Department of Legislative Services

2013 Session

FISCAL AND POLICY NOTE

Senate Bill 290 (Senators Stone and Manno)
Finance

Procurement - Prevailing Wage - Applicability

This bill increases the number of local public works projects that must pay a prevailing wage by lowering from 50% to 25% the share of total project costs that must be paid by the State for the prevailing wage law to apply.

The bill takes effect July 1, 2013.

Fiscal Summary

State Effect: General fund expenditures by the Department of Labor, Licensing, and Regulation (DLLR) increase by $43,700 in FY 2014 to enforce the prevailing wage statute at a larger number of public works project sites. Out-year expenditures reflect annualization and inflation. No effect on total State funding for school construction or other local capital projects, which is established annually in the State's capital budget.

(in dollars)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Revenues	$0	$0	$0	$0	$0
GF Expenditure	43,700	54,400	57,000	59,700	62,600
Net Effect	($43,700)	($54,400)	($57,000)	($59,700)	($62,600)

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

Local Effect: The local share of school construction costs may increase by between 2% and 5% in nine counties that will have to pay prevailing wages under the bill for their school construction projects. Given the inconsistency and inconclusiveness of the empirical research, however, actual effects may vary by project, and in some cases they may be negligible. The cost of other local capital projects that receive between 25% and 50% of project costs from the State may also increase by the same amount. Community college projects are not affected because they are already subject to the prevailing wage. Local revenues may increase slightly from liquidated damages collected under the bill. **This bill may impose a mandate on a unit of local government**.

Small Business Effect: Minimal. Construction contractors that are required to pay prevailing wages generally pass along the higher costs to the governmental entity.

Analysis

Current Law: Public works are structures or works, including a bridge, building, ditch, road, alley, waterwork, or sewage disposal plant, that are constructed for public use or benefit or paid for entirely or in part by public money. Contractors working on eligible public works projects in Maryland must pay their employees the prevailing wage rate. Eligible public works projects are those carried out by:

- the State; or
- a political subdivision, agency, person, or entity for which at least 50% of the project cost is paid for by State funds.

Any public works contract valued at less than $500,000 is not required to pay prevailing wages. The State prevailing wage rate also does not apply to any part of a public works contract funded with federal funds for which the contractor must pay the prevailing wage rate determined by the federal government.

Prevailing wages are wages paid to at least 50% of workers in a given locality who perform the same or similar work on projects that resemble the proposed public works project. If fewer than 50% of workers in a job category earn the same wage, the prevailing wage is the rate paid to at least 40% of those workers. If fewer than 40% receive the same wage rate, the prevailing wage is calculated using a weighted average of local pay rates. The State Commissioner of Labor and Industry is responsible for determining prevailing wages for each public works project and job category, subject to the advice and recommendations of a six-member advisory council appointed by the Governor.

The commissioner has the authority to enforce contractors' compliance with the prevailing wage law. Contractors found to have violated the prevailing wage law must pay restitution to the employees and liquidated damages to the public body in the amount of $20 a day for each laborer who is paid less than the prevailing wage. If an employer fails to comply with an order by the commissioner to pay restitution, either the commissioner or an employee may sue the employer to recover the difference between the prevailing wage and paid wage. The court may order the employer to pay double or triple damages if it finds that the employer withheld wages or fringe benefits willfully and knowingly or with deliberate ignorance or reckless disregard for the law.

The Governor must include at least $385,000 in the budget each year for the Prevailing Wage Unit within DLLR.

The University System of Maryland, Morgan State University, St. Mary's College of Maryland, and the Maryland Stadium Authority are all exempt from the prevailing wage law.

The State pays at least 50% of *eligible* school construction costs in all counties, as shown in **Exhibit 1**. Costs that are ineligible for State funding include, among other things, planning and design fees and movable objects or equipment (*e.g.*, furniture or bookshelves). Since total construction costs are higher than eligible construction costs, the State often pays less than 50% of total school construction costs in eight counties that receive a 50% State match of eligible costs.

