HB 1092

Department of Legislative Services
Maryland General Assembly
2012 Session

FISCAL AND POLICY NOTE

House Bill 1092 (Delegate Hucker, *et al.*)
Economic Matters

Prevailing Wage Rate - Contract Threshold Amount

This bill lowers the contract value threshold for the application of the State's prevailing wage law from $500,000 to $2,000.

Fiscal Summary

State Effect: General fund expenditures by the Department of Labor, Licensing, and Regulation (DLLR) increase by $250,000 in FY 2013 for enforcement. General fund revenues increase by approximately $296,000 in FY 2013 due to payment of liquidated damages paid by a larger number of contractors subject to the prevailing wage who do not pay the required wages. Out-year estimates reflect full year salaries and penalty payments, the elimination of one-time direct costs, as well as increased compliance with the prevailing wage statute. Given recent turmoil in the construction industry, the Department of Legislative Services (DLS) cannot reliably estimate the effect on the cost of State construction contracts that become subject to the prevailing wage under the bill, but they may increase by between 2% and 10%. Any such impact is not reflected in the table below and results in fewer State projects, especially capital maintenance projects, receiving funding annually rather than an increase in annual capital expenditures.

(in dollars)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
GF Revenue	$296,000	$262,500	$262,500	$262,500	$262,500
GF Expenditure	$250,000	$303,700	$324,100	$339,800	$356,200
Net Effect	$46,000	($41,200)	($61,600)	($77,300)	($93,700)

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

Local Effect: Local government revenues increase by approximately $99,000 in FY 2013 due to payment of liquidated damages by more contractors. Minimal or no effect in the 10 counties (including Baltimore City) that either are not subject to the prevailing wage requirement for school construction projects because they pay more than

50% of project costs or because they have their own prevailing wage statute for local projects. The local share of school construction costs may increase somewhat in the remaining 14 counties, but that estimate is uncertain given recent turmoil in the construction sector. **This bill may impose a mandate on a unit of local government.**

Small Business Effect: Minimal.

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 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. 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 (either the State or the local government that procured the project) 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 commissioner must forward a list of contractors and subcontractors who persistently and willfully violate the prevailing wage statute to the Secretary of State. Individuals on the list are prohibited from entering into a public works contract with a public body for two years.

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:

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 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 its prevailing wage unit currently monitors 248 prevailing wage projects throughout the State, including those procured by local governments. This number is substantially higher than totals reported in recent years, which have tended to be between 110 and 130 projects. In 2011, the unit investigated 199 project sites for prevailing wage compliance and recovered $234,554 in unpaid wages on behalf of laborers.

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 Expenditures:

Enforcement Costs: The bill results in a substantial increase in the number of contracts subject to the prevailing wage. Most large construction projects that involve new buildings or roads, or renovations and additions to existing buildings, easily exceed the $500,000 threshold under current law, so the bill affects primarily projects that involve systemic upgrades (new roofs, windows, or heating and cooling systems) or small-scale road repairs. In addition, some small local projects that receive at least half their funding from the State also become subject to the prevailing wage. The number of affected projects will fluctuate from year to year based on funding available for capital projects and on the nature of the projects that receive funding.

Based on its discussions with State agencies that contract for public works projects, DLLR estimates that approximately 550 additional projects are affected annually. DLS believes this estimate may be somewhat high, especially since future State expenditures on capital projects are likely curtailed as the State approaches its capital debt affordability limits. Nevertheless, DLS acknowledges that several hundred additional projects are likely affected annually.

DLLR's caseload standard for prevailing wage enforcement is 60 projects per investigator; there are currently 4 investigators handling the current caseload of nearly 250 projects. Existing contracts subject to monitoring and enforcement tend to be for large, complex projects that often involve multiple subcontractors and trades and dozens of laborers. By contrast, the projects affected by the bill are smaller, less complex projects with fewer laborers and subcontractors involved. As a result, there will be fewer payroll records to review for each project, and fewer subcontractors to work with. Therefore, DLS believes that, for these new projects alone, the caseload standards can be raised somewhat, to 70 projects per investigator. Assuming 300 new projects subject to prevailing wage enforcement, DLLR requires five new investigators – including an additional supervisor – and additional clerical support.

