Prevailing Wages

Introduction

The U.S. Congress passed the Davis-Bacon Act in 1931 during the Great Depression. According to this act, a law was implemented that required governmental contractors to pay ‘prevailing wages’ on projects that it took on behalf of the federal government. The effect of this legislation was that more than 40 states adopted the ‘little Davis-Bacon Acts’ or ‘prevailing wage’ laws. This was then, but later on, many states repealed these statutes. Still, many states today, including Michigan, carry on with such laws that seem to have become obsolete from those Depression-days (Vedder 1997). This paper shall attempt to take a closer look as to what the implications of implementing such laws are, with scrutiny of these laws as enacted in the state of Michigan. Various statistics shall be presented to highlight the advantages and disadvantages of using such laws in a state. The paper shall discuss the various issues that Michigan has faced in regards to these laws and will come up with some solutions and recommendations for the state of Michigan on whether it should continue to implement these rules or repeal from them.

Many jurisdictions, including that of the federal government, set the prevailing wages exactly at or very near to those that are demanded by the laborers according to the union-scale. “Prevailing wage laws, then, force contractors on government construction or other projects to pay their employees at the same rate as unionized members of the relevant occupation—whether it be bricklayers, carpenters, electricians, or other categories of workers—even if non-union contractors could perform the same work less expensively by paying their workers lower but mutually agreed-upon wages” (Vedder 1997). The governments usually use a very complex and intricate method to set these prevailing wages, “but because of the large number of distinct geographic labor markets and numerous occupational categories, the tendency is for wages to be set equal or approximate to those determined in local collective bargaining agreements between unions and contractors" (Vedder 1997). This is not true for all the states as in many of the states, these prevailing wages are not so obviously connected to the pay scales provided by the unions. Michigan, however, is considered to be a 'strong' prevailing wage state and the formulation that is used to derive these wages consist of tying the rates very closely to the union pay scales.

After a lot of research and contention, it has been concluded that prevailing wage laws are in fact bad for the economy and are considered to be poor policy. The argument against these laws is presented in more details in the course of this paper, but to summarize, it is concluded that prevailing wages restrict people from operating in a free market to allocate resources and use factors of production in an efficient manner. This retards job creation and contributes to lower economic growth. In context of Michigan, it was found that many of the workers wanted to move out of Michigan (and other prevailing wage states) and go in states where they can earn incomes that are better suited to their skills. This suggests that it would be wise for the Michigan legislature to repeal the Prevailing Wage Act of 1965 (Vedder 1997)

Prevailing Wages and Michigan

A federal district court judge, in December 1994, ruled that Michigan's prevailing wage law was preempted by ERISA, a federal pension law. In lieu of this judgment, the prevailing wage law was not enforced in the state of Michigan for the 30 months between 1994 and 1997. An appellate court reinstated the law in June of 1997. This allowed the economists to observe and analyze how the law (both its presence and its absence) was able to affect the economy of Michigan during these 30 months. This allowed the economists to determine the following:

- “Michigan’s prevailing wage law reduces employment in construction: During the 30 months (December 1994 - June 1997) when the law was ruled invalid, more than 11,000 new jobs were created as a consequence of the law’s invalidation—and the long term impact is much greater;
- Michigan’s prevailing wage law adds at least $275 million annually to the cost of governmental capital outlays—approximately the equivalent of five percent of the revenues raised from the state’s individual income tax;
- In 1990, African-Americans in Michigan were less than 50 percent as well represented in the construction industry as whites; black employment in Michigan construction was well below the national norm, reflecting both theoretical and empirical evidence that prevailing wage laws promote racial discrimination;
- States without prevailing wage laws had net in-migration of over 2.5 million persons from 1990 to 1996, while strong prevailing wage law states like Michigan had outmigration of 2.7 million; nationally, poverty rates are higher in prevailing wage law states; and
- Nationally, worker productivity appears to be lower in construction in states with strong prevailing wage laws, and construction costs are higher in public (prevailing wage) construction than in the private sector where market forces prevail” (Vedder 1997).

