Economic Impact Statement

Office of Legislative Oversight

Bill 35-21 Prevailing Wage Requirements – Construction Contracts – Amendments

SUMMARY

The Office of Legislative Oversight (OLO) anticipates that enacting Bill 35-21 would have a net positive impact on economic conditions in the County. By expanding the scope of County financed contracts covered under the Prevailing Wage Law and instituting a local hiring requirement to contracts that exceed the prevailing wage threshold, the Bill likely would increase wages and employment for County residents. Importantly, although higher labor costs may result in a net increase in total construction and service costs for County contracts, the County, not private contractors, would bear the additional costs in the form of higher BID prices. In contrast, however, OLO anticipates that the Bill may create barriers to entry for small businesses in County financed construction and service projects.

BACKGROUND

County's Prevailing Wage Law

Patterned after the Federal Davis-Bacon and State of Maryland's prevailing wage laws, the County's Prevailing Wage Law went into effect on July 1, 2009.[1] Prevailing wage laws set minimum wage and benefit rates for construction laborers working on publicly funded projects. The intention of these laws is to prevent nonlocal, low-wage contractors from depressing local wages and to allow contractors to compete on a more level playing field.[2]

Currently, the County's Prevailing Wage Law (hereinafter "PWL") applies to all contracts for County financed construction projects that exceed $500,000. Given the combined BID price and number of business involved in County financed construction projects per year, the County's current PWL covers a significant span of economic activity.

Table 1 presents data from FY19 through FY21 on executed County construction contracts (i.e., projects signed under contract between the County and a prime contractor). The total number of executed projects by prime contractors (i.e., the businesses awarded the project BID by the County) reached as high as eleven in FY20, and the total BID price of the projects when the contract was executed reached almost $40 million in FY21. **Table 2** presents data on all the executed County financed construction contracts that were completed in FY20. The five projects involved a total of 86 sub-contractors (i.e., third-parties that have entered into contracts with a prime contractor on County financed projects), with

[1] Office of Procurement, Prevailing Wage Law, https://www.montgomerycountymd.gov/PRO/dbrc/prevailing-wage-law.html.
[2] Kevin Duncan and Jeffrey Waddoups, "Unintended Consequences of Nevada's Ninety-Percent Prevailing Wage Rule," *Labor Studies Journal* 45:2 (2020): 167.

an average of 17 sub-contractors per project, and the total BID price of the projects was more almost $30 million, with an average BID price of almost $6 million per project.

Table 1. Executed County Financed Construction Contracts

Fiscal Year	Total Number of Executed Projects/ Prime Contractors	Total Number of Bidders	Total BID Amount
FY21	3	21	$39,995,742
FY20	11	53	$36,896,786
FY19	5	14	$6,220,100

Source: Office of Procurement, Montgomery County Government

Table 2. Completed Executed County Financed Construction Contracts in FY20

Total Number of Projects/Prime Contractors	5
Total Number of Bidders	18
Total Number of Sub-Contractors	86
Average Number of Sub-Contractors Per Project	17
Range of Sub-Contractors Across Projects	1 - 63
Total BID Amount	$29,651,080
Total PO Amount[3]	$29,932,607
Average BID Per Project	$5,930,216

Source: Office of Procurement, Montgomery County Government

Bill Description

If enacted, Bill 35-21 would **expand the scope of County financed contracts covered under the PWL** in three ways. First, the Bill would reduce the prevailing wage threshold minimum to contracts from $500,000 to $250,000. Second, the current law applies to County financed construction contracts that cover "the process of building, altering, repairing, improving,

[3] Encumbered $ amount by the department for the project after execution.

or demolishing any structure or building, or other improvements of any kind to any real property."[4] The Bill would expand the PWL to also include service-related contracts, or "routine operation, repair, and service contractors for maintenance of existing structures, buildings, or real property." Third, the Bill would apply the prevailing wage requirements to certain public-private partnerships, excluding affordable housing development projects.[5]

In addition to expanding the scope of the County's PWL, enacting Bill 35-21 would also **institute a local hiring requirement to County financed construction contracts that exceed the prevailing wage threshold**. In particular, the law would require County residents to fill "at least 51% of the new jobs to complete the [C]ounty financed construction contract that exceeds the prevailing wage threshold." However, the County may waive or reduce the local hiring requirement if the County determines that "a good faith effort to comply has been made by the contractor." Finally, contractors would be required to submit quarterly reports to the Department of Procurement.[6]

If enacted, Montgomery County would join DC in having both prevailing wage and local hiring requirements for certain government contracts. See **Table 3**.

