

MEMO

Date: Jan. 29, 2008

RE: CGR Report, "Prevailing Wage in NYS. The Impact on Project Cost and Competitiveness"

From: James Parrott, Fiscal Policy Institute

The CGR report sets out to address two issues:

- (1) the cost impact on construction projects in NYS when prevailing wage applies rather than "market" wage;
- (2) the "competitiveness" of NYS compared to other states if NYS applied a prevailing wage standard to IDA projects

This report has many weaknesses, it:

- employs a simplistic and crude methodology,
- reflects little understanding of the construction industry,
- employs a flawed understanding of how prevailing wage operates,
- completely ignores the economic development value of a skilled workforce, and
- generally reflects a poor understanding of economic competitiveness.

And above all, the CGR report makes a *fatal flaw* in assuming that the productivity of construction workers is the same for both prevailing wage and "market" wage projects within NYS and between areas in NYS and areas in other states in the U.S. A study that purports to look at relative production costs yet assumes that productivity is invariant across so many areas is flawed from the start, reaching conclusions that have to be suspect. As the saying goes, "garbage in, garbage out."

Empirical evidence and economic theory both argue that wage differentials within a given specific occupation and area are largely due to differences in the productivity of the worker. Holding other things constant, differences in productivity are largely a function of human capital characteristics, and in construction, that largely comes down to skill differences.

Prevailing wage is not just a wage standard, but it establishes a skill training requirement and mandates a state-registered multi-year apprenticeship training program. A prevailing wage standard is characterized by a built-in skilled workforce and involves the use of apprentices who are paid wages below the journey person wage level until completion of the 3-, 4- or 5-year apprenticeship training program. The so-called "market" wage data cited by CGR makes no allowance for skill levels.

The seminal 1984 Quarterly Journal of Economics article by Steven G. Allen found that skilled

construction workers who receive higher wages are about 20 percent more productive than less skilled workers.¹

Skills and productivity are the determinants of total bottom line costs, not wage rates. In a comprehensive study of highway construction costs covering all fifty states over a 14-year period, Bob Gasperow found that total construction costs per mile using workers in high-wage states (with wages 80% above workers in low-wage states) were 11% lower than costs per mile in the low-wage states. The number of worker hours needed to produce a mile of highway in the high-wage states was 40% less, and material usage was less because less work had to be done over. Gasperow concluded: “There is no basis for the claim that lower wage rates result in lower construction costs.”²

Other points that will be elaborated in a later version of this memo:

CGR assumes a monolithic construction sector, ignoring the fact that the mix of construction projects within an area (e.g., high-rise commercial vs. single family residential) can have a large impact on average (or median) wages, even by trade

CGR uses the journey person wage for its “prevailing wage” levels, ignoring the use of reduced wage and benefit rates for apprentices on prevailing wage projects

CGR ignores any benefit differentials (health care, paid time off, pensions, etc.) that may exist between workers paid the “market” rate and prevailing wage workers

CGR ignores the value of the prevailing wage apprenticeship system despite the fact that it provides for systematic skill training in a project-based industry where individual employers have little incentive to invest in training their workers

One implication of the CGR analysis, if it were well-founded, would be that NYS would be more “competitive” if it eliminated prevailing wage. This ignores the findings of several studies of the repeal of state prevailing wage laws that found that the consequences of repeal include lower quality construction and increased cost overruns.

In approvingly citing the Public Policy Institute use of various “business climate” comparisons, CGR betrays a primitive understanding of “competitiveness”.

The implied “vision” of economic development in the CGR analysis is “low-road”, that is, a low-skill, low-wage workforce, with inadequate safety training and few opportunities for advancement, health or retirement security.

¹ Unless otherwise noted, these and other citations can be found in Fiscal Policy Institute, *The Economic Development Benefits of Prevailing Wage*, May 2006.

² Bob Gasperow, “Wages, Productivity, and Highway Construction Costs,” available from the National Alliance for Fair Contracting.