HOW TO REDUCE MARYLAND’S PENSION LIABILITIES AND ATTRACT TOP TALENT TO MARYLAND’S PUBLIC SECTOR

BY CAROL PARK

EXECUTIVE SUMMARY

The Maryland State Retirement and Pension System—the state’s largest pension fund, covering a number of different employment categories but not teachers or law enforcement—reported an unfunded actuarial accrued liability of $19.7 billion as of June 30, 2017. This means that even if the state were to continue its current level of pension funding, the Fund will be nearly $20 billion short of covering its expected obligation to current state workers. This reflects a 166 percent increase in unfunded liability since June 30, 2006, when the Fund reported a net accrued liability of just $7.4 billion.

Overall benefit costs for a typical Maryland state employee have risen dramatically in the last 12 years. As of FY 2017, the pension retirement benefit cost
made up 32 percent of that cost, the single largest component. (See Figure 1). Maryland's state contribution for pensions was $2,561 per employee in FY 2006. In FY 2017, it became $11,192 per employee. Despite the reduction in the number of state employees in the State Personnel Management System (SPMS), Maryland's total contribution rose from $112.42 million in FY 2006 compared with $436.83 million in FY 2017. And yet Maryland continues to fall behind in its promised obligation. A new policy is needed that will treat state employees fairly while protecting state taxpayers.

To shed light on how to restructure Maryland's state employee benefits, the Maryland Public Policy Institute studied the recent trends and characteristics of Maryland's public sector employees. Based on these findings, the Maryland Public Policy Institute concludes that Maryland's pension benefit system is out of date and has failed to attract new talent to the public sector. This report recommends restructuring Maryland's public-sector employee benefits to reduce pension cost and accommodate the changing demands of the new generation. This report offers a list of non-traditional benefits that Maryland government should consider embracing to replace pension benefits.

**MARYLAND'S UNFUNDED PENSION LIABILITY**

Maryland’s unfunded pension liability has increased over the years. The Maryland State Retirement and Pension System reported an unfunded pension ratio average of 20.58 percent for the period 2006–2008 and 29.35 percent in 2015–2017. As of June 30, 2017, the Fund reported a net accrued liability of $19.7 billion. This is a 166 percent increase over the reported accrued liability of just $7.4 billion on June 30, 2006.

The Maryland Public Policy Institute’s 2018 State Pension Fund Investment Performance Report, released in May, concluded that the Fund’s continuous investment shortfalls are largely responsible for Maryland’s growing pension liability. According to the study, the Fund’s investment had underperformed its peer group median by roughly 1.26 percent per year in the last 10 years.

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**MARYLAND STATE EMPLOYEE BENEFITS**

Another cause of Maryland’s growing unfunded pension liability is that state and local budgets repeatedly short-change pension funds for years, resulting in large un-
funded liabilities that demand rapidly increasing annual contributions to return to healthy levels of funding.1 The Maryland Public Policy Institute studied Maryland’s state employee benefit and pension benefit cost suggest ways to reduce the state’s annual contribution burden. The data were collected from the Maryland Department of Budget and Management’s Annual Personnel reports for the years 2006–2017.

Table 1 summarizes the employee benefit and salary history for a typical state employee of Maryland in the State Personnel Management System. The “total benefit” includes pension, health, social security, worker’s compensation, unemployment, and leave benefits. The “total compensation” refers to average salary plus total benefit cost.

The data show an explosion in benefits for Maryland’s state employees in the last 12 years. In 2006, the total benefit cost for a typical Maryland state employee was $21,021. The total benefit cost reported for FY 2017 was $35,047, which is equivalent to $28,824.56 in 2006 dollars. The total benefit cost for a typical state employee of Maryland, adjusted for the rate of inflation, increased. In the last 12 years, the state’s total benefit expense for the full-time employees of SPMS rose from $922.7 million (43,895 × $21,021) in FY 2006 to $1.37 billion (39,031 × $35,047) in FY 2017.

