that “contractors who do not provide health insurance benefits for their workforce impose a burden on . . . individuals and businesses whose health insurance premiums increase because of shifting costs onto those payers.”). See also HOUSTON AFFIRMATIVE ACTION AND CONTRACT COMPLIANCE DIVISION, PAY OR PLAY PROGRAM: ANNUAL REPORT 1 (2008) (on file with the National Employment Law Project).

90. ORLANDO, FLA. POLICY AND PROCEDURES § 161.3(G)(7)(b) (on file with the National Employment Law Project) (providing that “[t]he Construction Contractor . . . shall provide said workers with health benefits. The Contractor may satisfy this health benefits requirement by providing to the workers on this project either 1) health benefits through a bona fide program or 2) by increasing the hourly wage by 20%. Evidence of the existence of a bona fide health benefits program, satisfactory to the City, must be submitted to the Public Works Department.”).

91. Interview with Alan R. Oyler, Public Works Director for the City of Orlando September 2008 (on file with the National Employment Law Project).

92. Living Wage Frequently Asked Questions, Question 18, MD. DIV. OF LABOR, LICENSING AND REGULATION (2008), <http://www.dlir.state.md.us/labor/prev/livingwagefaqs.shtml#18> (last updated September 27, 2010).



Finally, other states and cities have gone further and categorically mandated that all public contractors provide health benefits to their employees. For example, a 2008 New Mexico executive order instructed state agencies to include in bidding documents a requirement that prospective contractors provide health benefits to their New Mexico employees.<sup>93</sup> The order also requires contractors to maintain a record of the number of employees who have accepted coverage.<sup>94</sup>

Health benefits requirements have become especially common for public construction contracting. Nearly two-dozen Massachusetts cities and towns have adopted such health benefits requirements as conditions for prequalifying to bid on city construction projects.<sup>95</sup>

#### D. Paid Sick Days

Local governments have increasingly recognized that employers that provide their employees with paid sick days enjoy more stable and productive workforces. In response, they have begun to adopt new policies to encourage employers to do so – both within the public contracting process and more broadly.

When employers do not provide paid days off when their employees are ill, employees must choose between going to work sick or losing a day of pay, something many low-wage workers cannot afford. Many inevitably go to work sick, spreading illness to others and hurting productivity.

The first sick days requirements at the local level were enacted as part of living wage laws, many of which require businesses performing city contracts to provide their employees a specified minimum number of paid sick days – often together with paid holidays and vacation days.<sup>96</sup> More

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93. N.M. Exec. Order 2007-049 (2007), available at [http://www.generalservices.state.nm.us/spd/eo\\_2007\\_049.pdf](http://www.generalservices.state.nm.us/spd/eo_2007_049.pdf).

94. *Id.*

95. FOUNDATION FOR FAIR CONTRACTING OF MASSACHUSETTS, COMPENDIUM OF CITIES AND TOWNS IN MASSACHUSETTS WITH “RESPONSIBLE EMPLOYER” ORDINANCES (July 23, 2008) (on file with the National Employment Law Project). Examples of responsible contractor and prequalification laws from across the nation, some of which include health benefits requirements, have been compiled by the National Alliance for Fair Contracting. NATIONAL ALLIANCE FOR FAIR CONTRACTING, INC., STATE BY STATE LISTING OF RESPONSIBLE BIDDER/PREQUALIFICATION ORDINANCES, <http://www.faircontracting.org/f.html> (last visited December 22, 2010).

96. See, e.g. SAN DIEGO, CAL., MUN. CODE § 22.4220(c) (mandating ten paid sick, vacation, and/or personal leave days, and another ten unpaid leave days for illness or to care for an ill family member), available at <http://docs.sandiego.gov/municode/MuniCodeChapter02/Ch02Art02Division42.pdf>; OAKLAND, CAL., MUN. CODE ch. 2.28.030B (mandating twelve paid sick, vacation, and or personal leave days and another ten unpaid leave days for illness or to care for an ill family member), available at [http://library.municode.com/HTML/16308/level2/T2\\_C2.28.html#T2\\_C2.28\\_2.28.030](http://library.municode.com/HTML/16308/level2/T2_C2.28.html#T2_C2.28_2.28.030); NASSAU COUNTY, N.Y MISCELLANEOUS LAWS tit. 57 § 3(b) (mandating twelve paid days off for sick leave, vacation, and/or personal necessity), available at [http://www.nassaucountyny.gov/agencies/Comptroller/LivingWage/Amended\\_Living\\_Wage\\_Law.pdf](http://www.nassaucountyny.gov/agencies/Comptroller/LivingWage/Amended_Living_Wage_Law.pdf).

recently, cities such as San Francisco and Washington, D.C. have gone further by requiring that most or all employers provide these protections.<sup>97</sup>

