

# the fairness myth

A GROWING BODY OF EVIDENCE SHOWS “FAIR” WAGE LAWS MAY ACTUALLY CAUSE MORE HARM THAN GOOD.

So-called “fair” wage legislation or policies for public construction projects exist for federal governments in both Canada and the U.S. Many provincial, state and municipal jurisdictions across North America also regulate construction wages in some fashion. Most governments with these policies attach wage schedules that stipulate minimum pay rates for construction workers to their contract specifications. Others specify that contractors must be unionized or follow union collective agreements as a pre-condition to being awarded a contract.

Despite the prevalence of regulated wage policies, there is little objective evidence to support their legitimacy from a public policy perspective. Rather, there is a growing constituency within the construction industry and academic communities who believe these policies cause more harm than good. Their research suggests that wage regulations actually result in greater inequity. This is because the rationale for them is fundamentally flawed and based on erroneous assumptions. As a result, the rates paid under fair or prevailing wage regimes exceed the rates that would be payable in the absence of such policies. Consequently, tax dollars are unnecessarily being redirected to construction workers who are already well-paid in comparison to other industries.

Problems are further compounded when governments use erroneous methods to calculate the fair or prevailing wage rate for a construction occupation causing public works construction costs to be needlessly exces-

sive. These higher costs come not only at the expense of taxpayers, but may also contribute to higher unemployment and poverty by reducing employment opportunities.

## Perpetuating the Myth of Unfairness

In July 2000, the Canadian federal government implemented federal wage schedules for Alberta’s construction industry. While mention was made of “extensive consultation”, the news release omitted the fact that most local, provincial and national construction associations opposed these schedules. Business associations such as the Canadian Chamber of Commerce and the Canadian Federation of Independent Businesses also expressly opposed the measures.

Omitted as well was the fact that the process of developing the schedules spanned three years, involved three consecutive labour ministers and likely cost Canadian taxpayers more than a million dollars. In addition, industry charges that bureaucrats had misunderstood industry compensation practices resulting in errors that could increase federal public works construction costs by \$150 million, were not addressed. Nonetheless, Labour Minister Claudette Bradshaw trumpeted that, “Putting in place fair wage schedules will contribute to better labour relations and to a more cooperative and productive workplace.”

Could the average Canadian be faulted for thinking that re-introducing wage schedules could correct major problems in the construction industry? After all, why else would Canada’s Attorney General, the Hon. Anne McLellan, say wage schedules would ensure fairness for workers was “an essential element [for] conducting business with the government”? Surely most contractors must be treating their employees unfairly?

In the theoretically rational world where public policy is thought to be made, the expected answer would be

yes. But sometimes public policy is more about politicians and supporting bureaucrats weaving and perpetuating illusions than anything else.

It’s understandable how some politicians find minimum wage schedules politically attractive. What politician could be against “fair” wages? In Canada, that would be akin to being against hockey and maple syrup, or in the U.S., against motherhood and apple pie.

The fact is, fair wage proponents continue to base their assumptions on overexaggerated, stereotypical notions about how the construction industry operates. At the heart of this stereotype is the perception that undereducated and economically disadvantaged tradespeople need to be protected from exploitation by unscrupulous employers. An objective look at the facts suggests otherwise.

## Fair Wage Policies: Rooted in Protectionist Sentiments

Though the concept of regulating construction wages on public works projects in Canada has existed in many forms for more than a century, the rationale underlying this type of regulation has not been extensively studied.

In 1992, B.C.’s provincial government became the first major jurisdiction in North America to reintroduce wage schedules in two decades. This prompted three professors at the University of British Columbia and Simon Fraser University to undertake a comprehensive analysis of B.C.’s Fair Wages and Skills Development Policy. Their study, (*Globerman, Stanbury, Vertinsky: Analysis of Fair Wage Policies: British Columbia and Other Jurisdictions*), published in 1993, found there was little rationale beyond partisan politics to support the return of wage schedules. Indeed, the history of construction wage rate policies in the U.S. and Canada suggests that politics – particularly protectionist politics – seem to be the most common rationale behind these policies.

In reality, through their many iterations over the years, fair wage policies and regulations were conceived to benefit particular groups, typically con-

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struction unions, at the expense of other less politically powerful groups. That the union lobby is politically influential is evident in the fact that construction remains the only industry in most jurisdictions to be singled out for this type of regulatory control.

#### Fairness, Like Beauty, Rests in the Eyes of the Beholder

Today’s fair wage measures are rooted in historical efforts to achieve humanitarian social policy objectives through fiscal measures that were unabashedly protectionist. The Canadian House of Commons debates in 1900 on the Fair Wages Resolution illustrate this duality.

On one hand, proponents mentioned motives similar to their British parliamentary counterparts in “making provision against the evils disclosed before the “Sweating Committee”. At the same time, they also sought to prevent cheap labour in the form of “persons brought in from without the districts, and perhaps from without the country” from working on government projects.

In time, governments moved to standardize minimum pay rates. By “leveling the playing field”, any competitive advantages external competitors might bring to the labour component of a construction project were effectively eliminated, thus making competition more “fair”. However, as the Globerman et. al. study indicated, “fairness, like beauty, rests in the eyes

of the beholder.” The policies and regulations that developed over time, showed how subjective and relative “fair” could be.

Consider the Canadian government’s first Fair Wages Policy Order in 1922. Wages of no less than 30¢ per hour were payable to men. On the other hand, women could receive no less than 20¢ per hour. While the 50% difference was “fair” in 1922, such discrimination is beyond “unfair” today – it is illegal.