The increase in cost of employee benefits contributed to higher cost of compensation for each Maryland state employee in the SPMS. Cost of compensation for a typical state employee of Maryland rose from just $65,485 in FY 2006 to $90,227 in FY 2017. This is equivalent to $74,207.58 in 2006 dollars. Adjusted for the rate of inflation, there was a 133 percent increase in total compensation cost over the last 12 years.

The state’s contributions to the Fund for pensions have risen over the years, despite the reduction in the number of full-time employees in the SPMS. In FY 2006, Maryland’s contribution for pension benefits was just $2,561 per employee, or $112.42 million total. In 2017, the state’s contribution for pension benefits rose to $11,192 per employee, or $436.83 million in total. Adjusted for the rate of inflation, this is equivalent to a 220 percent increase in the state’s annual pension contribution in the last 12 years. (Recall, this total amount reflects the total pension cost

### Table 1: Historical Average Cost Per State Employee of Maryland

<table>
<thead>
<tr>
<th>Year</th>
<th>Average salary</th>
<th>Pension Retirement Costs</th>
<th>Total Benefit Cost Inflation-Adjusted</th>
<th>Total Benefit Cost (Actual)</th>
<th>Total Compensation</th>
<th>Pension Costs as % of Salary</th>
<th>Total Benefit Cost as % of Salary</th>
<th>Total Benefit as % of Total Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>44,464</td>
<td>2,561</td>
<td>21,021</td>
<td>21,021</td>
<td>65,485</td>
<td>5.76%</td>
<td>47.28%</td>
<td>12.18%</td>
</tr>
<tr>
<td>2007</td>
<td>46,080</td>
<td>3,147</td>
<td>21,382</td>
<td>21,991</td>
<td>68,071</td>
<td>6.83%</td>
<td>47.72%</td>
<td>14.31%</td>
</tr>
<tr>
<td>2008</td>
<td>47,450</td>
<td>4,394</td>
<td>22,694</td>
<td>24,237</td>
<td>71,687</td>
<td>9.26%</td>
<td>51.08%</td>
<td>18.13%</td>
</tr>
<tr>
<td>2009</td>
<td>48,530</td>
<td>4,556</td>
<td>23,609</td>
<td>25,124</td>
<td>73,654</td>
<td>9.39%</td>
<td>51.77%</td>
<td>18.13%</td>
</tr>
<tr>
<td>2010</td>
<td>48,057</td>
<td>4,541</td>
<td>23,436</td>
<td>25,349</td>
<td>73,406</td>
<td>9.45%</td>
<td>52.75%</td>
<td>17.91%</td>
</tr>
<tr>
<td>2011</td>
<td>47,934</td>
<td>6,099</td>
<td>24,049</td>
<td>26,833</td>
<td>74,767</td>
<td>12.72%</td>
<td>55.98%</td>
<td>22.73%</td>
</tr>
<tr>
<td>2012</td>
<td>48,770</td>
<td>6,282</td>
<td>23,738</td>
<td>27,034</td>
<td>75,804</td>
<td>12.88%</td>
<td>55.43%</td>
<td>23.24%</td>
</tr>
<tr>
<td>2013</td>
<td>48,829</td>
<td>7,424</td>
<td>24,579</td>
<td>28,402</td>
<td>77,231</td>
<td>15.20%</td>
<td>58.17%</td>
<td>26.14%</td>
</tr>
<tr>
<td>2014</td>
<td>50,700</td>
<td>8,001</td>
<td>26,329</td>
<td>30,918</td>
<td>81,618</td>
<td>17.36%</td>
<td>60.98%</td>
<td>28.47%</td>
</tr>
<tr>
<td>2015</td>
<td>55,182</td>
<td>9,142</td>
<td>27,210</td>
<td>31,990</td>
<td>87,172</td>
<td>16.57%</td>
<td>57.97%</td>
<td>28.58%</td>
</tr>
<tr>
<td>2016</td>
<td>55,180</td>
<td>9,336</td>
<td>27,206</td>
<td>32,389</td>
<td>87,569</td>
<td>16.92%</td>
<td>58.70%</td>
<td>28.82%</td>
</tr>
<tr>
<td>2017</td>
<td>55,180</td>
<td>11,192</td>
<td>28,824</td>
<td>35,047</td>
<td>90,227</td>
<td>20.28%</td>
<td>63.51%</td>
<td>31.93%</td>
</tr>
</tbody>
</table>

Source: Maryland Department of Budget & Management Annual Personnel Report, FY 2006–2017

The average of cost of pension retirement per employee as a percentage of the average Maryland state employee salary and the total benefits cost per employee as a percentage of average Maryland state employee salary have both risen steadily in the last 12 years.
only for SPMS members, not including state Department of Transportation employees, teachers, and so on).