As with other high road employment practices, evidence suggests that providing paid sick days helps employers retain a motivated and skilled workforce and reduces hidden public costs. Analyses have found that the modest costs of paid sick days are more than compensated for by the savings from increased productivity, reduced turnover, and reduced public health costs. For example, a report by the Institute of Women's Policy Research estimating the likely costs and savings from a proposed federal paid sick leave law projected a net savings of at least \$8 billion to employers and taxpayers as a result of reduced turnover, higher productivity and cost savings to the public health care system.<sup>98</sup> As Donna Levitt, manager of San Francisco's Office of Labor Standards Enforcement explained, "[w]e found that requiring city contractors to provide paid time off that employees may use when they are sick results in a healthier, more stable and more productive workforce."<sup>99</sup>

#### *E. Proper Employee Classification*

A significant workplace abuse that has become a special focus of state and local responsible contracting policies is the problem of employers illegally "misclassifying" their workers as independent contractors – a problem that has become widespread both in the construction field and in low-wage industries. While the chief responses to this problem extend far beyond public contracting, protection against misclassification can and should be a part of responsible contracting reform as well, since misclassification can distort the public contracting process.<sup>100</sup>

Under employment laws, workers in construction and low-wage industries seldom qualify to be treated as independent contractors. Many employers nonetheless attempt to treat their workers as independent contractors in order to evade payroll taxes, workers' compensation premiums, and unemployment insurance taxes. Misclassifying employees

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97. S.F., CAL., ADMIN. CODE ch. 12W (2006) (San Francisco Paid Sick Leave Ordinance), available at <http://www.municode.com/content/4201/14131/HTML/ch012w.html>; D.C. Accrued Sick and Safe Leave Act, D.C. CODE §§ 32-131.1-.17 (2001).

98. VICKY LOVELL, INSTITUTE FOR WOMEN'S POLICY RESEARCH, VALUING GOOD HEALTH: AN ESTIMATE OF COSTS AND SAVINGS FOR THE HEALTHY FAMILIES ACT 14 (2005), available at <http://www.iwpr.org/pdf/B248.pdf>.

99. Interview with Donna Levitt, Manager of San Francisco's Office of Labor Standards Enforcement March, 2009 (on file with the National Employment Law Project).

100. For a detailed reform agenda for responding to worker misclassification, see NATIONAL EMPLOYMENT LAW PROJECT, REBUILDING A GOOD JOBS ECONOMY: A BLUEPRINT FOR RECOVERY AND REFORM 9-10 (2008), available at [http://www.nelp.org/page/-/Federal/NELP\\_federal\\_agenda.pdf?nocdn=1](http://www.nelp.org/page/-/Federal/NELP_federal_agenda.pdf?nocdn=1); NATIONAL EMPLOYMENT LAW PROJECT, SUMMARY OF INDEPENDENT CONTRACTOR REFORMS (2008), available at [http://nelp.3cdn.net/ed7571b66f5e2cc263\\_fom6bn8pp.pdf](http://nelp.3cdn.net/ed7571b66f5e2cc263_fom6bn8pp.pdf).

as independent contractors also allows employers to evade workplace law obligations and sidestep offering employer-provided health insurance. According to a 2000 study commissioned by the U.S. Department of Labor, as many as 30 percent of firms illegally misclassify their employees as independent contractors.<sup>101</sup>

In addition to harming workers, independent contractor misclassification costs the federal and state governments billions each year in lost revenue. For example, the Fiscal Policy Institute estimated that independent contractor misclassification in New York results in an annual loss of \$500 million to \$1 billion in evaded workers' compensation premiums.<sup>102</sup> In Illinois, it is estimated that the state lost \$53.7 million in unemployment insurance taxes, \$149 million in income taxes, and \$97.9 million in workers' compensation premiums in 2005 alone as a result of independent contractor misclassification.<sup>103</sup>

Independent contractor misclassification has serious potential to distort the contracting process, since employers that engage in this misclassification enjoy a substantial and illegal cost advantage over law-abiding employers. To respond to this problem, many municipal level responsible contracting laws now require review of contractors' records of worker classification, both during the performance of the contract and in the initial determination of a bidder's eligibility to receive municipal contracts. Representative of this approach are ordinances in Worcester and Somerville, Massachusetts, which require contractors to certify weekly that they are properly classifying their workers as employees and are complying with all workers compensation and unemployment tax laws.<sup>104</sup> Under these ordinances, contractors that fail to comply face sanctions that include liquidated damages and removal from the project until compliance is obtained. Contractors with three or more violations are permanently barred from receiving municipal contracts.<sup>105</sup>

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101. EMPLOYMENT AND TRAINING DIVISION, U.S. DEPT. OF LABOR, PREPARED BY PLANMATICS, INC., INDEPENDENT CONTRACTORS: PREVALENCE AND IMPLICATIONS FOR UNEMPLOYMENT INSURANCE PROGRAMS iii (2000), available at <http://wdr.doleta.gov/owsdrr/00-5/00-5.pdf>.

