

Department of Legislative Services
 Maryland General Assembly
 2016 Session

FISCAL AND POLICY NOTE
 First Reader

House Bill 792 (Delegate McCray, *et al.*)
 Economic Matters

Public Work Contracts - Payroll Reporting Requirements (The Transparency Act of 2016)

This bill requires contractors under a public work contract valued at between \$400,000 and \$500,000 to keep and submit payroll records to the Commissioner of Labor and Industry in accordance with current law applying to contractors that are required to pay the prevailing wage. However, the bill exempts affected contractors from requirements that they certify that they are paying the prevailing wage and abiding by other prevailing wage requirements.

Fiscal Summary

State Effect: General fund expenditures by the Department of Labor, Licensing, and Regulation (DLLR) increase by as much as \$150,000 on a one-time basis in FY 2017 to develop an online payroll submission system for nonprevailing wage payroll submissions. Annual contractual maintenance for the new system increases costs minimally each year, including in FY 2017. Any outreach and enforcement resulting from the bill can likely be carried out with existing resources, as discussed below. Revenues are not materially affected.

(in dollars)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	153,800	5,100	5,100	5,200	5,200
Net Effect	(\$153,800)	(\$5,100)	(\$5,100)	(\$5,200)	(\$5,200)

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

Local Effect: Minimal. Local governments that procure public work contracts valued at between \$400,000 and \$500,000 will have to advise their contractors to submit their payrolls to DLLR, but there is no enforcement role for local governments.

Small Business Effect: Potential meaningful.

Analysis

Current Law: For a complete description of the State's prevailing wage statute, please see the **Appendix – Maryland's Prevailing Wage Law**.

Each contractor required to pay prevailing wage rates must (1) keep payroll records covering work performed directly at the work site; (2) allow the commissioner to inspect the records at any reasonable time and as often as necessary; (3) submit a complete copy of payroll records to the public body and the commissioner for the contractor and subcontractors who perform work at the work site in the form that the commissioner specifies; and (4) include a statement with the submitted payroll records stating they are accurate and that proper wages were paid. In most cases, submission of payroll records is done electronically. Although statute does not specify a deadline for the submission of payroll records, the Code of Maryland Regulations specifies that records must be submitted within 14 days after the end of each payroll period. Contractors are liable to the public body for liquidated damages in the amount of \$10 for each calendar day that they are late.

State Fiscal Effect: Payroll submission by prevailing wage contractors is done through an online submission program developed by DLLR. Although the same system could be used to collect payroll information from nonprevailing wage contractors affected by the bill, DLLR advises that, with the current system, it would not be able to distinguish easily between the two types of payroll submissions for the purpose of reporting and enforcement. Therefore, it must develop a parallel system for nonprevailing wage payroll submissions. With an antiquated information technology (IT) platform, DLLR must contract out most of its IT development work, resulting in a one-time expenditure of as much as \$150,000 to develop a parallel online payroll submission system. DLLR advises that annual contractual maintenance costs for the new system approximate \$5,000, plus inflation, with slightly lower costs in the first year due to the bill's October 1, 2016 effective date.

As there is no need to review payroll records to ensure that contractors are paying the appropriate prevailing wage under the bill, there is a limited enforcement role for DLLR. Although statute grants the Commissioner of Labor and Industry authority to assess liquidated damages for late payroll submissions, DLLR advises that it seldom if ever exercises that authority because it prefers to work with contractors and/or public bodies to ensure timely submissions. The Department of Legislative Services believes that outreach can likely be conducted through State agencies and local governments that contract for public work projects, which can be done with existing resources. However, to the extent that late submissions by nonprevailing wage contractors becomes a chronic issue, DLLR may require one additional wage and hour investigator for outreach and enforcement.

Small Business Effect: Small construction contractors that work on public work contracts valued at between \$400,000 and \$500,000 will have to submit their payroll records electronically to DLLR. For some contractors, this requirement will be a simple administrative task carried out by payroll staff, but for others with limited office staff or who process payrolls manually it could be an administrative burden.

Additional Information

Prior Introductions: None.

Cross File: Although designated as a cross file, SB 914 (Senator McFadden – Finance) is not identical (and has been withdrawn without a hearing).

Information Source(s): Anne Arundel, Dorchester, Garrett, and Montgomery counties; Maryland Association of Counties; Department of General Services; Department of Labor, Licensing, and Regulation; Department of Legislative Services

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min/ljm

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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; and
- any other public work for which at least 50% of the money used for construction is State money.

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. 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 Department of Labor, Licensing, and Regulation (DLLR).

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.

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, making virtually all K-12 school construction projects in the State eligible for payment of prevailing wages, subject to the \$500,000 contract value threshold.

The number of prevailing wage projects has risen dramatically in recent years. DLLR advises that, in calendar 2015, its prevailing wage unit monitored more than 1,500 projects, compared with 187 in fiscal 2011 and 446 in fiscal 2012. To accommodate the increase in projects, the number of prevailing wage investigators increased in fiscal 2016, from three to six, with each having a caseload of about 200 projects at any given time.

Five Maryland jurisdictions – Allegany, 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) regularly reviews 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 DLLR 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 2012-2015 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.

These empirical findings have been countered over the past 10 to 15 years by multiple large-scale studies that have 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 supported by the federal 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.