The average of cost of pension retirement per employee as a percentage of the average Maryland state employee salary and the total benefits cost per employee as a percentage of average Maryland state employee salary have both risen steadily in the last 12 years. In other words, the cost of providing state employee benefits, including pension benefits, has risen at a higher rate when compared with the rate of increase in state employee salary. (See Figure 2).

The pension retirement cost as a percentage of total benefit cost has also climbed up over the years, as shown in Figure 3. Since 2006, the percentage has risen from just 12.18 percent to 31.93 percent in 2017, an increase of 162 percent in the last 12 years. In other words, the rising total benefit cost for SPMS members can be largely accounted for by the rising pension retirement cost.

Over the years, various administrations have attempted to reduce Maryland’s state employee benefit costs. For example, the Martin O’Malley administration’s pension reforms of 2011, which sought to bring down benefit costs and increase employee contributions, were steps in the right direction. But further action will be needed to address the system’s growing long-term shortfall.

According to the Maryland Public Policy Institute 2017 report, pension benefits earned by Maryland’s public employees through services already performed enjoy strong legal protections. Prospective changes can, however, be made as long as those changes are “reasonable.” Further, changes can be freely made with respect to participants who have not yet satisfied the minimum service requirement to become entitled to a benefit under the plan.

That report concluded that restructuring state employee benefits—making prospective changes for participants who have not yet satisfied the minimum service requirement—to become entitled to a benefit under the plan.

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<table>
<thead>
<tr>
<th>Age</th>
<th>Years of Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full</td>
<td>Any</td>
</tr>
<tr>
<td>62</td>
<td>5</td>
</tr>
<tr>
<td>63</td>
<td>4</td>
</tr>
<tr>
<td>64</td>
<td>3</td>
</tr>
<tr>
<td>65</td>
<td>2</td>
</tr>
<tr>
<td>Early</td>
<td>55</td>
</tr>
</tbody>
</table>

Source: SRPS CAFR 2017

### CHARACTERISTICS OF MARYLAND’S

<table>
<thead>
<tr>
<th>Company</th>
<th>Innovative Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starbucks</td>
<td>Full tuition reimbursement</td>
</tr>
<tr>
<td>Facebook</td>
<td>Free housing for interns</td>
</tr>
<tr>
<td>Google</td>
<td>Free breakfast, lunch, and dinner</td>
</tr>
<tr>
<td>Netflix</td>
<td>Unlimited parental leave</td>
</tr>
<tr>
<td>Spotify</td>
<td>Egg freezing</td>
</tr>
<tr>
<td>Airbnb</td>
<td>Free vacations</td>
</tr>
<tr>
<td>Microsoft</td>
<td>Free gym membership</td>
</tr>
<tr>
<td>Genetech</td>
<td>Child care center</td>
</tr>
</tbody>
</table>

### STATE EMPLOYEES

Based on additional data collected from the Maryland Department of Budget and Management’s Annual Personnel reports for years 2006–2017, the Maryland Public Policy Institute found that Maryland’s public sector has been aging, albeit slowly. The average age of a state worker has increased from 45 to 47. This trend is unsettling because older employees will soon retire, leaving many jobs vacant. In addition, aging employees will contribute to increasing annual pension costs.

This trend is not unique for Maryland. Across the country, the public sector has struggled to compete with the private sector for talented workers. In a recent survey of more than 70 public sector leaders from 18 states, Accenture found that roughly two-thirds (64 percent) reported that it was difficult to attract and retain talent, but that recruiting young people was especially challenging. Among those with no experience in government work, only 20 percent of young people said they considered the public sector attractive.