102. FISCAL POLICY INST., NEW YORK STATE WORKERS' COMPENSATION: HOW BIG IS THE COVERAGE SHORTFALL? 2 (2007), available at [http://www.fiscalpolicy.org/publications2007/FPI\\_WorkersCompShortfall\\_WithAddendum.pdf](http://www.fiscalpolicy.org/publications2007/FPI_WorkersCompShortfall_WithAddendum.pdf).

103. MICHAEL KELSAY, JAMES STURGEON & KELLY PINKHAM, ECON. DEPT., UNIV. OF MO.-KANSAS CITY, THE ECONOMIC COSTS OF EMPLOYEE MISCLASSIFICATION IN THE STATE OF ILLINOIS 6-7, 18, 20 (2006), available at [http://www.faircontracting.org/PDFs/independant\\_contractor\\_abuse/Illinois\\_Misclassification\\_Study.pdf](http://www.faircontracting.org/PDFs/independant_contractor_abuse/Illinois_Misclassification_Study.pdf).

104. SOMERVILLE, MASS. CODE OF ORDINANCES ch. 2, § 2-355 (2008), available at [http://library.municode.com/HTML/11580/level4/PII\\_C2\\_AVIII\\_D1.html#PII\\_C2\\_AVIII\\_D1\\_s2-355](http://library.municode.com/HTML/11580/level4/PII_C2_AVIII_D1.html#PII_C2_AVIII_D1_s2-355); WORCESTER, MASS. REV. ORDINANCES ch. 2, § 35 (2008), available at <http://www.worcesterma.gov/e-services/document-center/city-clerk/revised-ordinances-2008-1.pdf>.

105. *Id.*

By screening out employers that engage in misclassification, these responsible contracting policies strengthen incentives for complying with the law, minimize the hidden public costs such as lost tax revenue that result from misclassification, and prevent law abiding employers from being unfairly undercut in the bidding process.

#### IV.

#### CONCLUSION AND RECOMMENDATIONS

The variety of responsible contracting strategies implemented by cities and states provide a roadmap for how federal procurement can and should be reformed. Cities and states have found that rewarding employers that invest in their workforces with quality jobs not only benefits communities, but can also reduce hidden public costs and deliver more reliable contract services for the taxpayers.

Drawing on these best practices, the federal government should adopt responsible contracting reforms as it modernizes the federal contracting system. Specifically, the government should make serious law-breakers ineligible for federal contracts and establish a preference for employers that provide good jobs. To do this, the government should:

1. Institute more rigorous responsibility screening of prospective bidders to ensure that federal contracts are not awarded to employers that are significant or repeat violators of workplace, tax, or other laws. This enhanced screening should incorporate:
  - Front end review of prospective bidders before bids are evaluated – the approach that has been found more reliable than review conducted later in the selection process. Where appropriate, such front end review should take the form of prequalification, which states and cities have found to be especially effective and is preferred by many responsible contractors.
  - Disclosure of names of companies undergoing responsibility review in order to allow the public to provide relevant information about firms' compliance records.
  - Review of prospective bidders' records of misclassifying employees as independent contractors.
2. Establish a preference in the contractor selection process for employers that provide good jobs. A preference provides a way to factor into contractor selection the benefits these employers afford not just America's workers, but also the taxpayers through reduced hidden public costs and performance improvements associated with high road employment practices. Specifically,

preference should be given in the contractor selection process to employers that:

- Pay a living wage to their employees.
  - Provide quality, affordable health benefits to their employees and their families.
  - Provide paid sick days to their employees.
3. Improve the newly authorized national contractor misconduct database mandated by the 2008 National Defense Authorization Act so that it can be a more powerful tool for responsible contracting. Specifically, the administration should:
- Expand the database to include all violations of federal statutes, especially those relating to the workplace, and to include pending litigation and settlements.
  - Expand the database to cover contractor misconduct reported by state and municipal agencies, including misconduct on federally assisted contracts and grants.
  - Make the database transparent by allowing public access.
4. Strengthen monitoring and enforcement of contractors' compliance with existing and new workplace standards through:
- Expanded hiring and training of contracting officers and staff within the U.S. Department of Labor's Wage and Hour Division and Office of Federal Contract Compliance Programs.
  - Reporting of contractor and subcontractor wages and benefits.
  - Targeted enforcement focusing on industries and regions known for pervasive violations of prevailing wage and other laws.
  - Improved monitoring of existing contracts.
  - Greater use of the suspension and debarment process to screen out unqualified contractors.

The vast majority of these reforms would not require new legislation. They can and should be implemented under the federal procurement system's mandate that agencies purchase from responsible contractors that offer the best value for the government.

By drawing on these best practices that have proven effective in states and cities, the federal government can deliver improved accountability and results for the taxpayers, while promoting the quality jobs that communities need.

