SB 718

Department of Legislative Services

2012 Session

FISCAL AND POLICY NOTE

Senate Bill 718 (Senator Kittleman, *et al.*)

Finance

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 $373,700 in FY 2013, reflecting the downsizing of the prevailing wage enforcement unit, which will be tasked only with enforcing the living wage law. Future year estimates reflect annualization, employee turnover, and inflation. 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 currently subject to the prevailing wage, but they may decrease slightly. Any such impact is not reflected in the table below. No effect on revenues.

(in dollars)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Revenues	$0	$0	$0	$0	$0
GF Expenditure	(373,700)	(508,500)	(511,100)	(516,700)	(522,200)
Net Effect	$373,700	$508,500	$511,100	$516,700	$522,200

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

Local Effect: Minimal or no effect in the 11 counties that either are not currently 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 decrease somewhat 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 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 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.

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 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 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 proposed fiscal 2013 State budget for the unit includes 10 full-time equivalent (FTE) regular positions and a total budget of $653,133. In the absence of additional funding to enforce the State's living wage law, the unit has allotted two full-time investigators to enforcing the living wage. DLS assumes that, with repeal of the prevailing wage law, one wage and hour supervisor and one investigator must be retained to continue monitoring the living wage law and the full-time assistant Attorney General assigned to the unit is reduced to a half-time position. The rest of the prevailing wage unit ceases to function on the bill's October 1, 2012 effective date.

Therefore, general fund expenditures by DLLR decrease in fiscal 2013 by $373,720 to retain two investigators and a 0.5 FTE assistant Attorney General, which accounts for the bill's October 1, 2012 effective date. It is assumed that supervisory and administrative functions for the employees who remain in the unit are transferred to other units within DLLR's Division of Labor and Industry. Savings continue to accrue in the out-years, subject to employee turnover and inflation.

Contract Costs: For recent prior versions of this and 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.

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**. 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. It is assumed, therefore, that the repeal of the prevailing wage has no effect on the cost of school construction projects in the eight jurisdictions that have a 50% State share (Anne Arundel, Baltimore, Kent, Montgomery, Queen Anne's, Talbot, and Worcester counties plus Garrett County beginning in fiscal 2014) because those projects likely are not currently 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 (IAC), 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 larger local share may drop the State share of total costs below 50%.

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

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 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.

Additional Information

Prior Introductions: SB 659 of 2011 received a hearing by the Senate Finance Committee, but no further action was taken. HB 621 of 2009 received an unfavorable report from the House Economic Matters Committee.

Cross File: None.

Information Source(s): Montgomery and Prince George's 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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