As a result, public sector workers are aging; workers under 30 represent 26 percent of the private sector workforce, but they are only 14 percent in state and local government.

According to the 2017 Census Bureau, the median age of government employees is 45.6 compared to the median age of 42.2 in the U.S. workforce as a whole. Note that the av-
Another finding is that Maryland’s public sector workers are becoming more transient. In the last 12 years, just 3.17 percent of state employees had been employed by the state for over 30 years while 36.6 percent of state employees had been employed by the state for only 1–5 years. The average length of employment of Maryland state employees in the last 12 years was 12.6 years. This trend is also not unique for Maryland. A 2016 study by Gallup found that 60 percent of U.S. millennials were open to moving to a new job and more than one-fifth had moved jobs in the past year alone.6

MARYLAND PENSIONS ARE OUT OF DATE
Given the trends observed, the question is how to restructure Maryland’s state employee benefits to attract young workers who tend to switch jobs often, while at the same time reduce employee pension benefit costs to reduce Maryland’s annual contribution.

In Maryland, the current benefit system, which prioritizes traditional pension plans, fails to meet the needs of young workers, and therefore has failed to attract top young talents to Maryland’s state government. As noted above, young people change jobs often. When people are making decisions about their next job, they are not always thinking about pension plans. In Maryland’s current system, employees who want to transition to work outside of state employment are not entitled to the state’s pension unless they’ve worked for the state for at least 30 years. According to the SPRS, “Members are eligible for full service pension allowances upon accumulating 30 years of eligibility service regardless of age.” Without 30 years of eligibility service, one must be above the age 62 with five years of eligibility service, or above the age of 63 with four years of eligible service, and so on to qualify for partial benefits. (See Table 2).7

In the last 12 years, the average state employee of Maryland had only worked for the state for 12.6 years. That means only a small percentage of employees would be eligible to receive the full pension benefits because they have successfully fulfilled the 30-year eligibility service requirement. A typical Maryland state employee would need to work for additional 17.4 years to qualify for full pension benefits, making the state pension irrelevant for most workers. The typical state employee of Maryland would not even qualify for the early benefit at age 55, which still requires at least 15 years of eligible service.

Therefore, it is time to question if state employee retirement benefits should be altered to deliver more flexible benefits that would attract new talent to Maryland’s state jobs and reduce the total benefit cost.

BORROWING IDEAS FROM THE PRIVATE SECTOR EXPERIENCE
While Maryland’s public sector faces an uphill climb in attracting young talent, the private sector across the country has already adopted measures to attract young workers with innovative and non-traditional benefits that the millennials and other young talent actually care about. Private employers have moved away from providing retirement benefits to focus on providing more innovative perks. According to the Pew Research Center, only 6 percent of millennials have a defined benefit pension plan while 9 percent of Generation X and 13 percent of Baby Boomers do. Some 68 percent of millennials do not have any retirement plan at all and appear to value other forms of compensation more.8 These statistics show that benefits continue to evolve.

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Family-friendly policies and career-related benefits have become more popular over the years while pension benefits lost their attractiveness. Table 3 lists some of the most innovative and popular benefits among the millennials offered by contemporary employers. Some or most of these benefits are not necessarily costlier than pension benefits, but are more attractive to young workers.

The Maryland Public Policy Institute considered what benefits private sector employers are offering in Maryland. The largest and most well-known Maryland-based company, Marriott International, provides benefits that are unavailable for state employees, including career-related services and family benefits. For example, Marriott offers its employees career planning, coaching and mentoring, and leadership program benefits. Marriott also offers a child care discount, adoption assistance, and a day care flexible spending account, in addition to commuter benefits and paid volunteer time off. Marriott also offers a tuition reimbursement program that covers up to 25 percent of the costs for team members who want a job-related certification or a degree. All of these perks are clearly geared toward meeting the changing needs of the new generation.