Prevailing Wages: Good?

It was during the Great Depression that the government of the United States first decided to implement prevailing wage laws. In those times, the national unemployment rate was at about

14 percent and was expected to rise even further, while the total output, or GDP, decreasing (Vedder & Gallaway 1997, 77). This was a serious matter for the US government as the rising levels of unemployment presented it with many problems. The governmental officials were at a loss as to solving this problems and tried to adopt many policies by which to alleviate such worries. The Hoover administration decided to present its case for prevailing wage laws. It was argued that if the higher wages (higher than the normal market rate) for the workers were mandated, the workers would have more income and thus be able to spend more in the economy. The argument was that this would allow the US economy to spend its way out of the Great Depression. Many businessmen also decided to advocate this 'high wage doctrine' and this was perhaps the one argument that formed the basis of many other legislations during both the Hoover and Roosevelt administrations (e.g. the National Industrial Recovery Act, National Labor Relations Act, etc.) (Vedder 1997).

This was one argument. Another side of the story that was in favor of the original Davis-Bacon legislation was that the union contractors wanted to be protected against competition from lower-wage non-union workers. "Rep. Robert Bacon was prompted to introduce his bill in 1931 after witnessing one contractor's use of black Alabama laborers to construct a government hospital in Rep. Bacon's Long Island district. A review of the legislative history of the Davis-Bacon Act makes it clear that the idea behind "prevailing wages" was seen by some congressmen as a way to reduce out-of-state competition and discourage the use of non-white labor" (Vedder 1997). But perhaps the strongest argument that is given in support of prevailing wages, one that prevails even today, is that such laws help in the reduction of poverty. Advocates of this theory persist that the workers that are affected by such laws continue to receive a healthy amount of income that is able to keep them above the poverty line. "Finally, some pro-prevailing wage advocates have said that paying high wages insures quality work or, alternatively, that high wages lead to greater labor morale thereby promoting efficiency, and thus these laws cost little or nothing" (Vedder 1997).

Prevailing Wages: or Bad?

However, there are many arguments that go against prevailing wage laws and many economists have contemplated about the uselessness of such laws. As already discussed, the court ruling in 1994 allowed the economists to collect some empirical evidence against prevailing wages, yet there is also some very compelling theoretical evidence against these laws. Many economists feel that prevailing wage laws are obsolete, discriminatory ineffective, inefficient, and very expensive to taxpayers. Many states have thus decided to repeal prevailing wages laws. There are four theoretical argument against prevailing wages laws:

1. One argument is that these laws force the employers to pay the workers much more than they anticipate and thus should be paid. The universal law of demand states that the quantity demanded of labor would be inversely proportional to the price. This means that the employers would want to hire more workers if the cost of hiring them is low. Similarly, the law of supply states that if the wages are high, there will be a higher labor supply and vice verse. If the prevailing wages laws is in effect, it removes the market of labor's ability to determine an equilibrium wage rate as these laws forces the wage rates to go up where the labor supplied is much more (in excess) than the labor demanded. This means that prevailing wage rates tend to produce unemployment, thereby reducing the employment opportunities for the workers in the affected fields.