Therefore, general fund expenditures increase by $250,037 in fiscal 2013, which accounts for the bill's October 1, 2012 effective date. This estimate reflects the cost of hiring four wage and hour investigators, a wage and hour supervisor, and one office clerk to monitor and enforce prevailing wage requirements for approximately 300 additional projects. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	6
Salaries and Fringe Benefits	$221,497
Operating Expenses	28,540
Total FY 2013 State Expenditures	**$250,037**

Future year expenditures reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

Contract Costs: For 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. 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 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 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.

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 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.

In some cases, especially for transportation projects that receive federal funds, the federal prevailing wage requirement may replace the State requirement, yielding little or no savings for those projects.

State Revenues: With the number of projects subject to prevailing wage requirements expected to at least double, revenues from liquidated damages are expected to increase, as well. In the first year, DLS expects that the rate of compliance will be below current levels due to the large number of small contractors who typically do not work on large contracts confronting prevailing wage requirements for the first time. Liquidated damages have averaged just over $350,000 annually over the last three years. Assuming they increase by 150%, liquidated damage payments by contractors increase by approximately $526,500 on an annualized basis in fiscal 2013; due to the bill's October 1, 2012 effective date, the actual increase is approximately $395,000 (75% of the annualized amount). In subsequent years, revenues from liquidated damage payments are expected to decrease as compliance increases, with the rate of compliance reflecting current rates.

DLLR advises that approximately 75% of liquidated damage payments are paid to the State for State-funded projects, and 25% are paid to local public bodies for locally funded projects. Therefore, State general fund revenues increase by an estimated $296,000 in fiscal 2013, and by lesser amounts in the out years as compliance improves.

Local Revenues: Local revenues increase from the payment of liquidated damages to local public bodies. Based on the projections above, local revenues increase by a total of approximately $99,000 in fiscal 2013, across all locally funded projects; revenues decrease in the out-years due to increased levels of compliance by contractors on local projects.

Local Expenditures: 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, lowering the threshold for prevailing wage projects has no effect on the cost of school construction projects 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**. 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 the eight jurisdictions that receive a 50% State match of eligible costs (Anne Arundel, Baltimore, Kent, Montgomery, Queen Anne's, Talbot, and Worcester counties, plus Garrett County beginning in fiscal 2014). It also has little or no effect in Prince George's County and Baltimore City because all projects in Prince George's County and projects valued at more than $5,000 in Baltimore City are already subject to local prevailing wage laws. It is not clear whether the prevailing wage in Allegany County applies to all or just some public works projects.

The number of school construction projects affected by the bill will vary from year to year. A review of school construction projects with a total value of less than $500,000 that might otherwise be affected by the bill found that all but three of the approximately 40 projects that have received funding approval for fiscal 2013 from the Board of Public Works are in jurisdictions that either do not have to pay prevailing wages (because the State share of the total costs is less than 50%) or have local prevailing wage laws already in place.

For school construction projects in the remaining 14 local jurisdictions that become subject to the prevailing wage, determining the effect of requiring payment of prevailing wages on project 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 Interagency Committee on School Construction (IAC), 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. IAC 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, IAC 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.

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

Small Business Effect: A larger number of contractors on State and local public works projects will be subject to prevailing wage requirements. It is assumed that contractors pass along any increase in labor costs to the public body that procures their services. For small contractors, however, the requirement to pay all employees on a public works project the prevailing wage may impose a considerable administrative burden to comply with the requirement, including obtaining wage determinations for each worker and providing bi-weekly payroll records to DLLR.

Additional Comments: The bill may increase the workload of State procurement units by requiring them to issue written solicitations for public works projects valued between $2,000 and $15,000 to comply with prevailing wage requirements. Current State regulations do not require written solicitations for projects valued at less than $15,000.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Baltimore, Garrett, and Montgomery counties; 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; Department of Legislative Services

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