

December 15, 1983

TRIMMING THE HUGE COST OF DAVIS-BACON

INTRODUCTION

The Davis-Bacon Act, enacted in 1931, requires contractors to pay the "prevailing" wage on federally funded construction projects. The purpose of the Act was to protect local construction labor from the competition of itinerant contractors and their lower paid, often minority, employees.

The Davis-Bacon Act has generated controversy since it became law. Critics argue that it raises wage levels artificially, boosting the cost of federal construction projects, and discriminates against nonunion and minority workers. There is also considerable dispute concerning the method used to determine the prevailing wage.

Nearly every academic study has concluded that the Act's primary effect is to raise the wage and employment levels of union workers to the detriment of nonunion and minority workers. It should be no surprise, therefore, that organized labor has been the Act's biggest supporter.

By driving up the price of federal construction, Davis-Bacon currently is costing the taxpayer more than \$1 billion annually.¹ This is an unnecessary cost and a particularly heavy burden at a time of huge federal deficits. As such, Davis-Bacon at long last should be repealed. This would be consistent with the Reagan Administration's objective of reducing government spending while eliminating burdensome regulations. Most important, repeal would generate thousands of new employment opportunities for the jobless.

¹ Congressional Budget Office, "Modifying the Davis-Bacon Act: Implications for the Labor Market and the Federal Budget," July 1983, p. 29.

BACKGROUND

The Davis-Bacon Act was the first federal legislation mandating minimum wages for nonfederal workers. The Act requires contractors of federally funded construction projects to pay wage rates and fringe benefits at least equal to those prevailing on similar projects in private industry. The law applies to all contracts with a value of over \$2,000. And while the Act itself applies to federal construction, its prevailing wage provisions have been added to nearly 60 other laws dealing with federally financed and federally assisted construction.

The prevailing wage rates are determined by the Department of Labor (DoL) based upon its assessment of the compensation paid to equivalent workers in the area. Davis-Bacon, in other words, is a variant of the minimum wage.

The purpose of the Act was to shield local contractors and construction workers from the competition of outside contractors paying lower wage rates in order to win federal government contracts. Or as Representative Robert Bacon (R-NY) put it during the debates in 1931, "A practice has been growing up in carrying out the building where certain itinerant, irresponsible contractors, with itinerant, cheap, bootleg labor have been going around throughout the country picking off a contract here and a contract there."²

Wage Determinations

A 1979 study by the General Accounting Office (GAO) concluded that "after nearly 50 years, the Department of Labor has not developed an effective program to issue and maintain current and accurate wage determinations; it may be impractical to ever do so."³ Much of the problem involves a precise definition of the term "prevailing wage." The DoL's determination is based upon the rate paid to: (1) the majority of workers in the area of the proposed construction project, adjusted for the appropriate job classification; or (2) if there is no majority, then the rate paid to the greatest number of workers providing it is greater than 30 percent of those employed; or (3) if no such rates exist, then the average wage rate used.⁴

² 74, Congressional Record, 6510, February 28, 1931.

³ U.S. Comptroller General, The Davis-Bacon Act Should Be Repealed (HRD 79-18) (Washington, D.C.: General Accounting Office, April 27, 1979).

⁴ In May 1982, the DoL published new regulations for the administration of Davis-Bacon. Among the revisions was the elimination of the so-called 30 percent rule, and effective June 28, 1983, this step has been omitted. However, the ruling may be appealed in the courts and the rule could be reinstated.

Unless the average wage rate is used, however, the determination may be nowhere near the prevailing wage in any normal sense of the term. Indeed, the provisions of the Act have often been based on as few as 30 percent of workers within a job classification. This may be quite different from the average wage rate paid to workers in the area.⁵ There is also an inherent bias toward using the generally higher union wage scales, rather than the typical construction wage, since union members are more likely to be paid a standard rate, while nonunion rates tend to vary considerably between workers. In addition, the determinations are based on both field surveys and the voluntary submission of wage data. The latter method tends to encourage a union rate bias, since data from collective bargaining agreements are easily available, while data for nonunion workers are more difficult to compile. In fact, one analysis by GAO found that 57 percent of determinations were based on collective bargaining agreements.⁶ Not only was the department's methodology flawed in this way, contended the GAO study, but the DoL in many instances "deleted, added, and changed the wage data received without adequate reason or rationale."⁷

Since the use of union negotiated wages as the base for the prevailing wage tends to push wage rates on federal projects above market levels, federal construction costs are raised.⁸ Open shop (nonunion) contractors are forced to raise their bids on federal construction projects and pay above market wages.

Several other weaknesses in the way the Act is administered also lead to artificially high wage determinations and project costs. Worker classifications and the appropriate geographic area for wage comparisons, for instance, result in inflated determinations. The GAO found that "...many of the wage rates prescribed by Labor were not based on similar construction work."⁹ Davis-Bacon rates are supposed to reflect wage rates prevailing in the private sector, but the DoL usually includes in its calculations labor costs from other federally funded projects. This tends to raise the rates still further, leading to excessive costs.