Table 3. Government Construction Contracting Rules by Jurisdiction

Jurisdiction	Prevailing Wage Rate	Local Hiring Requirement
DC	Yes	Yes[7]
Fairfax	Ordinance Proposed[8]	No
Montgomery	Yes	Legislation Introduced

INFORMATION SOURCES, METHODOLOGIES, AND ASSUMPTIONS

As previously discussed, the County's current PWL covers a significant span of economic activity. OLO anticipates that enacting Bill 35-21 would have non-negligible impacts on economic conditions in the County by expanding the scope of County financed contracts covered under the PWL and instituting a local hiring requirement to County financed construction contracts that exceed the prevailing wage threshold.

[4] https://codelibrary.amlegal.com/codes/montgomerycounty/latest/montgomeryco_md/0-0-0-5067
[5] Montgomery County Council, Bill 35-21.
[6] Ibid.
[7] https://does.dc.gov/sites/default/files/dc/sites/does/publication/attachments/FIRST%20SOURCE_Construction%20Factsheet.pdf
[8] See https://www.fairfaxcounty.gov/boardofsupervisors/board-supervisors-legislative-committee-meeting-march-16-2021.

Given data and time limitations, however, OLO was unable to use a quantitative methodology to arrive at estimates of the anticipated impacts of the changes to the County's current PWL. Instead, OLO relied on qualitative sources to inform the claims made in subsequent sections of this analysis. In particular, OLO consulted the following sources:

- peer-reviewed research articles on the economic impacts of prevailing wage laws in the United States,
- Council staff analysis of Bill 21-08, which established the County's PWL,
- the fiscal and policy note for House Bill 37, Maryland General Assembly,
- a representative from a non-union construction company, and
- County personnel involved in the implementation in the County's PWL.

Before proceeding, OLO believes it is important to highlight a **scope limitation** with this analysis which arises from the potential for Bill 35-21 to increase total BID prices for County construction and/or service contracts and the negative opportunity costs this outcome would create.

Conventional economic theory implies that increased wage rates would increase costs for construction and service contracts.[9] Consider the following hypothetical scenario in which the "wage differential method" is used to estimate the impact of PWLs on total costs: If the prevailing wage premium exceeds market rates by 10 percent and labor costs on County contracts are 50 percent of total costs, then the prevailing wage standards would increase total costs by 5 percent (10% x 50%). Statistical studies published in peer-reviewed journals, however, have questioned whether conventional economic theory applies in the context of publicly funded construction projects. In general, studies have not found statistically significant evidence of PWLs increasing BID prices for publicly funded construction projects (with the exception of housing projects).[10] To explain why, economists have theorized that prevailing wage laws cause construction companies to replace unskilled workers with skilled workers and capital for labor, which in turn increases productivity and efficiency.[11]

While OLO sees the statistical studies as more reliable than earlier studies that rely on the wage differential method, the current state of the literature nonetheless has limitations. In particular, there is a lack of experimental or quasi-experimental studies that can overcome common sources of bias, namely selection bias and confounding variables, and thus more reliably estimate the *causal effect* of PWLs on BID prices and other outcomes. As noted in the State's analysis of House Bill 34,

> "[t]he 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."[12]