NEW BENEFITS FOR THE NEW GENERATION OF MARYLAND
Given the difference in the types of perks offered, it is no surprise that Maryland’s public sector is aging, despite the dramatically increased spending on state employee benefits in the last 12 years. While expensive pension benefits exist as part of the incentives employers provide
to attract employees to work for them, they have clearly not enticed many young, talented workers to come and work for the state of Maryland. Maryland government has failed to acknowledge that millennials face more immediate financial hurdles they have to clear before they can worry about their retirement. In addition, the new generation values mobility, freedom, and personal control, but the rigidity of Maryland’s pension system is antithetical to those values.

It is therefore time to restructure Maryland’s public sector employee benefits, to not only reduce pension cost, but also to accommodate the changing demands of the new generation. Maryland needs to shift the focus from the distant benefits of pension and retirement to something concrete and accessible for younger employees. The new focus should be on benefits that millennials can achieve in the short-term, not something that will not matter for 30 years.

Maryland government should consider offering the following nontraditional benefits in the coming years. Replacing pensions with a combination of these benefits would lead to cost savings and help Maryland’s public sector become more competitive in attracting top talent.

**Tuition Reimbursement**

According to Deloitte, 71 percent of U.S. employers offer tuition assistance to their employees. Research suggests that these tuition reimbursement programs more than pay for themselves by reducing turnover because the majority of employees who participate in those programs are more likely to stay with their current employer. For instance, health insurer Cigna saved an estimated $1.29 in reduced turnover and recruiting costs for every $1 it spent on tuition reimbursement. Cigna’s plan allows employees to study anywhere they want and covers application, registration, testing, and graduation fees up to $5,250—the maximum per worker for which an employer can claim a federal tax deduction.

Maryland’s public sector should consider supporting its state employees in professional development opportunities by offering job-related tuition assistance at Maryland public universities and colleges. Implementing such programs would not only help attract talented employees who value professional development, but also encourage workers to study in Maryland, rather than move to another state for further education.

**Student Loan Repayment Assistance**

According to the American Student Assistance survey, 86 percent of American students revealed that student debt assistance would be a deciding factor in staying with an employer. Over the years, student loans have increased nationally because the price to attend college, even at state schools, has increased, including in Maryland. In 2007, in-state tuition at the University of Maryland, College Park was $6,566. In 2016, it was $10,180. Correspondingly, Maryland student debt rose 118 percent between 2004 and 2014, or more than four times the rate of inflation.

Maryland government should consider offering student loan repayment assistance to its employees. Although some Maryland state employees are eligible for the Federal Loan Forgiveness Program, one must have already completed 120 monthly payments—10 years—in order to participate. According to the Project on Student Debt, 58 percent of Maryland undergraduates from four-year institutions who graduated in 2014 had debt, and the average total was $27,457. If that debt were to be repaid over five years, it would equate to $530.82 per month, which equals $6,369.84 per year. Because of massive student debts, many graduates in Maryland and across the United States are now living with parents at home and delaying marriage and home ownership. Loan repayment assistance could reshape young Marylanders’ lives by enabling them to plan for the future.

**Child Care Benefits**

In the next 10 years, it is projected that 85 percent of the American workforce will be working parents. Today, the monthly child care bill for two-child households exceeds the cost of rent in most of the country. The national average for at-home care is $28,354 per year, while in-center care is $8,589 per year. Many families are struggling to balance family and work while providing their children with quality care. Employees with inadequate child care are more likely to be late for work, absent, or distracted on the job than parents who are confident about their children’s care.

As companies scramble to adopt parent-friendly benefits to retain employees with children, Maryland should consider extending child care benefits to its state public employees. According to data by the Maryland Family Network’s Child Care Demographics Report of 2017, average child care costs range between $10,965 and $27,075 and the percentage of median income spent on child care range from 16.1 percent to 29.7 percent. Even providing partial child care support would be significant because, unlike pension plans, child care benefits resolve the immediate challenge of working and caring for children.

**Mortgage or Housing Assistance Benefits**

Historically, Americans bought their home in their 30s, but today’s millennials have put off home ownership until later
years because of the student loan repayment burden. In addition, the cost of purchasing a single-family home has risen in relation to incomes, particularly in larger metropolitan areas. Private sector employers have recognized the need to provide their employees with financial assistance to help purchase homes. Increasingly, employers are setting up programs to provide home purchase assistance to their staff, often through their employee benefit plans.