In some areas, there is not enough construction to provide the information needed for an accurate determination of the prevailing wage. In such cases, the DoL may consider wage rates paid

⁵ GAO, op. cit., pp. 52-53.

⁶ Ibid., p. 43.

⁷ Ibid., p. iii.

⁸ In 1981, unionized construction workers earned an average of \$2,700 more year than their nonunion counterparts. Calculated from CBO, op. cit., p. 16.

⁹ GAO, op. cit., p. 50. This may occasionally occur because there is no comparable construction in the private sector, e.g., on interstate highways. One could easily argue, however, that most such building should be returned to the state and local level or the private sector anyway.

on the nearest similar construction. But this can lead to an upward bias in the prevailing wage determination. One recent study of rural construction projects revealed that only 28 percent of the federal projects ended up being built by local contractors, compared with 47 percent of the private projects.¹⁰ So the Act's original aim of protecting local employment is actually undermined in the case of many rural projects.

The cumulative effect of these factors affecting wage determinations is that the cost of federal projects is raised relative to nonfederal. The net result, according to the DoL, was that Davis-Bacon rates in 1982 were more than 5 percent above average rates, resulting in additional costs of \$568 million.¹¹

Use of Labor

The Davis-Bacon Act affects the way labor is used. For example, the DoL often does not recognize semiskilled or helper categories in its wage determinations. If a worker undertakes a particular job, then he must be paid the full Davis-Bacon rate for that job classification, regardless of his skill level. When a general laborer is employed to paint on a public project, for instance, he must be paid a skilled painter's wage; if he then does some carpentry, he must be paid a skilled carpenter's wage.

This provision discriminates against nonunion contractors who employ less specialized, more adaptable workers. Nonunion firms also tend to make greater use of apprentices and helpers, and forcing them to pay journeymen's wages to relatively inexperienced workers raises costs and limits their ability to undertake federal projects. The DoL has estimated that allowing the unlimited use of helpers on public projects would have saved \$480 million in fiscal year 1982.¹²

Compliance

Excessive prevailing wage determinations and the misallocation of labor are not the only costs imposed by Davis-Bacon. Compliance costs raise the expense of federal projects to contractors and hence to taxpayers. Contractors must submit weekly payroll information, such as hours worked and wages paid, for each employee on a Davis-Bacon project. These requirements are particularly burdensome for small contractors who lack the staff to comply easily. The DoL has estimated that these compliance costs amounted to \$100 million in 1982.¹³ There are, of course,

¹⁰ Cited in CBO, op. cit., p. 26.

¹¹ U.S. Department of Labor, Final Regulatory Impact and Regulatory Flexibility Analysis of Davis-Bacon Related Regulations (1982), cited in CBO, op. cit., p. 26.

¹² Ibid.

¹³ Ibid.

additonal costs to the taxpayer arising from the federal bureaucracy needed to administer the program.

In sum, DoL estimated that in 1982 Davis-Bacon inflated wage costs by \$570 million. In addition, it led to compliance costs of \$100 million and \$480 million in other costs by its restrictive use of helpers. Since the Act does little more than misallocate resources and inflate the cost of federal construction by over \$1 billion, the taxpayer gains nothing.

THE ECONOMIC EFFECTS

Job Losses

In addition to the direct budget costs of Davis-Bacon, the Act harms the economy. Perhaps most damaging is its depressing impact on construction employment levels. By setting an artificially high wage floor, Davis-Bacon increases the cost of each employee. The result: the number of job openings available for any given federal outlay is reduced. If federal construction outlays rise to take account of the labor costs imposed by the Act, federal construction employment may not fall, but the wind-fall gains to these construction workers merely reduce the funds and jobs available to workers in other industries.¹⁴

Barriers to Low-Skilled Workers

Davis-Bacon favors union workers. High prevailing wage determinations, for instance, give contractors the incentive to hire only the most skilled workers, since less skilled workers do not warrant the high wages mandated by the Act. While young, unskilled workers may be willing to accept lower wages to gain entrance to the construction industry and develop a skill, they are precluded from doing so by the raw economics of the Davis-Bacon Act.