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[9] Lameck Onsarigo, Kevin Duncan and Alan Atalah, "The Effect of Prevailing Wages on Building Costs, BID Competition, and Bidder Behaviour: Evidence from Ohio School Construction," *Construction Management and Economics* 38:10 (2020): 917-933.
[10] Ibid; Kevin Duncan and Russell Ormiston, "What Does the Research Tell Us about Prevailing Wage Laws?," Labor Studies Journal 44:2 (2019): 139-160; and Duncan and Waddoups, "Unintended Consequences of Nevada's Ninety-Percent Prevailing Wage Rule."
[11] Ibid.
[12] https://mgaleg.maryland.gov/2021RS/fnotes/bil_0007/hb0037.pdf

Given the state of research, OLO believes that enacting Bill 35-21 may increase total County construction and service contracts. For one, it is possible that productivity and efficiency gains achieved through labor and capital substitutions may not entirely offset increases in labor costs on County financed construction projects. Second, and more importantly, productivity and efficiency gains would arguably be more difficult to achieve on County *service* contracts. Thus, OLO expects enacting Bill 35-21 to result in a net increase in annual BID prices, which, by definition, would be paid for by the County, not private contractors.

Importantly, a net increase in BID prices for County financed construction projects and/or services may potentially result in forgone construction projects and/or services that otherwise would occur in the absence of enacting Bill 35-21. This outcome would create negative opportunity costs in the form of reduced opportunities for businesses to work as prime contractors or sub-contractors on County contracts. But due to data and time limitations, OLO does not account for this potential negative opportunity cost in its analysis in subsequent sections.

VARIABLES

The primary variables that would affect the economic impacts of enacting Bill 35-21 are the following:

- total number of County residents working on County contracts;
- average wages of County residents working on County contracts; and
- total number of small business prime and sub-contractors on County contracts.

IMPACTS

WORKFORCE ▪ TAXATION POLICY ▪ PROPERTY VALUES ▪ INCOMES ▪ OPERATING COSTS ▪ PRIVATE SECTOR CAPITAL INVESTMENT ▪ ECONOMIC DEVELOPMENT ▪ COMPETITIVENESS

Businesses, Non-Profits, Other Private Organizations

OLO anticipates that enacting Bill 35-21 would have an overall neutral impact on private organizations based in the County in terms of the Council's priority indicators.[13] This conclusion is based largely on the likelihood that businesses bidding on County contracts would pass any net increase in total costs to the County in the form of higher BID prices. As a result, OLO expects that operating expenses and business incomes for contractors (prime or sub) should be insulated from the negative effects of higher labor costs.

However, OLO anticipates that enacting Bill 35-21 may have divergent impacts on certain businesses. On the one hand, the Bill has the potential to benefit certain businesses based in the County. If the Bill increases local employment on

[13] Montgomery County Code, Sec. 2-81B, Economic Impact Statements, https://codelibrary.amlegal.com/codes/montgomerycounty/latest/montgomeryco_md/0-0-0-80894.

County financed projects (see subsequent section), then certain business would benefit from any increase in household spending on goods and services that result from net increases in household income.

On the other hand, certain small businesses may experience negative impacts. While statistical studies generally have found little evidence of PWLs significantly reducing the number of bidders for publicly financed projects,[14] OLO is unaware of studies that investigate the impact of PWLs on the *composition* of bidders in terms of business size, location, or other policy-relevant characteristics. Nevertheless, there is reason to believe that enacting Bill 35-21 may reduce the participation of small businesses in County financed construction and service projects.

Expanding the scope of the County's PWL and instituting a local hiring requirement would create reporting and compliance requirements for prime contractors as well as sub-contractors that would otherwise not be subject to the law in the absence of enacting Bill 35-21. OLO believes that small businesses would be more sensitive to the administrative burden created by these requirements because they lack the resources that large businesses have to pay for accounting, bookkeeping, and other administrative tasks. Thus, the Bill has the potential to create a barrier to entry for small business contractors unable/unwilling to take on the administrative burdens associated with the reporting and compliance regulations. These businesses may forgo business income they would otherwise attain from working on County contracts in the absence of enacting the Bill.

Beyond these impacts, OLO does not anticipate that enacting Bill 35-21 would significantly affect private organizations in terms of the Council's other priority indicators.

Residents

OLO anticipates that enacting Bill 35-21 would have a net positive impact on County residents in terms of the Council's priority indicators.