The state of Maryland should consider adopting similar housing or mortgage assistance programs for its public employees. Maryland is one of the top 10 states with the highest average mortgage debt, at $256,744 per household. In addition, Zillow predicts that Maryland’s housing costs will rise by 4.3 percent within the next year. As such, Marylanders would highly value housing purchase assistance, especially young residents who are considering purchasing a house. With the average mortgage debt of $256,744 for Maryland, the average monthly payment for a 30-year mortgage at 4 percent would be around $1,225.74 per month. Even if Maryland government covered 50 percent of that amount, it would only cost $7,354.44 per year.

Flexible Work Hours
Millennials value the ability to work remotely and have control over their schedule. Thirty-five percent of millennials say they value schedule flexibility over pay. As such, leading companies across the country have been using flexible benefit packages as a strategic tool to enhance their attractiveness as employers. In a 2017 survey of 8,000 millennials from 30 countries, 64 percent revealed that their employers have adopted flexible location arrangements, allowing them to work from home, the office, or elsewhere.

Maryland should consider providing these inexpensive perks for its government employees. The standard 9-to-5 workday is not accommodating to Marylanders. In 2017, Baltimore was ranked the 19th most congested city in the county, which means that commuting during standard work hours adds wasted hours to people’s busy schedules.

Overall, benefits that millennials would value the most are not necessarily the ones that cost more. Offering flexible work benefits does not cost much but has the potential to attract talent to Maryland’s public sector. A recent study by the Society for Human Resource Management also found that employees who work from home are actually more productive.

This list is far from comprehensive. It is only a snapshot of the wide range of possible benefits that could be more attractive than pension benefits. The key takeaway from the list is that it is time for Maryland to focus on providing benefits that would accommodate employees’ short-term financial needs, rather than offer something that will not matter for another 30 years to come. Adopting one or a combination of the suggested benefits above would help to attract young talent to state employment.

Although some of these benefits may seem like monetary transfer, offering these benefits would be more efficient and less controversial than paying workers additional money because these benefits are geared towards helping state employees become more productive. The added productivity would ultimately benefit the state as well, and not just the workers, which would lead to a higher return for the same taxpayer dollars invested.

A reduction in current benefit costs, especially pension costs, would not only save taxpayers’ money today, but would also save money in the future through lower unfunded actuarial liabilities.

CONCLUSION
The average state government employee benefit package in Maryland costs $35,047 per year for its 39,031 full time equivalent employees, according to the FY 2017 Annual Personnel Report. This adds up to $1.37 billion for FY 2017 alone. The pension benefit alone cost $436.83 million, or 31.93 percent of the total burden.

If providing pension plans helped successfully attract top talent to join Maryland’s public sector, $437 million would be money well-spent. The problem is that pension benefits are not highly prized by the new generation. Using taxpayers’ money to finance such pension benefits will end up hurting every Marylander, and not just public-sector employees. To move forward, the state’s payroll must be used more efficiently, and not to finance outdated benefits. Adopting a wise combination of the above-recommended non-traditional benefits in place of the traditional pension benefit would be one way to guarantee better use of Marylanders’ tax money while attracting more high-quality state workers.

A reduction in current benefit costs, especially pension costs, would not only save taxpayers’ money today, but would also save money in the future through lower unfunded actuarial liabilities. It is time to restructure Maryland state employee benefits to reduce pension retirement benefits and close the $19.7 billion gap in pension liability. In the coming years, the way to entice the best talent to Maryland’s public sector while reducing the state’s pension liability will be to replace the outdated pension benefits with updated benefits that are highly valued by the new generation.

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ment economics from Yale University and a B.A. in economics from the University of Toronto. Previously, she worked as a policy analyst at the Independent Institute and as a policy analyst at the Reason Foundation. Park’s research has been published by The Washington Post, Forbes, Baltimore Business Journal, The Hill, and many others.


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