

**Analysis of Kentucky Governor's Study
"The Impact of Prevailing Wage Laws on
Labor Costs for Capital Construction
Projects"**

**Prepared for
National Alliance for Fair Contracting**

By

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The Office of the Kentucky State Budget Director has distributed a study, "The Impact of Prevailing Wage Laws on Labor Costs for Capital Construction Projects". The study concludes that the State's construction expenditures will be reduced if the State's prevailing wage law is repealed. The savings on the total cost of construction is asserted to be 6.65 percent due to a 17.1 percent reduction in the labor cost of the project. As a result of questionable use of data and erroneous assumptions, the conclusions are incorrect.

The study is flawed for a number of reasons, the three major ones being:

- o Inappropriate use of Bureau of Labor Statistics wage data.
- o Assumption of a one-for-one substitution of higher paid workers with lower paid workers.
- o Assumption that in the absence of legislated rates, no above average rates would be paid.

These shortcomings and others are addressed in this analysis commissioned by the National Alliance for Fair Contracting. The Alliance requested the Construction Labor Research Council to review the Governor's Study to evaluate its methodology and conclusions. CLRC is an industry supported organization that has provided data and analysis for over 25 years on issues related to labor costs and labor supply. Its findings are recognized by labor, management and project owners for their objectivity. CLRC takes no position on legislative matters, but provides evaluations of issues addressed by others.

Use of Bureau of Labor Statistics Wage Data

To determine construction costs in the absence of prevailing wage laws, it is necessary to estimate the wages that would have been paid without the legislation. To perform this "what if" exercise, the State relies on data from the Bureau of Labor Statistics (BLS), the U.S. Government's premier data collection agency. The data utilized is the Occupational Employment Statistics (OES) series, an employer survey of hourly wages paid to all employees. Data for construction, and all occupations, are available for Kentucky and each of its metropolitan areas.

OES is a good data base to make the kind of analysis the State has made; however, were the data used properly, rather than the way the State utilized it, the conclusion

would have been that no savings in construction costs would have been identified. The State erred because it:

- o improperly adjusted for low residential rates which are included in OES, but not prevailing building construction rates

- o failed to remove low apprentice rates from OES data as they are excluded from the prevailing building construction rates.

- o failed to remove lower paid persons with construction skills, but not working in the construction industry from the OES data.

All of these factors resulted in too low an average wage rate to compare to the prevailing rate, therefore, calculating savings that do not exist.

The State properly references the Bureau of Labor Statistics (BLS) data base Occupational Employment Statistics (OES) to compare average rates to prevailing rates. Also, quite properly, the State has recognized that residential rates, which are generally at the low end of the range, are included in the OES data, but its adjustment is inappropriate. The impact of residential on the survey data is significant. In 2005 the residential segment accounted for 52 percent of Kentucky construction volume (F.W. Dodge, a leading industry data source).

The OES also understates the occupational average because it includes apprentices. The prevailing occupational rate excludes apprentices. This difference in coverage reduces the OES occupational average.

Another source of OES understatement is that it is an occupational average not a construction occupational average. A number of occupations associated with the construction industry have workers who are employed not only in construction, but in other industries. For example, one-third of all electricians do not work in the construction industry. These non-construction workers are likely to have lower hourly wage rates. Hence, again, the OES is an inappropriately low comparison to the prevailing occupational rate.

The issue is, therefore, one of using the OES data to properly compare the wages of Kentucky construction workers with prevailing rates, so that the impact on State construction projects can be measured. The methodology included in the State report is insufficient to permit a direct recalculation of wage rates and differentials. What is believed to be the proper adjustment follows.

The objective is to properly adjust the OES average to more accurately reflect the universe of Kentucky construction workers within the scope of prevailing wage rates. Removing residential workers, apprentices and non-construction industry workers would provide a more appropriate measure of wages. As these are all below average paying categories, they were removed from the average. Since they cannot be precisely identified, the individuals paid the lowest quarter of wages were removed from the data as a proxy for these workers.

The revised average all crafts rate increased by 15.3 percent in the statewide data and 15.1 percent for the Louisville metropolitan area. This virtually eliminates the 17.1 percent of labor cost savings identified in the study. When other factors are considered the “savings” disappear.

Worker Substitution

When a job is available, the wage rate offered is the primary determinant of the quality and quantity of applicants. This is true for all situations, not just construction craft workers. Better skilled workers are attracted to and qualify for better paid positions. This is true because they are more productive, they complete the job faster, and they commit fewer errors. The marketplace is willing and eager to pay for these attributes.

The State’s study ignores the benefits of higher skills to a workplace. It is irrational, naïve and incorrect to conclude that reducing wages has no impact upon output per individual. Reduced wages result in reduced skills and additional labor inputs.

Fortunately, there are data covering Kentucky which document this situation. An analysis performed for the National Heavy and Highway Alliance demonstrated that wages paid to construction workers are a poor indicator of the total cost per mile of highway. Examining projects from 1994 through 2002, highway cost data indicated:

| | <u>United States</u> | <u>Kentucky</u> |
|----------------------|----------------------|-----------------|
| Average Hourly Wage | \$ 18.20 | \$17.26 |
| Hours per Mile | 8,053 | 14,953 |
| Labor Costs Per Mile | \$146,563 | \$258,062 |
| Total Costs Per Mile | \$746,381 | \$1,276,881 |

Kentucky paid wages below the national average, but it took 86 percent more hours to build a mile of highway. Lower productivity resulted in higher labor inputs and higher highway cost. Project cost, not hourly wage rate, is the relevant measure of cost effective construction.

Project Rates without Prevailing Wages

The calculations in the State study rely on the assumption that average rates will always be paid on projects while prevailing rates or any other above average rate will never be. Since, as has been demonstrated, lowest wage rate is not the same as lowest project cost, contractors would have the option of paying higher rates to achieve reduced project costs. The State's methodology is flawed because it ignores the positive contribution of higher paid workers to cost effective construction. Average rates, however defined, do not identify the best means for a contractor to minimize project cost. With the material in the report, it is not possible to determine if average rate ever equals prevailing rate, but it is believed to be unlikely.

Other Points

State Says

Response

"Overwhelming conclusion in the economics literature is that prevailing wage laws increase construction costs."

Without getting into a contest as to who has more references, the State's conclusion is a minority position.

Impact of fringe benefits

Agree that this is difficult to quantify; however, workers with pensions and health insurance do not make the same demands on public services paid by taxpayers.

Prevailing wage prevents use of Helpers

Using the same OES data, helpers account for an insignificant seven percent of Kentucky construction occupations.

Improper classification of laborers as craft workers

Incorrect, opposite is true – craft workers may be reclassified as laborers to reduce workers compensation costs.

Laws distort capital-labor input allocations.

Again, ignores changes in labor rates affecting labor quantities.

Compliance costs reduce bidders, but create excess profits

Undocumented oversimplification ignoring many factors creating competitive advantage. Also ignores other legal constraints imposed on public contracts that also affect companies differently.

The report is also critical of the data collection process. This may be true, but it is not a justification for repeal. The solution is to fix the system. The State's solution is analogous

to saying that because government relief efforts related to Katrina were poorly administered, the program should be discontinued.

Conclusions

The State's report is a weak argument for eliminating prevailing wage laws in Kentucky.

This analysis has been prepared by the Construction Labor Research Council, Washington, D.C.