HB 621

Department of Legislative Services

Maryland General Assembly
2009 Session

FISCAL AND POLICY NOTE

House Bill 621 (Delegate Bates, *et al.*)
Economic Matters

Procurement - Prevailing Wage Rate Law - Repeal

This bill repeals the State's prevailing wage law.

Fiscal Summary

State Effect: General fund expenditures by the Department of Labor, Licensing, and Regulation (DLLR) decrease by $565,100 in FY 2010 to eliminate the prevailing wage enforcement unit. Future year estimates reflect annualization and inflation. Legislative Services cannot reliably estimate the effect on State revenues or on the cost of State construction contracts currently subject to the prevailing wage, given recent turmoil in the construction sector.

(in dollars)	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Revenues	$0	$0	$0	$0	$0
GF Expenditure	(565,100)	(786,600)	(821,200)	(857,300)	(895,100)
Net Effect	$565,100	$786,600	$821,200	$857,300	$895,100

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

Local Effect: No effect in eight counties and Baltimore City, which either fund more than 50% of school construction projects or have local prevailing wage statutes. The local share of school construction costs may decrease by as much as 7% in other jurisdictions, but that estimate is uncertain given recent turmoil in the construction sector.

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.

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 work 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 work 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 work 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 on 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.

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 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.

DLLR advises that each year on average about 90 construction projects throughout the State are subject to the prevailing wage, including those procured by local governments.

Four Maryland jurisdictions – Allegany, Montgomery (beginning in July 2009), 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: Repealing the prevailing wage law reduces expenditures by DLLR to enforce the law. Assessing the short- and long-term effects on the State's construction contract costs have been complicated by the recent downturn in the construction industry.

Administrative Costs: The prevailing wage unit within DLLR's Division of Labor and Industry enforces employers' compliance with the prevailing wage. The Governor's proposed fiscal 2010 budget for the unit includes 11 full-time equivalent regular positions, one contractual position, and a total budget of $753,436. In the absence of additional funding to enforce the State's living wage law, the unit has allotted some staff time to enforcing the living wage but has no other function. Legislative Services assumes that the unit ceases to operate, resulting in a decrease of general fund expenditures by DLLR in fiscal 2010 of $565,077, given the bill's October 1, 2009 effective date. Savings continue to accrue in out-years.

Contract Costs: The effect of prevailing wage laws on the cost of public works contracts has been studied extensively since the 1980s. Early theoretical studies concluded that higher wages under prevailing wage contracts increase contract cost 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%. However, an increasing number of studies carried out in the past 10 years have found no statistically significant effect on contract costs.

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%. As noted above, however, most recent studies have failed to find an effect even of that size. Among the reasons cited in the research for the absence of a cost effect include:

- the gap between prevailing wages and market wages has been closing due to the construction boom in the early and middle part of this decade;
- 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.

Other studies have examined the revenue effects of prevailing wage laws. A recent study in Missouri determined that prevailing wages yielded substantial sales and income tax revenue for the State.

The virtual collapse of the construction sector recently makes speculation about the effects of the prevailing wage on contract costs a perilous endeavor. Although research over the past decade indicates that there may be no measurable effect on contract costs, the conditions that existed when that research was conducted no longer exist. There is no reliable information about the relationship between prevailing and market wages in the current economic environment. An expanding pool of available labor could widen the gap between market and prevailing wages, or it could exert downward pressure on all wages, yielding no gap between the two wage rates.

Local Fiscal Effect: Although many local public works projects receive State funds, most do not reach the 50% State funding threshold that makes them subject to the prevailing wage law. The notable exception is public school construction projects in some counties. However, repealing the State's prevailing wage statute has no effect on the local share of school construction costs in the State's five largest jurisdictions, among others, because of the cost-sharing threshold and local prevailing wage laws.

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. Since total construction

Exhibit 1
State Share of Eligible School Construction Costs
Fiscal 2006-2012

County	FY 2006-2009	FY 2010	FY 2011	FY 2012
Allegany	90%	91%	91%	91%
Anne Arundel	50%	50%	50%	50%
Baltimore City	97%	94%	94%	94%
Baltimore	50%	50%	50%	50%
Calvert	69%	64%	61%	61%
Caroline	89%	86%	86%	86%
Carroll	65%	61%	61%	61%
Cecil	70%	75%	75%	75%
Charles	70%	77%	77%	77%
Dorchester	77%	72%	71%	71%
Frederick	72%	72%	72%	72%
Garrett	70%	65%	60%	59%
Harford	65%	60%	59%	59%
Howard	58%	61%	61%	61%
Kent	50%	50%	50%	50%
Montgomery	50%	50%	50%	50%
Prince George's	69-75%*	73%	73%	73%
Queen Anne's	70%	65%	60%	55%
St. Mary's	72%	75%	75%	75%
Somerset	97%	92%	88%	88%
Talbot	50%	50%	50%	50%
Washington	65%	73%	73%	73%
Wicomico	81%	87%	87%	87%
Worcester	50%	50%	50%	50%

*For fiscal 2006-2008, the State share for Prince George's County is 75% for funding allocated up to $35 million, and 69% for funding allocated in excess of $35 million as required in law. The split share expired in June 2008 and for fiscal 2009 the State share for Prince George's County is 69%.

Source: Public School Construction Program 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. It is assumed, therefore, that the repeal of the prevailing wage has no effect on the cost of school construction projects in the six jurisdictions that have a 50% State share (Anne Arundel, Baltimore, Kent, Montgomery, Talbot, and Worcester counties) because those projects likely are not subject to the prevailing wage law. It also has no effect in Allegany and Prince George's counties and Baltimore City because projects in those jurisdictions are subject to local prevailing wage laws.

Moreover, 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 higher State matches 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 remain subject to the prevailing wage, determining its effect on school construction costs has been complicated by recent dramatic fluctuations in factor costs over the past eight years, including labor rates. Research conducted in 2004 by Dr. Yale Stenzler, former executive director of the State's Public School Construction Program (PSCP), concluded that from fiscal 2001 to 2003, prevailing wage rates increased school construction costs by between 5% and 10%. However, the study coincided with a steep increase in the cost of all construction inputs, including fuel, materials, and labor, and the study was not able to completely isolate the effect of the prevailing wage from that of other inputs on total construction costs.

One strategy for estimating the impact of prevailing wage rates on school construction costs is to compare project bids that provide both prevailing wage and market wage rates. Local school systems occasionally solicit side-by-side bids to help them determine whether they want to accept the full State match (and be subject to the prevailing wage), or a lesser State match without being subject to the prevailing wage. PSCP is aware of a handful of such side-by-side bids procured in fiscal 2008 by Carroll and Frederick counties. The bids show an average cost difference of 7.8% between prevailing wage bids and market wage bids in Carroll County and approximately 6.0% on one project in Frederick County. However, PSCP acknowledges that the sample of bids is not sufficient to draw any firm conclusions, and notes that those bids occurred before the recent downturn in the construction market.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Board of Public Works; 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; Economic Policy Institute; Department of Legislative Services

Fiscal Note History: First Reader - February 22, 2009
ncs/rhh

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