2. Employers that tend to show discriminatory behavior towards their employees on account of their sex, race, age, etc, the prevailing wages laws makes it easier for them to get away with it. It also makes it less punishable by law and makes it financially easier for the employers. This was referred to by one congressman as a problem of cheap colored labor, which was both anti-competitive and racist in origin (Vedder & Gallaway 1995). "Consider a state without a prevailing wage statute, where Contractor A wants to hire a plumber. He offers the generally agreed-upon, market hourly wage of $10 per hour and receives one job applicant, an African-American. Even if Contractor A possesses some racial prejudice, he almost certainly will hire the black applicant because he needs a plumber. To get more applicants in the hopes of attracting a preferred white worker, he would have to offer to pay more, thus lowering his profits. Now suppose a prevailing wage law sets plumber wages at an abovemarket rate of, say, $15 per hour. Contractor A gets three applicants, two white and one black. He can now hire a white worker without a financial penalty. In other words, prevailing wage laws remove the financial disincentive for employers to engage in racial discrimination since all workers must be paid according to the same wage rate" (Vedder 1997).
3. Sine prevailing wages are higher than normal wages that are normally agreed upon, they should lead to either the contracted goods being places at a higher rate, or to reduce the quantity of the goods/services that is being provided. "For example, suppose it costs $5 million to build on average one mile of highway when contractors pay voluntary market wages, but $5.5 million when they pay government-mandated prevailing wages. Suppose further that a state highway department has a budget of $300 million for new highways. Without prevailing wages, 60 miles of road can be built; but with such wages, only 54

miles can be constructed" (Vedder 1997). Thus prevailing wage laws tend to reduce real infrastructure investments.

4. There are some very obvious administrative issues that come up when the wage rates for the same job appear in an irregular manner. The complexity of keeping up with these wage rates considerable raises the administrative costs and allow for the possibilities of fraud and abuse.

Empirical Evidence:

According to the theory, prevailing wages laws should cause unemployment in the areas in which it is implemented in, "since at the above-market "prevailing" wage, some workers are not hired compared with the number that might be when employers and workers are free to negotiate wages themselves" (Vedder 1997). It is easy for us to test this hypothesis. It has been noted that the construction industry is one that is most affected by prevailing wages laws. It has also been noted that in an average year, about twenty five percent of all the construction in US takes place in the public sector. This public sector is one that sees the implementation of the prevailing wages laws in many states, including Michigan. In 1996, for example, public construction in the US was over $141.1 billion, almost precisely one-fourth the total new construction of $568.9 billion (U. S. Bureau of the Census 1997). For the purpose of this example, we shall divide the states into two basic categories: one that would include the eighteen states who do not have prevailing wages laws, and the other would include the thirty-three states that have such laws in effect. Michigan (and 12 others) can be categorized as being 'strong' prevailing wage laws (Thieblot 1996, 317). By comparing the number of construction workers per thousand jobs in these states, it was found that those states that were strong in prevailing wage laws had the highest percentage of unemployment.

Another way to approach this problem is to observe and analyze the experience that Michigan underwent when the prevailing wages laws was repealed for the duration of 30 months from December 1994 to June 1997. According to various studies that were conducted, it was found that the job growth in the construction industry was small in Michigan's prevailing wages period (about 4,000 jobs per year). This was comparable to the 17,600 per year that were created once the prevailing wages laws was abolished for the brief period of 30 months. This suggests a sluggish rate of job growth during the era of wage restraints was followed by a marked expansion in the job market when those restraints were removed (Vedder 1997). Some people might argue that this can be related to the economic boom of the early 1990s or for seasonal patterns. However, seasonally adjusted figures also show the same results that there were more jobs created in the period of 30 month in which the prevailing wages law was repealed.

It was also found that the employment grew during the period in which the prevailing wages laws were not applied in Michigan. The statistics that were obtained showed that the growth rate was moderately high, with 277,800 jobs in the period without the prevailing wage vs. 241,948 jobs in the earlier period. "Thus, some of the greater rise in construction employment in the period without prevailing wages is attributable to slightly more robust general employment growth reflecting cyclical conditions and the passage of time. Accordingly, the estimate of job growth during the suspension of the prevailing wage law was reduced by about 13 percent to account for the moderate general rise in employment growth in that period, yielding a total estimated construction job growth in the era of no prevailing wages of 11,337 jobs" (Vedder 1997).

