SB 667

Department of Legislative Services

2013 Session

FISCAL AND POLICY NOTE

Senate Bill 667 (Senator Kittleman, *et al.*)
Finance

Procurement - Prevailing Wage - School Construction

This bill raises the share of a school construction project that must be funded by the State for the prevailing wage law to apply from 50% to 75%.

The bill takes effect July 1, 2013.

Fiscal Summary

State Effect: No effect on total State funding for school construction, which is established annually by the Governor and General Assembly through the capital budget process. However, more school construction projects may be eligible for State funding. No effect on the cost of enforcing compliance with the prevailing wage requirement. No effect on revenues.

Local Effect: No effect in Anne Arundel, Baltimore, Garrett, Kent, Montgomery, Queen Anne's, Talbot, and Worcester counties, whose school construction projects are exempt from the current prevailing wage law (and will remain exempt). Also no effect in Allegany, Prince George's, Somerset, or Wicomico counties or Baltimore City, which either have local prevailing wage statutes or have State shares higher than 75% and, therefore, remain subject to the prevailing wage. The local share of school construction costs in 11 other jurisdictions that may no longer have to pay prevailing wages for school construction projects may decrease by between 2% and 5%; that estimate is based, however, on inconsistent and inconclusive research findings. The actual effects on project costs may vary and, at times, may be negligible.

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: Contractors working on eligible public works projects must pay their employees the prevailing wage rate. Eligible public works projects are those valued at more than $500,000 and 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, including school construction projects.

Public works are structures or work, 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. The State prevailing wage rate does not apply to any part of a public works project 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 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. Regardless of the commissioner's findings, an employee of an eligible public works project who is not paid the prevailing wage may sue the employer to recover the difference between the prevailing wage and paid wage.

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**. The State share of costs is updated every three years. The last update was in 2010 and affects the State share in fiscal 2013 through 2015. 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 jurisdictions that receive a 50% State match of eligible costs. Therefore, almost all school construction projects in jurisdictions with a 50% State match are not required to pay the prevailing wage.

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.

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: The bill does not have a significant effect on the Department of Labor, Licensing, and Regulation's (DLLR) prevailing wage enforcement activities. As shown below, the bill exempts from the prevailing wage law school construction projects in 11 counties that currently are required to pay prevailing wages based on the State share of their construction costs. These 11 counties, however, typically account for a relatively small portion of the total number of school construction projects funded each year. For instance, of the 317 total projects already approved for funding by the Board of Public Works for fiscal 2014, 24 (7.6%) are in the affected counties and meet the $500,000 cost threshold and, therefore, no longer are subject to the prevailing wage statute. DLLR currently has four investigators in its prevailing wage unit monitoring more than 500 projects, an average of 125 projects per inspector. A reduction of about 25 prevailing wage projects, therefore, is not sufficient to warrant any reduction in staff resources. To the extent that staff workloads are somewhat lighter, DLLR may redirect investigative resources to the living wage unit, which has been understaffed since its inception.

For this bill and recent prior versions of this and other prevailing wage bills, the Department of Legislative Services (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.

Any decrease in the cost of local school construction projects, however, has no effect on State funding for the Public School Construction Program, which is established annually by the Governor and General Assembly through the capital budget process. To the extent that some projects cost less, more projects may be eligible for State funding.

Local Fiscal Effect: Raising the cap that determines eligibility for prevailing wages has no effect on the cost of school construction projects in 13 jurisdictions, some of which fall into multiple categories:

- eight jurisdictions have a 50% State share in fiscal 2014 (Anne Arundel, Baltimore, Garrett, Kent, Montgomery, Queen Anne's, Talbot, and Worcester counties), so they are not subject to the State prevailing wage law;
- Allegany and Prince George's counties and Baltimore City (and Montgomery County, already captured above) have local prevailing wage laws, so the cost of school construction projects in those jurisdictions remains unaffected; and
- the State share of school construction in Somerset and Wicomico counties is more than 80%, so it is assumed that most projects in those counties remain subject to the prevailing wage.

That leaves 11 counties whose current State share of eligible costs is between 55% and 80% that likely will no longer have to pay prevailing wages on school construction projects. However, if a contract award is substantially higher than the maximum State cost estimated by the Interagency Committee on School Construction, some school construction projects in jurisdictions with State matches slightly above 50% may not have to pay the prevailing wage under current law. This is because only local funds may be used to cover the project's higher-than-projected costs, and that may drop the State share of total costs below 50%.

For school construction projects that are no longer subject to the prevailing wage statute under the bill, the cost of those projects is estimate to decrease by between 2% and 5%, as explained above. Given the inconsistency and inconclusiveness of the empirical research, however, actual effects may vary by project, and in some cases they may be negligible.

Additional Information

Prior Introductions: SB 712 of 2012 and SB 187 of 2011 each received a hearing from the Senate Finance Committee, but no further action was taken on either bill. SB 462 of 2009 received an unfavorable report from the Senate Finance Committee.

Cross File: None.

Information Source(s): Department of Labor, Licensing, and Regulation; Public School Construction Program; Department of Legislative Services

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Analysis by: Michael C. Rubenstein

Direct Inquiries to:
(410) 946-5510
(301) 970-5510