Department of Legislative Services

2011 Session

FISCAL AND POLICY NOTE

Senate Bill 187 (Senator Kittleman)
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, 2011.

Fiscal Summary

State Effect: No effect on total State funding for school construction, which is established annually in the State's capital budget. Given recent turmoil in the construction sector, the Department of Legislative Services (DLS) cannot reliably estimate the bill's effect on the State share of the cost of individual school construction projects that are no longer subject to the prevailing wage. To the extent that the prevailing wage currently increases the cost of those projects that would be exempt under the bill, additional school construction projects may be eligible for State support with available funding.

Local Effect: No effect in Anne Arundel, Baltimore, Garrett, Kent, Queen Anne's, Talbot, and Worcester counties, whose school construction projects are or will be exempt from the prevailing wage law (and will remain exempt). Also no effect in Allegany, Caroline, Montgomery, 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 10 other jurisdictions that may no longer have to pay prevailing wages for school construction projects may decrease by between 5% and 10%, 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. Some small businesses may be more willing to bid on multiple-prime school construction projects if they do not have to comply with prevailing wage monitoring and reporting requirements.

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 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. 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.

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.

The Department of Labor, Licensing, and Regulation (DLLR) advises that it currently oversees 151 prevailing wage projects throughout the State, of which fewer than 10% are school construction projects.

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: Given the small number of school construction projects monitored by DLLR, the reduction in the number of school construction projects subject to the prevailing wage does not lower DLLR's enforcement workload enough to reduce expenditures.

For recent prior versions of this bill, DLS conducted extensive research on the effects of the prevailing wage on construction costs. This research has revealed that the effect of prevailing wage laws on the cost of public works contracts has been studied extensively since the 1980s, with varied results. 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%. 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 increases 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 the past 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.

The virtual collapse of the construction sector recently makes speculation about the effects of the prevailing wage on contract costs difficult. 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: 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. 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. Raising the cap that determines eligibility for prevailing wages has no effect on the cost of school construction projects in 14 jurisdictions, some of which fall into multiple categories:

- eight jurisdictions have a 50% State share (Anne Arundel, Baltimore, Kent, Montgomery, Talbot, and Worcester counties, and Queen Anne’s County reaches 50% in fiscal 2013 and Garrett County in fiscal 2014) and are not (or will not be) subject to the State prevailing wage law;

- Baltimore City and Allegany, Montgomery, and Prince George's counties also 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 four rural counties (Allegany, Caroline, Somerset, and Wicomico counties) and Baltimore City is at least 80%, so it is assumed that at least some projects in those counties remain subject to 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

That leaves 10 counties whose current State share of eligible costs is between 55% and 80% that may be affected by the bill. 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 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 several 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, more recent examples are not available. 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.

DLS advises that the local share of school construction costs may decrease by up to 7.0% in 10 counties that may no longer have to pay prevailing wages, but this estimate is uncertain given recent turmoil in the construction market and lack of consensus among studies of the effect of prevailing wages.

Additional Information

Prior Introductions: SB 462 of 2009 received an unfavorable report from the Senate Finance Committee. SB 27 of 2006 was heard by the Senate Finance Committee, but no further action was taken on the bill.

Cross File: None.

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

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