Exhibit 1
State Share of Eligible School Construction Costs
Fiscal 2012-2015

County	FY 2012	FY 2013	FY 2014	FY 2015
Allegany	91%	93%	93%	93%
Anne Arundel	50%	50%	50%	50%
Baltimore City	94%	93%	93%	93%
Baltimore	50%	50%	50%	50%
Calvert	61%	56%	56%	56%
Caroline	86%	81%	78%	78%
Carroll	61%	58%	58%	58%
Cecil	75%	70%	69%	69%
Charles	77%	72%	67%	63%
Dorchester	71%	69%	69%	69%
Frederick	72%	67%	62%	60%
Garrett	59%	54%	50%	50%
Harford	59%	63%	63%	63%
Howard	61%	60%	60%	60%
Kent	50%	50%	50%	50%
Montgomery	50%	50%	50%	50%
Prince George's	73%	68%	63%	62%
Queen Anne's	55%	50%	50%	50%
St. Mary's	75%	70%	65%	64%
Somerset	88%	83%	82%	82%
Talbot	50%	50%	50%	50%
Washington	73%	71%	71%	71%
Wicomico	87%	96%	96%	96%
Worcester	50%	50%	50%	50%

Source: Public School Construction Program

Background: The federal Davis-Bacon Act, originally enacted in 1931, requires contractors working on federal public works contracts valued at more than $2,000 to pay their employees the prevailing local wage for their labor class, as determined by the U.S. Secretary of Labor. The general intent of the law, and similar state and local laws, is to stabilize local wage rates by preventing unfair bidding practices and wage competition. Thirty-two states and the District of Columbia currently have prevailing wage laws; since 1979, nine states have repealed their prevailing wage laws.

Maryland adopted a prevailing wage law in 1945 (Chapter 999), but it only applied to road projects in Allegany, Garrett, and Washington counties. In 1969, the statute was amended to include State public works contracts exceeding $500,000. There have been periodic changes to the law and the definition of "prevailing wage." In 1983, the law was broadened to include public works projects in which the State funds 50% or more of the total project costs and 75% or more in the case of public schools. Chapter 208 of 2000 (SB 202) reduced the prevailing wage threshold for public schools from 75% to 50% of construction costs, thereby bringing school construction projects in line with prevailing wage requirements for other public works projects.

The number and value of prevailing wage projects has risen dramatically in just two years. DLLR advises that its prevailing wage unit currently monitors more than 500 projects, compared with 187 in fiscal 2011. The total value of those projects has also increased, from $3.1 billion in fiscal 2011 to more than $4.1 billion currently, which includes projects procured by local governments. In fiscal 2012, the unit investigated 535 project sites for prevailing wage compliance, recovered $755,472 in unpaid wages on behalf of laborers, and collected $218,525 in liquidated damages on behalf of the State and local governments.

Four Maryland jurisdictions – Allegany, Montgomery, and Prince George's counties and Baltimore City – have local prevailing wage laws requiring public works projects in the jurisdiction to pay prevailing wages, including school construction.

State Fiscal Effect: By lowering the State funding threshold for prevailing wage projects from 50% to 25%, the bill increases the number of local public works projects, most notably public school construction projects, that have to pay prevailing wages and are, therefore, subject to prevailing wage monitoring and enforcement by DLLR.

Although many local public works projects receive State funds, most do not reach the 50% State funding threshold that makes them subject to the current prevailing wage law. The most notable exception is public school construction projects in some counties. As noted above, counties with a 50% State match for school construction generally do not have to pay prevailing wages. For fiscal 2014, these eight counties are Anne Arundel, Baltimore, Garrett, Kent, Montgomery, Queen Anne's, Talbot, and Worcester counties, although Montgomery County has a local prevailing wage statute and, therefore, is not affected by the bill. In addition, with a State share of 56% and 58% respectively, some projects in Calvert and Carroll counties may also not qualify for prevailing wages under current law, depending on the distribution of eligible and ineligible costs. By lowering the State funding threshold from 50% to 25%, however, the bill makes school construction contracts in as many as nine counties fall under the prevailing wage statute if their value exceeds $500,000.

Administrative Costs: The prevailing wage unit within DLLR's Division of Labor and Industry enforces employers' compliance with the prevailing wage as well as the State's living wage law. A review of the projects approved for funding to date by the Board of Public Works in fiscal 2014 for the Public School Construction Program reveals that as many as 29 additional school construction projects may become subject to the prevailing wage law and therefore be added to DLLR's oversight workload (in fiscal 2013, the equivalent number was 30). In addition, local capital projects valued at $500,000 or more and that receive between 25% and 50% of total project costs from the State are subject to the prevailing wage law under the bill, whereas under current law they are exempt. The number of such projects varies from year to year, so the Department of Legislative Services (DLS) cannot provide a reliable estimate of how many there are. Together, however, it is reasonable to assume that about 50 prevailing wage projects are added to DLLR's workload each fiscal year.