Another finding that was concluded after the analysis of the 30-day suspension period was that the labor costs rise because of prevailing wages. The impact of these rising labor costs depends on three factors:

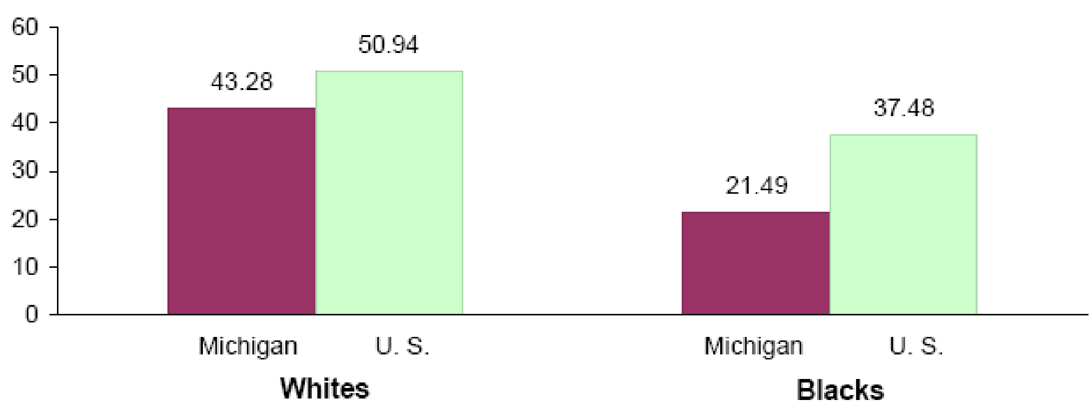
1. The amount by which the prevailing wages are more than the wages that would otherwise been paid,
2. The proportion that the labor costs occupy in the total cost of construction, and
3. The impact of prevailing wages on the productivity of the workers.

It was found that the prevailing wages were almost fifty percent more than what the workers would be getting otherwise. This clearly raises the cost of labor. Also, it is also clear that about 20-30 percent of the total construction costs goes to the laborers (U. S. Bureau of the Census 1992, 712). Also, it was noted that there was an added expense for construction of schools, which the prevailing wages imposed. This caused a lot of frustrations amongst the many officials of Michigan's school district because prevailing wages made it more difficult for them to gain the consent of important bond proposals from doubtful taxpayers. Statewide in 1998, only 44 out of 107 proposed school bond proposals worth $2.2 billion were approved by voters (Arens 1998). James Kos, superintendent of Hamilton Public Schools in Allegan County, argues that a repeal of the prevailing wage law could save his district "between one and $1.5 million in construction costs and we'd be able to use that money for students" (Kuipers 1999, A1).

Many economists still argue that there is a chance that the prevailing wages will improve the morale of the workers and work to supply a labor force that is more skilled. They also tend to present the argument that prevailing wages raises productivity, according to the concept of 'efficiency wages in the neo-Keynesian economics (Akeroff & Yellin 1986). In order to test this proposition, state government data on construction workers were gathered from the U. S.

Department of Labor and data on the value of construction contracts were gathered from the U. S. Department of Commerce. The average productivity of workers in the "no prevailing wage" and "strong prevailing wage" states was then compared by dividing the value of construction contracts in 1997 by the number of construction workers (Vedder 1997). The results indicated that the output per construction worker was actually about four percent higher in the states without prevailing wages, suggesting that the existence of such laws may lead to inefficiencies and reduced productivity, enhancing our confidence in stating that prevailing wage laws materially raise the costs to taxpayers.

As discussed earlier, there is a reason to believe that prevailing wages would tend to reduce the employment opportunities for groups that have racially discriminating behavior. Even historically, many of the proponents of the Davis-Bacon Act wanted to reduce the number of African American employees in the workplace. The Chart below summarizes the Michigan and the nation the number of construction workers per 1,000 total employed for both blacks and whites, using data from the 1990 Census of Population.



The Prevailing Wage Act of 1965 may be the reason fewer minorities participate in Michigan's construction labor force than do in the nation as a whole.

