OFFICE OF THE MAYOR
160 N. MAIN STREET, SUITE 850
901-545-5468

TO: A C Wharton, Jr., Mayor

FROM: Sybille S. Noble
Executive Assistant to the Mayor

DATE: October 30, 2007

RE: Prevailing Wage Ordinance for Shelby County

A couple of months ago, you asked that I act as point person in a discussion of a prevailing wage ordinance for Shelby County. I have now reviewed a considerable amount of literature on prevailing wage. My conclusion is that there are sufficient justifications for implementation of a prevailing wage ordinance and not many arguments against.

Direct Costs of Prevailing Wage Laws

Because prevailing wage laws dictate the wages and benefits paid to construction workers on public projects, the strongest voices against prevailing wage laws are those who believe that (i) free market forces ought to dictate wages, and (ii) mandated wage rates artificially increase the costs of public projects, with estimates ranging from 10%-30%. However, the preponderance body of available research has found that prevailing wage laws do not have a statistically significant impact on the total cost of public construction projects. Studies have shown that when such a program is first introduced there may be a period of adjustment in order to obtain the level of efficiency needed to affect the higher labor costs. But over/time (as little as 17 months following implementation), higher workforce efficiency prevails and overall project cost increases become insignificant.[1]

In theory, the higher wage mandates drive employers to hire more skilled workers. These skilled workers have higher productivity and produce higher quality work. At least one

[1] Kevin Duncan, Peter Philips and Mark Prus, "Prevailing wage legislation and public school construction efficiency: a stochastic frontier approach," Construction Management and Economics 631 (2006).

study has shown a correlation between prevailing wage laws and the reduction in cost overruns.[2]

Skills Development

Prevailing wage laws are believed to contribute to more workforce training. In the construction industry, where tradesmen generally do not work for one employer, but move from employer to employer, there is arguably no strong incentive for job training. Given the weak employer-employee relationship, proponents argue that there must be an incentive imposed by the government that rewards skills training. Prevailing wage laws provide that incentive. If every employer quotes the same labor rates, then the price differential would have to be based on other factors, like efficiency. If higher skilled employees are more efficient, then the prevailing wage laws work to provide incentives for skills development. This is training that would not have been provided if price competition rates existed.

The higher wages traditionally paid to union workers help to support the unions' apprenticeship programs that also contribute to a more highly skilled workforce in the construction industry. Without the higher prevailing wage typically paid by unions, no single employer has an incentive to invest in the long term training of an employee. This is despite the fact that the construction industry needs highly skilled workers. This is deemed to be a "market failure" that prevailing wage laws are thought to correct.

Social Costs

Studies also exist to support the view that prevailing wage laws reduce construction injuries and workers' compensation costs,[3] raise health and pension coverage for construction workers,[4] and minimize the shifting of health coverage and pension coverage for construction workers.[5]

Prevailing wage laws have been shown to have a significant increase in both wages and benefits as a percentage of compensation. In prevailing wage law jurisdictions,

---

[2] Peter Philip, et.ol, "Losing Ground : Lesson from the Repeal of Nine Litter Davis Bacon Acts," Working Paper, 1995, pp. 2-3.

[3] Hamid Azari-Rad, "Prevailing Wage Laws and Injury Rates in Construction," in The Economics of Prevailing Wage Laws, eds. Hamid Azari-Rad, Peter Philips and Mark J. Prus (Ashgate: Burlington, VT).

[4] Jeffrey S. Petersen, "Health Care and Pension Benefits for Construction Workers: The Role of Prevailing Wage Laws," Industrial Relations, vol.39 no. 2 (April 2000) : 246-264

[5] C. Jeffrey Waddoups, "Health Care Subsidies in Construction: Does the Public Sector Subsidize Low Wage Contractors?" in The Economics of Prevailing Wage Laws, eds. Hamid Azari-Rad, Peter Philips and Mark J. Prus (Ashgate: Burlington, VT) 2005, PP. 198-211

employers generally seek out jointly managed health and welfare programs to meet their obligations. Although most statutes or ordinances allow an employer to increase wages in lieu of providing health benefits, there is a tax law incentive in providing the benefits. By increasing the number of insures under prevailing wage laws, a government entity reduces the socialized cost of providing health care to the uninsured through safety net hospitals like The Med. Without the requirement on employers to provide health benefits, the tax paying public bears the cost.

Prevailing wage laws have also shown to contribute to a reduction in construction injuries. In one study comparing statistics of states that had prevailing wages with those that did, the author found that non-prevailing wage states had a statistically significant 5% to 9% higher injury rate. When Kentucky suspended the coverage of schools under its prevailing wage law, there was an 11% increase in serious injuries and a 16% increase in lost days per serious injury. When Utah's prevailing wage laws were repealed, injury rates went up 14% overall, serious injury rates went up 15%, and the number of lost days increased 12%. These worker compensation costs are likely borne by the public in the form of higher workers' compensation premiums and higher costs of uninsured health coverage. In explaining the correlation between prevailing wage rates and social costs, SUNY-New Paltz economics professor Hamid Azari-Rad demonstrated how prevailing wage requirements set in motion a causal chain of higher wages, better training, safer construction work, the retention of experienced workers, and an environment where other regulations such as tax laws, insurance coverage and safety rules are followed.[6] Construction companies that compete on cheapening labor, posited Azari-Rad, also tend to circumvent workers' compensation coverage, a development that reduces the incentive to create a safe workplace and shift the costs of workers compensation to other employers.

Economic Development

There are also economic development arguments associated with prevailing wage laws. Undoubtedly, prevailing wage laws increase wages, but they also encourage the development of a high-skill, high-wage economy that provides decent health and pension benefits and economic security to workers. While there is no income tax in Tennessee or Shelby County, higher wages have a direct influence on sales tax revenue.[7]

Also, where competition for jobs is not based on the cost of labor, there is less opportunity for out of state construction companies using cheap labor to win bids. When

---

[6] Azari-Rad, supra note 3.

[7]See, e.g., Michael Greenberg, et al., "Evaluating the Economic Effects of a new State-Funded School Building Program: the Prevailing Wage Issue," 28 Evaluation and Program Planning 33, 33-45 (2005). The authors found that their economic models suggested that compliance with the state prevailing wage las in a $10 billion school construction program in New Jersey would generate $1.3 billion in state tax revenues

labor is constant, there is a more conducive bidding environment for local contractors using local workers.[8]

Finally, in prevailing wage jurisdictions, there is less likelihood for highly skilled workers to leave the locality in search of higher wages, and potentially skilled workers will be attracted to the field.[9]

Summary

In summary, the preponderance of the economic research supports the view that prevailing wage laws are not only good for employees working on public projects, but also for the construction industry and community as a whole.

Therefore, there is sufficient academic research to support you if you choose to pursue adoption of prevailing wage legislation.

I have attached a copy of the City of Memphis' policy for your consideration.

---

[8] Lois M. Jackson, Robert Bruno, Phil Schrader, Tony Sindone, "An Evaluation of Prevailing Wage in Minnesota: Implementation, Comparability and Outcomes," Working Paper, 2006, p. 5
[9] Ibid.