Prevailing Rate of Wage Act (Davis-Bacon Act)
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The GAO on Davis-Bacon:

A Fatally Flawed Study

Summary of an economic critique by the Center to Protect Workers' Rights

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S U M M A R Y

The Davis-Bacon Act requires that workers on federal and federally-funded construction projects be paid no less than the prevailing wages in their area. This law is administered by the Department of Labor (DOL), which issues formal determinations of the rates which prevail for the various crafts of the construction industry on projects of a similar character within a particular area. In the almost fifty years since its initial passage, the Act has made an important contribution to the productivity and efficiency of the construction industry and to the standard of living of construction workers.

In April of this year, the General Accounting Office (GAO) issued a Report entitled "The Davis-Bacon Act Should be Repealed," in which they criticize both the basic concept of the Act and the manner in which it is being administered.

Since this GAO Report has come to play a central role in the current debate over the Davis-Bacon Act, it is important that the validity of the GAO's evidence, methodology and reasoning be carefully scrutinized. In reviewing this GAO Report, we have found flaws so serious as to render their arguments inconclusive and groundless. These flaws result from a misapplication of data and a misunderstanding of the Act's purposes and benefits.

I. The Davis-Bacon Act Still Serves An Important Purpose and Should be Retained.

The first basic point made in the GAO Report is that the Davis-Bacon Act should be repealed because "significant changes

in economic conditions. . .make the Act unnecessary." Their argument is essentially that the law was passed in response to problems faced by construction workers during the Great Depression. Since depression-era conditions no longer exist, the GAO argues, the law is an anachronism and should be repealed.

The GAO's argument reflects a misunderstanding of the history and purpose of prevailing wage legislation. It is true that the hardships created by the Depression gave final impetus to the passage of the Davis-Bacon Act. However, the Act, like many other important pieces of reform legislation enacted in the 1930's, was intended to represent a permanent reform, improving the equity and efficiency of our economic system.

One of the key purposes of the Davis-Bacon Act is to prevent the government from using its tremendous economic power to disrupt the free working of local labor markets.

The government's unusual power over the construction labor market comes largely from the fact that it is directly responsible for a substantial share of the output of many segments of the industry. This domination of a market by a single purchaser is termed "monopsony," a situation analogous to the domination of a market by a single seller, which is known as monopoly.

Economic theory indicates that a monopsonist, in the absence of countervailing power, will be in a position to exploit the seller by paying a price below that which would be determined by competitive market forces. In construction, since labor is likely to be the only element of cost over which an

employer can exercise any degree of short-term control, the contractor will be likely to cut wages in order to maintain profit margins. This is analogous to the situation of monopoly, where artificially high prices tend to be passed along to the ultimate consumer.

The Davis-Bacon Act serves as a check on the government's potential role as a monopsonist in the market for construction. Rather than using its massive economic clout to drive down contract prices and wages whenever it can, the government has agreed, through the passage of prevailing wage laws, to forego the privileges of market power and to rely on the wage rates determined in the private sector.

The Davis-Bacon Act also has a role to play in helping to stabilize conditions in the construction industry and in preventing wage-cutting from becoming a means of winning government contracts. There are a number of special characteristics of construction -- persistently high unemployment rates, the casual nature of most employment relationships, and the transient connection between many firms and the communities they serve, for example -- which result in tendencies towards wage cutting and instability in this industry.

The problem of wage-cutting is particularly likely to crop up on government projects because of laws which require the government to award contracts to the lowest qualified bidder. Again, since labor is one element of construction costs over which an individual contractor can exercise significant control, there is a real temptation to try to underbid competitors by paying lower wages. The problem may be especially

severe in cases where an out-of-town contractor underbids competitors by undercutting local wage rates.

By stabilizing wages on government projects at locally prevailing rates, the Davis-Bacon Act makes an important contribution towards maintaining a decent standard of living for construction workers. In addition, the Act also provides important benefits to individual contractors, to the construction industry as a whole, and to the government itself.

Prevailing wage protection is beneficial to the industry because it helps insure that wages and benefits will be sufficiently high and sufficiently stable and predictable to allow the recruitment, training and retention of a pool of skilled workers able to meet the needs of any contractor who undertakes a job within the area. While any individual construction company -- particularly a transient firm -- might not have a large stake in the long-term development of a skilled labor force, this is of vital importance to the local industry as a whole. For this reason, there is a substantial community interest in insuring that there are adequate rewards to "human capital" investments in acquiring construction skills, and that there are adequate incentives to keep these skilled workers from drifting away into other employment.

