SB 95

Department of Legislative Services

Maryland General Assembly
2021 Session

FISCAL AND POLICY NOTE
Third Reader

Senate Bill 95 (Senator Kramer)
Finance Economic Matters

Public Utilities - Investor-Owned Utilities - Prevailing Wage

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This bill requires investor-owned gas and/or electric utilities to require contractors and subcontractors on specified underground projects to pay their employees at least the applicable prevailing wage rate. The bill applies to projects involving the construction, reconstruction, installation, demolition, restoration, or alteration of any underground gas or electric infrastructure of the company, and any related traffic control activities.

Fiscal Summary

State Effect: The Public Service Commission (PSC) can implement the bill with existing budgeted resources. The bill is not anticipated to materially affect utility rates, although there is likely some upward pressure over time due to increased costs for underground utility projects, as discussed further below.

Local Effect: The bill does not materially affect local government finances or operations.

Small Business Effect: Potential meaningful.

Analysis

Current Law: Contractors and subcontractors working on eligible public works projects in Maryland must pay their employees the prevailing wage rate. "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. "Public work" does not include, unless let to contract, a structure or work whose construction is performed by a public service company under order of PSC, regardless of public supervision or direction or payment wholly or partly from public money.

See the **Appendix – Maryland's Prevailing Wage Law** for additional information, including a discussion of estimated project costs associated with paying the prevailing wage.

State/Local Effect/Small Business Effect: PSC can implement the bill with existing budgeted resources. The Department of Legislative Services (DLS) cannot provide an estimate of the total costs for investor-owned gas and electric utilities to comply with the bill. Ultimately, costs incurred under the bill that are determined to be just and reasonable by PSC may be recovered in future base rates, which are paid by all utility customers, including the State, local governments, and small businesses. The overall effect is mitigated by the bill's limited applicability to only contractors and subcontractors working on underground projects and the nature of utility cost recovery through rate cases.

Based on a review of empirical research – see the prevailing wage law appendix below – DLS believes the costs for the affected projects, going forward, may increase by 2% to 5%, with the potential for variances outside of that range. That *does not mean* that utility rates will likewise increase by 2% to 5%, because rates are also based in large part on the sum total of undepreciated utility infrastructure ("rate base"). In addition, not all utility projects are underground. Therefore, the bill is not anticipated to materially affect utility rates, although there is likely some upward pressure over time due to increased costs for underground utility projects.

Specific to small contractors and subcontractors working on underground utility projects, those small businesses are required to pay at least the applicable prevailing wage rate; prevailing wage rates tend to be higher than nonprevailing wage rates. The effect may be meaningful for particular contractors.

Additional Information

Prior Introductions: HB 1048 of 2020 received a hearing from the House Economic Matters Committee, but no further action was taken. Its cross file, SB 1011, passed second reading in the Senate, but no further action was taken.

Designated Cross File: HB 174 (Delegate Brooks) **-** Economic Matters.

Information Source(s): Public Service Commission; Office of People's Counsel; Maryland Department of Labor; Department of Legislative Services

Fiscal Note History:	First Reader - January 18, 2021
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Appendix – Maryland's Prevailing Wage Law

Contractors and subcontractors working on eligible public works projects in Maryland must pay their employees the prevailing wage rate. "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.

Eligible public works projects are:

- those carried out by the State;
- an elementary or secondary school for which at least 25% of the money used for construction is State money;
- any other public work for which at least 50% of the money used for construction is State money; and
- specified projects in tax increment financing districts if the local governing body approves of the application of prevailing wages.

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 (1) 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 or (2) specified construction projects carried out by public service companies under order of the Public Service Commission.

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 based on annual surveys of contractors and subcontractors working on both public works and private construction projects.

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 or $250 per laborer per day if the employer knew or reasonably should have known of the obligation to pay 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 the Maryland Department of Labor (MDL).

The University System of Maryland (USM), Morgan State University (MSU), St. Mary's College of Maryland, and the Maryland Stadium Authority (MSA) are all exempt from the prevailing wage law. However USM, MSU, and MSA all voluntarily comply with prevailing wage requirements for contracts that exceed the $500,000 threshold.

History of the Prevailing Wage

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 of $500,000 or more. 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 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. Chapters 281 and 282 of 2014 further lowered the State funding threshold for school construction projects to 25% of total construction costs, thereby requiring the vast majority of public school construction projects in the State to pay the prevailing wage, subject to the $500,000 contract value threshold.

The number of prevailing wage projects has risen dramatically in recent years. MDL advises that, during fiscal 2020, its prevailing wage unit monitored 1,091 projects, down slightly from 1,120 projects in fiscal 2019, but significantly up from 496 in fiscal 2014. To accommodate the increase in projects, the number of prevailing wage investigators increased in fiscal 2016 from three to six; there are currently five investigators.

Six Maryland jurisdictions – Allegany, Baltimore, Charles, 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; Montgomery County's prevailing wage ordinance does not apply to school construction projects.

Research on the Effects of Prevailing Wage on Contract Costs

The Department of Legislative Services (DLS) has reviewed research on the effect of prevailing wage laws on the cost of public works contracts and has found inconsistent and/or unreliable 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. Another deficiency in the research is that it almost always relies on project bid prices (*i.e.*, the anticipated cost prior to the beginning of construction) rather than actual final costs. As most construction projects experience change orders or cost overruns affecting their cost, reliance on bid prices negatively affects the validity of the findings. Therefore, research findings related to the effect of the prevailing wage on project costs are inconsistent and often inconclusive. A similar review of research conducted by MDL (at the time, the Department of Labor, Licensing, and Regulation) for the Task Force to Study the Applicability of the Maryland Prevailing Wage Law also concluded that "data limitations create difficulty for researchers on both sides of the issue."

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 then 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 and data quality challenges identified above.

More recent empirical data from several counties 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. Data provided to the Public School Construction Program by Anne Arundel, Carroll, Frederick, Howard, and Washington counties, from 2012 through 2015, shows that the cost differential between bids with and without prevailing wages for 266 individual bids submitted for 26 different school construction and renovation projects averaged 11.7%, with a range from 0% to 49%. As with other research data, these represent bid prices, not actual construction costs. An independent analysis of the Maryland side-by-side bid data concluded that factors other than prevailing wages, including bid timing and the level of competition for the bids, accounted for most of the differences between the prevailing wage and nonprevailing wage bids.

A series of large-scale studies completed about 10 years ago found no statistically significant effect of prevailing wages on contract costs. As with the earlier studies that found a project cost effect, control group and data quality issues may have also affected these studies' findings, but the studies themselves cited the following possible explanations for the absence of a cost effect:

- 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, and which is supported by the U.S. Bureau of Labor Statistics, is that labor costs represent between 20% and 30% of construction costs. Therefore, a 10% gap between prevailing wages and market wages could theoretically increase total contract costs by about 2.5%, and a 40% gap in wages could increase total contract costs by about 10%. That is consistent with the findings of some of the empirical studies that have been conducted, but as noted above, more recent empirical 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, with some projects exhibiting higher cost differences and others experiencing negligible differences.