Open-shop contractors awarded a federal contract must raise the wage levels of workers on the project to Davis-Bacon levels. This can create morale problems when employees on the contract are paid more than others doing similar work in the private sector. Further discontent may arise when wage rates are returned to market levels on completion of the project. One survey found that 23 percent of the open-shop contractors questioned reported that working on Davis-Bacon projects would be disruptive to their normal routine and so they would be unlikely

¹⁴ While not reducing employment in the construction industry in this case, Davis-Bacon may raise the industry's unemployment rate since higher wage rates will increase labor supply, i.e., those seeking work, in the construction industry. In addition, by raising costs to the federal government, resources and jobs will be drained from the private sector.

to bid on a federal contract. Of those who had undertaken Davis-Bacon construction, 20 percent said they would not want to do so again.¹⁵

Discrimination

A government imposed wage rate above the market level creates a surplus of job seekers, making discrimination easier. By undermining competitive forces in this way, Davis-Bacon allows employers to discriminate by race (or for any other reason) without suffering a financial penalty. Without Davis-Bacon, minority workers could offer their services at a lower wage, and employers who discriminated would then have higher labor costs and consequently lower profits. Thus, a free market would make discrimination more difficult.

Davis-Bacon also eliminates opportunities for low-skilled minority workers, because trainee and helper restrictions deny these workers employment experience and on-the-job training.

Consider the case of the House of Umoja's Boystown Construction Project in Philadelphia.¹⁶ In 1981-1982, the House of Umoja, a neighborhood group, undertook a construction and rehabilitation project to house delinquent black youth. The project consisted of two phases: Phase A was partly funded from government sources, and therefore subject to Davis-Bacon requirements. The contractor did not hire any of the Umoja youth for his part of the project. His reason: local youth were generally not productive enough to merit payment at the high Davis-Bacon scale.

Phase B, however, was privately financed and not subject to the Act. The work was performed by the Umoja Construction Company, consisting of ex-offenders and young local workers monitored by experts. Umoja supplied about two-thirds of the man-hours on the project, and it was completed at about 40 percent of the cost of Phase A, even though the construction was almost identical. Phase B allowed disadvantaged minority youths to acquire the basic skills needed for a future in the construction industry.

An additional three phases of the Umoja Boystown are being planned, using \$700,000 of public funds, but the House of Umoja staff complain that Davis-Bacon will restrict the opportunities for young people. As construction director Thomas Massaro puts it, "For the proud and proven young men of the Umoja Construction Co. to sit by once again as outsiders earn big dollars on their block would be a tragedy."¹⁷

¹⁵ Cited in CBO, op. cit., p. 31.

¹⁶ See Memo from project director Thomas Massaro to Robert L. Woodson, "House of Umoja Boystown Construction Project Winning and Losing on Davis-Bacon," November 11, 1982.

¹⁷ Ibid., p. 5.

The original supporters of the Act knew well that the law would reduce opportunities for blacks. George Mason University economist Walter Williams noted in recent testimony before the Senate Subcommittee on Labor that South Africa imposes restrictions very similar to Davis-Bacon:

White racist unions there support laws like the Davis-Bacon Act for the expressed purpose of protecting white labor from low wage black competition. Over there they call these laws "standard rate." Their stated intent is one thing; yours is another. The effect is roughly the same in both places.¹⁸

Effect on Inflation

Some critics of Davis-Bacon argue that the Act is inflationary, since higher wages on construction projects raise costs and push up prices. Higher federal construction costs do push up prices of public construction and related goods, leaving taxpayers with less money to spend on other goods. But this causes the prices of those other goods to ease. So Davis-Bacon is not of itself inflationary, though it changes relative prices. Davis-Bacon, however, does contribute to inflation when its direct consequences, such as an increase in the deficit or higher unemployment, encourage the government to adopt the easy money policies that do cause inflation.¹⁹

Competition

The assumption underlying Davis-Bacon is that competition is harmful to jobs and income and that protectionist measures are beneficial. The view that competition is destructive to economic improvement is, of course, erroneous. Proponents of Davis-Bacon misunderstand the role of competition in improving productivity and income levels.

In addition, there should be no reason why the local construction industry should be "protected" from competition any more than other occupations in a given locality. If defenders of Davis-Bacon are to be consistent in their arguments, they should be against competition among suppliers or any firms servicing the industry--indeed, all competition.

Stability

Supporters of the Davis-Bacon Act invariably fall back on the contention that construction is more unstable and insecure than

¹⁸ Testimony of Professor Walter Williams in "Hearings Before the Subcommittee on Labor of the Committee on Labor and Human Resources, U.S. Senate," April 29, 1980, p. 244.

¹⁹ See Dwight R. Lee, The Inflationary Impact of Labor Unions (College Station, Texas: Center for Education and Research in Free Enterprise, Research Monograph Series, No. 5).

other industries. Cyclical and seasonal factors tend to raise unemployment in the construction industry. But since construction workers are paid higher hourly wages than most other workers, these higher wages tend to offset the seasonal risk. Moreover, Davis-Bacon actually adds to the risk of unemployment by pricing some workers out of a job.