Given the rapid increase in the number of prevailing wage projects in recent years without additional staff resources, DLLR cannot accommodate any further increase with current staffing levels. Therefore, general fund expenditures by DLLR increase by $43,736 in fiscal 2014, which accounts for a 90-day start-up delay given the bill's July 1, 2013 effective date. This estimate reflects the cost of adding one additional wage and hour investigator to monitor the additional prevailing wage sites. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Position	1
Salary and Fringe Benefits	$38,090
Operating Expenses	5,646
Total FY 2014 State Expenditures	**$43,736**

Future year expenditures reflect a full salary with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

Local Fiscal Effect:

Contract Costs: For this bill and recent prior versions of this and other prevailing wage bills, DLS conducted an extensive review of research on the effect of prevailing wage laws on the cost of public works contracts and found inconsistent results. The primary challenge confronted by all prevailing wage researchers is identifying an appropriate "control group" consisting of projects of similar type, timing, and location that do not pay the prevailing wage. In most jurisdictions that require a prevailing wage, all projects of a specified type and size are subject to it, so there is no natural control group. Some researchers have compared project costs in States or localities before and after they adopted prevailing wage requirements, but their findings are clouded by the difference in time, during which construction costs changed and other factors were not consistent. Therefore, research findings related to the effect of the prevailing wage on project costs are inconsistent and often inconclusive.

Early theoretical studies concluded that higher wages under prevailing wage contracts increase contract costs by between 10% and 30%, but many of those studies were flawed, and their findings could not be replicated. For instance, a frequently cited study of 18 projects by the U.S. General Accounting Office was found to have omitted from its analysis 12 projects in which the prevailing wage was actually lower than the market wage. Empirical studies carried out in the 1990s found much smaller contract cost effects, often in the range of between 2% and 10%, but those studies were hampered by the control group challenge identified above.

Recent empirical data from the Public School Construction Program yields similar results. Local school systems occasionally solicit side-by-side bids with and without prevailing wages to help them decide whether they want to accept the full State match (and, thus, be subject to the prevailing wage) or a lesser State match without being subject to the prevailing wage. Recent bid solicitations for three new or replacement schools in Howard and Washington counties used this approach. Based on the lowest submitted prevailing wage bids, the use of prevailing wages increased the bids by 6.6%, 8.2%, and 8.7%, respectively. Although the sample is not large enough to draw any firm conclusions, it is possible that the gap between market and prevailing wages is lower in more urban areas of the State, where there is greater competition for construction projects.

These empirical findings have been countered over the past 10 years by studies that have found no statistically significant effect of prevailing wages on contract costs. Among the possible reasons cited in these studies for the absence of a cost effect include:

- higher wages are associated with higher productivity, reducing the overall cost of the project;
- contractors may be saving money in other areas, such as using lower-cost supplies and materials; and
- contractors may absorb some of the cost of paying higher prevailing wages in order to remain competitive in government procurement.

One area of the research in which there is a general consensus is that labor costs, including benefits and payroll taxes, represent between 20% and 30% of construction costs. Therefore, a 10% gap between prevailing wages and market wages would increase total contract costs by about 2.5%. That is consistent with the findings of some of the empirical studies that have been conducted, but as noted above, recent studies have failed to find an effect even of that size. Nevertheless, given the empirical evidence that prevailing wages tend to be higher than nonprevailing wages and that labor costs are a significant portion of overall project costs, DLS believes that it is reasonable to expect that the prevailing wage requirement adds between 2% and 5% to the cost of a public works project. Given the inconsistency and inconclusiveness of the empirical research, however, actual effects may vary by project, and in some cases they may be negligible.

Community College Construction Grant Program: The Community College Construction Grant program provides funds to assist local governments in the acquisition of property and in the design, construction, renovation, and equipping of local and regional community college buildings, site improvements, and facilities. The level of State support is based on two criteria: (1) the portion of the project that meets the eligibility requirements for State support; and (2) the State/local cost-sharing formula contained in statute. The State share of capital projects for regional colleges is 75% of project costs, while other community colleges receive between 50% and 70% of project costs, depending on the wealth of the jurisdiction. This means that all community college capital projects are already subject to the State's prevailing wage requirement and, therefore, are not affected by the bill.

Liquidated Damages: The counties with projects that become subject to the prevailing wage statute under the bill also may receive liquidated damages collected by DLLR from contractors who violate the prevailing wage law. Given the small number of projects likely to be affected, DLS expects local revenues from liquidated damages to be minimal.

Additional Information

Prior Introductions: SB 368 of 2012 received a hearing in the Senate Finance Committee, but no further action was taken on the bill.

Cross File: HB 1098 (Delegate Olszewski, *et al.*) - Economic Matters.

Information Source(s): Harford, Montgomery, and Talbot counties; Department of Budget and Management; Department of General Services; Department of Labor, Licensing, and Regulation; Public School Construction Program; Maryland Department of Transportation; University System of Maryland; Department of Legislative Services

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