The Davis-Bacon Act also protects individual contractors who are committed to maintaining decent labor standards. The Act guarantees equality of opportunity for such employers, giving them a chance to compete for government projects on an equal footing with firms whose only interest is short-run savings in wage rates.

Finally, prevailing wage laws are of practical importance in protecting the interests of the government and taxpayers. All too often, cut-rate labor is associated with shoddy work in general, both because skilled and experienced workers are not willing to work for substandard pay and because contractors who cut corners on wages are also likely to cut corners elsewhere. While payment of prevailing wages certainly does not guarantee quality work, it at least makes it possible to hire people with the skills needed to do a job quickly, efficiently and properly.

In summary, far from being obsolete, the Davis-Bacon Act continues to serve a number of important purposes. The simple fact that the Depression is over provides no more reason for the repeal of this law than it does for the repeal of any of the other economic and social reforms enacted during the 1930's.

II. The Department of Labor Does a Good Job in Administering the Davis-Bacon Act.

The second principal theme of the GAO Report is that the Labor Department is doing a poor job of administering the Davis-Bacon Act, and that the Act may, in fact, be impossible to administer.

One of the main criticisms of DOL procedures made by the GAO is that wage determinations are often issued without a survey of wages being paid in the area having been taken, with the Davis-Bacon rates being based instead on union-negotiated wages.

This finding, by itself, indicates no deficiencies in the Labor Department's procedures, despite the efforts of the GAO to imply otherwise. The Department has other tools at its disposal for determining wage rates besides making a full-scale survey. Regional office staffs try to stay in close contact with contracting agencies, employer associations, labor unions, and others familiar with local conditions. In many cases, based on information gathered in this manner, it may be clearly evident that union wage rates prevail for particular kinds of construction in particular areas. In such cases, the union rates are obtained from the relevant collective bargaining agreements without the need for a time-consuming and expensive wage survey.

Thus, there is nothing wrong with the Labor Department not taking surveys in all cases, and the GAO report presents no

reasons to believe that the DOL has been erroneously deciding that surveys are not needed.

Indeed, an examination of the GAO's own figures suggests that the Labor Department has been making wise use of its survey resources. In the residential construction sector, where open shop construction is most prevalent, fully 81% of the determinations studied were based on wage surveys. In the heavy construction sector where unions are strongest, full surveys were taken in only one of five determinations sampled. In terms of regions, surveys were most common (80% of determinations) in the Atlanta Region, an area of relatively light unionization. In the Chicago Region -- a heavily unionized area -- surveys were taken for only 31% of the determinations sampled.

The evidence presented by the GAO to back up its other charges concerning the Act's administration is equally unconvincing. For example, the claim is made that the Labor Department's survey procedures are deficient because responses are not always received concerning all projects in an area. This is not really a problem at all, since virtually everyone would agree that a representative sample should be sufficient basis for a wage determination. The GAO found that the response rate on the DOL surveys it studied averaged 54%, which seems ample for producing estimates with a reasonable level of confidence.

The GAO takes issue with the Labor Department's practice of including data from federally-funded projects when determining Davis-Bacon rates. However, use of data from federal projects is a practical necessity in many cases, since private sector counterparts are very scarce for many of the things which the government builds -- dams, airports, sewers, bridges, harbor facilities, etc.

The GAO Report also charges that the Labor Department's wage determination policies often have the effect of "importing" rates into an area from other localities. The GAO indicates that its studies uncovered a number of situations where rates determined in one area were "extended" to cover adjacent or even nonadjacent counties.

However, it appears that the GAO findings on this subject may largely reflect confusion over terminology. According to the Labor Department, many of the supposed cases of "importation" found by the GAO apparently represent situations in which negotiated rates actually prevail over a multi-county area and thus were properly used in more than one determination.

In addition, there are situations where the Labor Department must go outside of a particular locality when issuing Davis-Bacon determinations. Such situations are likely to arise in sparsely populated areas, where the Department's staff may have to go to adjacent counties in order to find a sufficient number of projects to provide a basis for a wage determination. This practice will not lead to any significant distortions, since it

is very likely that the contractor (and a substantial number of the skilled workers) will also need to be brought in from surrounding areas.

This "borrowing" of wage rates is actually fairly rare. According to Labor Department statistics, none of the area determinations and less than 8% of the project determinations issued in fiscal year 1978 were based on data from outside the locality in question.