Productivity

Defenders of Davis-Bacon maintain that it has a positive effect on productivity by inducing contractors to improve worker skills to warrant the prevailing wage. This is a variant of the theory that minimum wage laws "shock" employers into greater efficiency, and it is refuted by University of Dallas economist W. H. Hutt:

It is just not true that prospects of adversity stimulated managerial and technological imagination, enterprise, and effort more than the prospects of prosperity. If it were true, it would be wise for governments to impose burdens on any sector of the economy they wished to foster--taxing industry to give it a jolt and thereby cause it to flourish!²⁰

Any wage floor, including Davis-Bacon, simply encourages firms to change their mix of inputs. They might substitute higher quality labor for their existing workforce or substitute capital equipment for labor. This will raise the productivity of labor, but reduce the productivity of other inputs. Labor productivity is not synonymous with efficiency. Any government intervention that requires profit-maximizing firms to alter their production mix means higher total costs and reduced efficiency.²¹

POSSIBLE REFORMS

Repeal of the Davis-Bacon Act would be the ideal reform. If repeal is not now possible, at least the most damaging provisions of the Act should be removed. The Labor Department, for example, in May 1982, issued regulations to significantly improve administration of the Act. These changes include: (1) replacing the "30 percent rule" with guidelines that would set the prevailing wage based on a majority, or, in the absence of a majority, the average pay rate; (2) changing the "locality" rules so that high wage rates from an urban area would less likely be applied to a

²⁰ Cited in ibid., p. 303.

²¹ For a fuller discussion of the productivity debate, see Joseph D. Reid, Jr., "Labor Unions in the American Economy: An Analytical Survey," Journal of Labor Research, Summer 1982, pp. 277-294, and Michael R. Metzger and Robert S. Goldfarb, "Do Davis-Bacon Minimum Wages Raise Product Quality?" Journal of Labor Research, Summer 1983, pp. 265-272.

suburban or rural region (the opposite would also be true); (3) excluding federal projects from all wage determinations;²² (4) allowing two "helpers" for every three journeymen on a construction site, thus giving employers greater flexibility in hiring unskilled and semiskilled workers and thereby reducing labor costs; and (5) relaxing the reporting requirements for firms.

Though these proposed changes are a step in the right direction, legal challenges led the courts to strike down two of the regulations. Fortunately, the "30 percent rule" has been eliminated from the wage determination procedure. This bias long has favored union wages.

In addition to regulatory reform of the Act, legislative changes could alleviate some of the worst features.²³ The \$2,000 threshold, which has remained constant since 1935, could be raised in line with current construction costs. This would reduce the number of projects subject to Davis-Bacon requirements. In addition, certain types of construction, such as military projects and low-income housing, could be exempted from the Act. The threshold for many housing projects is based on unit size, not value. So the Davis-Bacon trigger for federally assisted housing could be raised from eight units to, say, twenty. Partial deregulation of this could prove to be successful, because it would remove some of the worst effects of the law, while arousing less political opposition than outright repeal.

Further legislative changes could include basing the prevailing wage on a range of wages paid to workers in the private sector. Also, wage data from other federal projects could be excluded in the calculation of the prevailing wage, as could the application of metropolitan rates to rural areas. Though these latter reforms have been adopted through the regulatory process, they could be strengthened in place legislatively.

Helpers and apprentices could be given more recognition in the wage determination process. While the ideal would be to allow unlimited use of helpers and apprentices, the maximum ratio of helpers to journeymen at least could be eased. This would provide many new employment opportunities for minority and unskilled workers.

Finally, compliance costs could be reduced dramatically by allowing firms to submit compliance statements, rather than weekly payroll records, and to report on a less frequent basis.

²² The provision would not apply to highway and heavy construction projects, where there is little nonfederal construction.

²³ Two bills incorporating many useful changes are S. 1172, introduced by Senator Don Nickles (R-OK), and H.R. 3846, introduced by Congressmen Charles Stenholm (D-TX) and Arland Stangeland (R-MN).

Such a change would only require a statement at the beginning and end of a contract, though this would require dealing with the Copeland Anti-Kickback Act.

CONCLUSION

The Davis-Bacon Act is justified on neither efficiency nor equity grounds. It distorts the labor market by imposing a wage floor on federal construction contracts; it increases unemployment in the construction industry; it boosts costs to the taxpayer; and it prices lower-skilled workers--most notably nonunion and minority workers--out of the market.

The net effect of the Act is to transfer resources from taxpayers, consumers, nonunion workers, and the unemployed to unionized construction workers. Not only does Davis-Bacon lower total economic output by misallocating resources, it redirects income to workers typically paid above average wages. The reason for this inequity is quite simple: Unions and union contractors have a great deal of political clout.

The government should undertake policies that raise productivity and wages for all Americans by providing incentives to improve capital accumulation and innovation as well as education and training. A law that raises real wages by providing a wage floor can never benefit all workers. The Davis-Bacon Act and many other government regulations serve only to benefit special interest groups at everyone else's expense.

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