

Department of Legislative Services  
2013 Session

**FISCAL AND POLICY NOTE**

Senate Bill 878

(Senator Manno)

Finance

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**Procurement - Prevailing Wage Rates for School Construction - Application**

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This bill requires that all school construction projects of \$500,000 or more that receive any State funds pay prevailing wages to contractors.

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**Fiscal Summary**

**State Effect:** No effect on total State funding for school construction or other local capital projects, which is established annually by the Governor and General Assembly through the capital budget process. The Department of Labor, Licensing, and Regulation (DLLR) can handle enforcement responsibilities with existing resources. No effect on revenues.

**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, which may reduce the number of projects funded each year. Given the inconsistency and inconclusiveness of the empirical research, however, actual effects may vary by project, and in some cases they may be negligible. Local revenues may increase minimally from liquidated damages collected under the bill. **This bill imposes 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.

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**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 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-local cost share formula is updated every three years. 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.

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

<b>County</b>	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>	<b>FY 2015</b>
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

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**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:** The bill applies “to the construction of an elementary or secondary school.” Therefore, it is assumed that the bill applies only to the construction of new or replacement schools but not to major or systemic renovations of existing schools. It is further assumed that all such construction projects equal or exceed the \$500,000 threshold for the prevailing wage law to apply. By applying the prevailing wage requirement to all school construction projects that receive State funds, the bill increases the number of local projects that have to pay prevailing wages and are, therefore, subject to prevailing wage monitoring and enforcement by DLLR.

As noted above, counties with a 50% State match for school construction generally do not have to pay prevailing wages. For fiscal 2014 and 2015, these eight counties are Anne Arundel, Baltimore, Garrett, Kent, Montgomery, Queen Anne’s, Talbot, and Worcester counties; however, 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 making all school construction projects subject to the prevailing wage requirement, the bill makes school construction contracts in as many as nine counties fall under the prevailing wage statute if their cost equals or 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 five new and replacement buildings have been approved in the nine affected counties and will, therefore, be added to DLLR's oversight workload in fiscal 2014. Even with the recent increase in its prevailing wage caseload, the Department of Legislative Services (DLS) believes that DLLR can handle that level of increase with existing enforcement resources. To the extent that the number of affected projects is larger, DLLR may require one additional wage and hour investigator to carry out its enforcement responsibilities.

### **Local Fiscal Effect:**

*Contract Costs:* For this bill and recent prior versions of 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.

*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 any increase to local revenues from liquidated damages to be minimal.

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### **Additional Information**

**Prior Introductions:** None.

**Cross File:** None.

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

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