Finally, the GAO criticizes the procedures which the Labor Department uses to determine prevailing rates from the data collected. Specifically, they object to the use of the so-called "30% rule."

The 30% rule specifies that the prevailing wage will be the rate paid to the greatest number of workers, provided that this rate is received by at least 30% of the workers employed. If no rate is received by 30% of the employees, the average wage is used. The GAO believes instead that an average should be used in all cases. However, an arithmetic average is not a suitable measure of prevailing wages in labor markets where the distribution of wage rates is skewed in one direction or another. In these cases, the average can be well below or above the rate actually received by a majority of the workers in an area. This is especially likely to occur , for example, in areas where there is substantial unionization.

Aside from the weaknesses of the averaging method, there is simply no evidence that the 30% rule significantly distorts wages on federal construction projects. When a special DOL study examined all wage determinations issued in 1978 using the 30% rule, they found that the differences between these rates and those which would be computed using an averaging method came in both directions and tended to cancel each other out.

In general, the GAO's charges concerning the DOL's wage determination practices tend to be unsubstantiated and misleading. They rely heavily on isolated examples, some purely hypothetical. An examination of the GAO's own figures on wage determinations suggest that DOL is making efficient use of its resources. The Department's practices appear to be perfectly reasonable adaptations to the actual circumstances of the wage determination process.

The general soundness of the Labor Department's Davis-Bacon procedures is confirmed by the results of a study conducted by the President's Council on Wage and Price Stability (COWPS) in 1976. This study was based on a comparison of Davis-Bacon wage rates with the average wages reported in a special survey of the construction industry taken by the Bureau of Labor Statistics (BLS). The comparisons were made for both commercial and residential building in 19 cities for September 1972. Because the BLS rates represent the results of scientific surveys taken by an experienced independent statistical agency, this study allows for an examination of the general accuracy

and validity of Davis-Bacon data collection methods as well as the specific effects of the 30% rule.

The results of the COWPS study tend to confirm the belief that, on average, wage determinations under the Davis-Bacon Act are quite similar to those which actually prevail in the economy. COWPS found that,in the residential sector, the Davis-Bacon rates averaged only 3.1% higher than the rates reported by BLS. In commercial construction, the Davis-Bacon rates were 2.7% below those reported by BLS. Naturally, in individual cases, the two sets of rates differed by larger amounts, resulting from differences in the way they are computed. However, this study provides no evidence that, on the whole, the level of wages required on federal projects is any higher than those actually prevailing for similar work.

III. The Davis-Bacon Act Does Not Contribute to Excessive Costs of Federal Construction, Nor Is It Inflationary.

The final charge made by the GAO is that the Davis-Bacon Act results in unnecessary construction and administrative costs, and that it has an inflationary effect on the economy as a whole. This claim is clearly false for a number of reasons.

First, the survey on which the GAO conclusions are based is so seriously flawed as to render the results meaningless. The GAO used a sample of only 30 cases to represent the universe of 17,000 wage determinations. Clearly, this sample size is far too small to allow for any valid conclusions to be drawn regarding the totality of DOL wage determinations.

This fact is acknowledged in several places within the GAO Report. Fox example, on page 100, the Report's authors state, "...we recognize that our sample size was insufficient for projecting the results to the universe of construction costs during the year with any statistical validity." The Comptroller General himself admitted that a sample of 1200, rather than 30, would have been required to produce statistically valid results.

The study on which the GAO charges are based is suspect for several other reasons as well. The GAO asserts that, despite the miniscule size of the sample, the projects they studied are at least representative of the universe of Davis-Bacon determinations. However, the Report presents no evidence to substantiate this claim. On the contrary, what limited data

is available suggests exactly the opposite. For example, cases in which union rates were determined to prevail seem to be overrepresented in the GAO sample. While these account for only 43% of the determinations issued by the DOL, they account for 66% of the cases studied by the GAO. Determinations for residential construction also seem to be overrepresented. These account for 26.7% of the sample, while housing and redevelopment account for only 2.5% of the value of public construction. Determinations for highway construction seem to be underrepresented (3.3% of sample but 24.8% of public construction).

Since the wage determination process is likely to be most difficult in situations where there is substantial open shop activity, the areas which are overrepresented in the sample seem to be those in which problems are most likely to be found. Thus, it would appear that the GAO sample may be systematically biased in a way which serves to artificially increase the reported incidence of error in DOL determinations.