Source: U. S. Bureau of the Census

Even though employment was lowered because of prevailing wages laws, as discussed earlier, we find that this employment was particularly reduced for the blacks, which is consistent with the theory that prevailing wage laws reduce financial disincentives for employers to discriminate by race. “Nationwide, blacks in 1990 were 74 percent as well represented in construction as whites (as measured by the percent of workers working construction). That underrepresentation may well reflect the discriminatory impact of the national Davis-Bacon Act as well as individual state prevailing wage laws. The Michigan strong prevailing wage law, however, seems to compound the racial effects. In Michigan, blacks in 1990 were less than 50 percent as well represented in construction as were whites. The Michigan figure is well below that for the nation as a whole. While other factors could be at work here, it is not known what they are” (Vedder 1997). There is very strong, even compelling, circumstantial evidence that the Michigan prevailing wage law has reduced employment opportunities in particular for blacks (Hunter 1997).

Conclusion

This paper has discussed the prevailing wages laws in Michigan and has reviewed many evidences and data that pertain to the various ways in which these prevailing wages affect the economy. It has been found that Michigan is a strong prevailing wages state. This discussion has led us to believe that these prevailing wages are having an adverse effect on the economy of Michigan. The evidence has pointed to prevailing wages being responsible for the rise in unemployment, construction costs, as well as social costs such as racial discrimination etc. prevailing wages have known to cause significant unemployment in the economy. It was also found that the temporary annulment of the prevailing wages laws resulted in more than eleven thousand new jobs to come up. Thus, both the theoretical as well as empirical evidences suggest that workers (both the majority as well as the minority) will particularly gain from the removal of prevailing wage restrictions. Prevailing wages restrict people from operating in a free market to allocate resources and use factors of production most efficiently, thus retarding job creation and contributing to lower economic growth. Thus it is concluded, under the evidence, that the state of Michigan should repeal the Prevailing Wage Act of 1965.

References:

1. Akeroff, G & Yellin, J, (1986), *Efficiency Wage Models of the Labor Market*, New York: Cambridge University Press.

2. Arens, M (1998), "The Need for Debt Policy in Michigan Public Schools," (*Mackinac Center for Public Policy*, May 1998), Online at http://www.mackinac.org/article.asp?STD98-02 (Accessed October 25, 2005)

3. Hunter, R P, (1997), "Union Racial Discrimination is Alive and Well," *Mackinac Center for Public Policy Viewpoint on Public Issues 97-26*, September 1997, Online at http://www.mackinac.org/article.asp?VPT97-26 ((Accessed October 25, 2005).

4. Hirsch, B T & Macpherson, D A, (1998), *Union Membership and Earnings Data Book,* Washington, D. C.: Bureau of National Affairs

5. Kuipers, 1999, "End 'prevailing wage' law: Representative says move could save millions," *The Holland Sentinel*, April 8, 1999, p. A1.

6. Thieblot, A. J (1996), "A New Evaluation of Impacts of Prevailing Wage Law Repeal," *Journal of Labor Research*, 17(2), Spring 1996, p. 317.

7. U. S. Bureau of the Census, "1990 Census of Population: Social and Economic Characteristics", Washington, D. C.: *Government Printing Office*, 1993, Vols. CP-2-1, pp. 81-82, and CP-2-24, pp. 209-210.

8. U. S. Bureau of the Census, *Census of Construction Industries, 1992*, p. 713.

9. U. S. Bureau of the Census, (1997), *Statistical Abstract of the United States: 1997*, p. 715.

10. Vedder, R, (1999), "Michigan's Prevailing Wage Law and Its Effects on Government Spending and Construction Employment," *The Mackinac Center for Public Policy*, Michigan: September 1999) Online at: http://www.mackinac.org/archives/1999/s1999-07.pdf (Accessed October 25, 2005)

11. Vedder, R K & Gallaway, L E, (1995), "Cracked Foundations: Repealing the Davis-Bacon Act," *St. Louis: Center for the Study of American Business* October 1995

12. Vedder, R K, & Gallaway, L E, (1997), "Out of Work: Unemployment and Government," *Twentieth-Century America*, Updated Edition, New York: New York University Press, p. 77.