The prevailing wage rate is intended to reflect the rate paid for comparable work in the private sector within the County. The Maryland Department of Labor calculates the wage rates for each job classification in non-residential construction trades. To do so, the Department conducts an annual, non-representative survey which registered contractors, contractor's associations and labor organizations voluntarily participate in. Using the survey data, the Department of Labor sets the rates for particular job classifications with the following formula:

- Rate paid to 50% of workers.
- If fewer than 50% of workers are paid the same wage rate, rate paid to 40% of the workers.
- If fewer than 40% of workers are paid the same wage rate, the rate becomes a weighted average of all the raids paid to the workers.[15]

[14] Duncan and Ormiston, "What Does the Research Tell Us."
[15] Jim Tudor, "Maryland Prevailing Wage: Under Construction," Presentation, Maryland Department of Labor. See also https://www.dllr.state.md.us/labor/prev/prevoverview.shtml#survey.

Because union wage rates within jurisdictions are usually the same, the majority wage typically reflects the union wage.[16] Data from the U.S. Bureau of Labor Statistics indicate that union wages in the construction and service industries have been consistently higher than non-union wages.[17] Thus, expanding the scope of the County's PWL likely would increase wages and benefits for workers on County financed contracts that would otherwise not be covered by the PWL in the absence of enacting Bill 35-21. Affected residents in turn would likely experience a net increase in household income.

Moreover, in theory, expanding the scope of the County's PWL and instituting a local hiring requirement should prevent businesses from drawing on nonlocal, low-wage workers to attain a competitive advantage in bidding for County contracts. Thus, enacting Bill 35-21 should increase the total number of County residents working on County contracts. Affected residents in turn would likely experience a net increase in household income. However, several factors that may mitigate local employment effect are worth noting. For instance, to meet the local hiring requirement, construction companies may rotate employees residing in the County between private and public, rather than increasing the total share of residents in their workforces. Also, the potential for productivity and efficiency gains may result in a net decrease in employees working on County contracts.

Beyond these impacts, OLO does not anticipate that enacting Bill 35-21 would significantly affect residents in terms of the Council's other priority indicators.

DISCUSSION ITEMS

Not applicable

WORKS CITED

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Duncan, Kevin and Russell Ormiston, "What Does the Research Tell Us about Prevailing Wage Laws?," Labor Studies Journal 44:2 (2019): 139-160

Montgomery County Code. Sec. 2-81B. Economic Impact Statements.

Montgomery County Council, Bill 35-21, Prevailing Wage Requirements - Construction Contracts - Amendments, Introduced on October 12, 2021

[16] Duncan and Waddoups, "Unintended Consequences of Nevada's Ninety-Percent Prevailing Wage Rule"; and Onsarigo, et al, "The Effect of Prevailing Wages on Building Costs, BID Competition, and Bidder Behaviour."

[17] https://www.bls.gov/news.release/union2.t04.htm; and https://www.bls.gov/opub/mlr/2013/04/art2full.pdf

Onsarigo, Lameck, Kevin Duncan and Alan Atalah, "The Effect of Prevailing Wages on Building Costs, BID Competition, and Bidder Behaviour: Evidence from Ohio School Construction," *Construction Management and Economics* 38:10 (2020): 917-933.

Rubenstein, Michael, Fiscal and Policy Note, House Bill 37, Fiscal and Policy Note, Maryland General Assembly, 2021 Session.

Tudor, Jim, "Maryland Prevailing Wage: Under Construction," Presentation, Maryland Department of Labor.

CAVEATS

Two caveats to the economic analysis performed here should be noted. First, predicting the economic impacts of legislation is a challenging analytical endeavor due to data limitations, the multitude of causes of economic outcomes, economic shocks, uncertainty, and other factors. Second, the analysis performed here is intended to *inform* the legislative process, not determine whether the Council should enact legislation. Thus, any conclusion made in this statement does not represent OLO's endorsement of, or objection to, the Bill under consideration

CONTRIBUTIONS

Stephen Roblin (OLO) prepared this report.