The principal use which the GAO makes of this survey data is to try to show that the administration of the Davis-Bacon Act leads to excessive wage rates on federal construction. In 12 of the 30 cases studied, the GAO found the Labor Department determinations to be higher than the rates which the GAO believed to prevail. For these 12 projects, the percentage difference between the DOL and GAO estimates was taken to indicate

the percentage by which labor costs have been artificially increased. This then became the basis for the conclusion that the Davis-Bacon Act results in several hundred million dollars of excess construction costs per year.

The data presented provide no support to such a sweeping conclusion. In addition to the serious questions about the size and biases of the GAO sample, there is no reason to believe that the GAO surveys were anywhere near as complete and comprehensive as those taken by the Labor Department. There are also at least two important differences between the survey methods used by the GAO investigators and those used by the DOL. Thus, for all of these reasons, there is no reason to believe that any differences between the GAO estimates of prevailing wages and the actual DOL determinations indicate problems with the Labor Department's procedures or practices.

A second general set of problems with the GAO methodology involves the assumptions which underlie the translation of differences in wage rates into differences in cost to the taxpayers. The GAO makes the assumption that any reduction in wage rates will translate directly into lower project costs. This is faulty reasoning. Such an argument ignores the fact that lowering wages does not necessarily result in lower costs. More times than not, the result is simply that less skilled workers are attracted to the job site. The hiring of lower paid, less skilled and less productive workers could translate

those short-term savings into long-term costs (longer completion times, waste, excessive maintenance, etc.).

A similar problem exists with the GAO's apparent assumption that all savings in project costs will be passed on to the consumer in the form of a lower final price. This is obviously an assertion which should be treated with considerable skepticism. In reality, the savings to the government will depend on how low the winning contractor has to set his bid to undercut competition. This is not likely to be directly related to the wages which are expected to be paid.

Third, the GAO's estimate that the administrative requirements of Davis-Bacon cost an additional $190 million per year represents a gross exaggeration. The only real basis for their figures is a survey taken by a contractor organization with the explicit purpose of providing support for the claim that these requirements are costly. Furthermore, in most cases the only significant administrative requirement of the Act is that contractors provide the government with a copy of their weekly payroll. Unless one believes that contractors would not otherwise keep payroll records, it is inconceivable that the requirements could be anywhere near as costly as the GAO claims.

Finally, the GAO also makes the charge that the Davis-Bacon Act not only contributes to excessive construction costs,

but also has an inflationary effect on the construction industry as a whole. This charge is even less substantiated than the others in the Report.

Even if the GAO could prove that Davis-Bacon leads to excessive costs, this does not mean that the Act is inflationary. Rather, the GAO misapplies the term. "Inflation" refers to the rate at which costs and prices are increasing, not to their levels. The allegation that construction costs are higher than they should be does not imply that these costs are increasing at an excessive rate; it does not even necessarily imply that they are increasing at all.

In fact, just the opposite has occurred. Wages in construction have recently failed to keep pace with wages in other sectors of the economy or with prices. Over the past five years, hourly earnings for construction workers increased at an average rate of 6.1% per year. At the same time, average hourly earnings for the private nonfarm economy as a whole were increasing at a rate of 7.8% per year, and inflation was averaging 8.0% per year. After adjustment for inflation, construction wages actually fell by 12.4% between 1973 and 1978.

Not only have wages in construction been failing to keep pace with inflation, but labor costs as a whole have been rising less rapidly than other elements of construction costs. Between 1949 and 1977, the share of the consumer's housing dollar attributable to labor costs fell from 31 cents to 17

cents, while the share going to banks rose from 5 cents to 11 cents, the share going to landowners rose from 11 cents to 25 cents, and the share going to developers (in profits and overhead) rose from 15 cents to 17 cents.

IV. Conclusion--The Arguments of the GAO Do Not Warrant Repeal.

The General Accounting Office has presented a very weak case for the repeal of Davis-Bacon. Serious methodological problems render its estimates of the costs of the Act virtually meaningless, and the GAO has failed to produce any convincing evidence of the law's inflationary impact. Contrary to the GAO's assertions, the Department of Labor administers the program adequately, and the available data suggests that the level of wages required on federal projects is similar to that which prevails in the construction labor market as a whole.

Finally, the Davis-Bacon Act has several important purposes -- helping to stabilize conditions in construction labor markets, preventing wages from being driven down as a result of the federal government procurement process, and providing a check on the government's tremendous economic power which could otherwise severely disrupt the labor standards of the local community. It is for these reasons that Congress should not repeal the Davis-Bacon Act or its provisions in any of the 77 related statutes which involve federally assisted construction.

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