A *Wall Street Journal* article in 1992 stated that the Davis-Bacon Act, the U.S. fair wage law which the U.S. Congress enacted in 1931, was written “to prevent black workers, mostly from the South, from competing with northern construction unions.” Apparently, Congressman Robert Bacon, a co-sponsor of the Act, became upset when an Alabama contractor was awarded a contract to build a hospital in his New York congressional district. The contractor brought with him a large contingent of black workers which “entirely upset” the local labour market and community.

While some of the motives behind these measures may be questionable, the Canadian Fair Wages and Eight-Hour Day Act of 1930 and the U.S. Davis-Bacon Act of 1931 must be viewed in the context of the times they were introduced. These are but two examples of the radically interventionist measures governments of the day adopted to deal with the hardships and economic chaos of the Great Depression. Wage regulations, such as these, simply reflected what Nobel Economics laureate Milton Friedman argues was a dramatic change in the public’s view of what role governments should play in the economy and day-to-day living.

The ensuing post-war economic reconstruction saw governments and businesses – particularly large businesses – increasingly turn to unions and collective bargaining to organize workplaces. A new economic and political order involving “big” government, “big” business and “big” labour emerged. With this, came the increasing influence of economic and social

interventionists who believed that positive social and economic outcomes could be engineered through government regulatory policy. This philosophy remained virtually unchanged through the '70s and '80s until governments started contemplating mounting public debt loads.

By this time, however, between 80 to 87% of the commercial, institutional, industrial and engineering-based construction was being done with international building trades’ union labour. With a virtually monopolistic hold on the industry, it’s no surprise that fair or prevailing labour rates closely matched or replicated those found in collective bargaining agreements. By 1978, prevailing wage laws were adopted by as many as 41 U.S. states and existed in many provinces and municipalities in Canada.

#### Toward a Freer Market for Determining Wage Rates

Escalating costs, labour unrest and declining productivity caused some contractors, construction owners and policy makers to question their relationships with the big construction unions. With double digit inflation and economies stagnating, American and British politicians began embracing the freer market principles which had won Milton Friedman the Nobel Prize for economics.

In the U.S., studies prepared by the Business Round Table (an organization of construction owners), and the Associated Builders and Contractors (ABC) which had emerged as an effective voice for open shop contractors, caused authorities to begin looking at the impact of prevailing fair wage policies and laws.

According to Globerman et. al., in 1979, the U.S. Government Accounting Office estimated that in 1967, the Davis-Bacon Act increased construction costs by \$228 to \$513 million and added some \$200 million in administrative costs to contractors and government. A 1983 U.S. Congressional Budget Office study also estimated that repealing the Davis-Bacon Act would have saved the U.S. government \$5.2 billion between 1984 and 1988.

While the union lobby was powerful enough to prevent repeal of the national law, a number of technical and administrative reforms were introduced by the U.S. Secretary of Labour. Nine U.S. states also repealed their wage laws regulating construction projects between 1979 and 1991.

Facing similar economic issues, Canadian governments also began investigating. In 1986, Labour Canada reviewed the Act and reached two conclusions:

1. The legislation was deemed to be largely irrelevant because hours of work and overtime problems the Act was designed to address in 1935 were now dealt with under provincial legislation, through collective agreements or by the marketplace.
2. The wage schedules and the surveys on which they were based were expensive to administer and statistically unsound.

Based on this analysis, the labour minister of the day suspended issuing wage schedules for a three-year trial period beginning April 1, 1987. The subsequent evaluation by Labour Canada in 1990 determined that of only fifty complaints, six involved wages and only four of the complaints were legitimate. Over the three-year period, Public Works Canada issued 4,622 contracts that had a total value of \$1.428 billion. The amount of wage arrears dealt with constituted 0.00002 % of the total value of the federal construction contracts. The average cost to process each complaint was \$16,200.

The report concluded, “The reintroduction of wage schedules would likely increase “fair wage” compliance levels marginally...Given the current resource situation, it is difficult to justify an expenditure of that magnitude in order to obtain a marginal increase in compliance.”

These low complaint numbers indicate that freer and competitive unionized and non-unionized labour markets were efficiently establishing wage rates for the construction industry. Considering that in Alberta, for exam-

ple, the average weekly earnings in construction exceeded the industrial aggregate average by almost 19% in 1996, it seems apparent that producing wage schedules was a pointless exercise from a public policy perspective.

#### Trying to Turn Back the Clock

Despite the fact the construction industry was operating quite effectively without wage regulations, the 1990's saw a resurgence in wage policies and regulations in Canada. What brought about this change? Whereas building trades' unions had enjoyed virtual monopolistic dominance in the 1970's and early 1980's, by the 1990's, 80% of construction was being done on an open shop basis. The resurgence in wage policies and regulations can be directly attributed to building trade craft unions attempting to regain, through government policy, the market share they lost during the 1980's.

In particular, newly-elected NDP governments in B.C. and Saskatchewan quickly moved to stem the market share losses of their unionized supporters. Each government set about doing it in a different way.

In 1991, a labour lawyer who had represented various building trades' unions for many years was appointed Saskatchewan's Labour Minister. Almost immediately, he announced that the NDP government would reintroduce union preference for its construction projects. After two years of opposition, the government opted to change tendering specifications for Crown Corporation capital construction projects. These specifications set building trades' collective agreement rates and employment conditions as the fair wage regime. One project, which then *Financial Times* columnist Diane Francis affectionately dubbed Saskwaterngate, clearly showed the folly of this approach when labour costs increased by 35%.

In B.C., the provincial NDP government introduced the Fair Wages and Skills Development Policy. Wage rates were set at approximately 87% of the provincial building trades' union rates. While the NDP dismissed the impact the policy would have on construction

costs, the Quantity Surveyors Society of British Columbia calculated that the policy would increase costs by \$100 million annually.

The re-introduction of wage schedules by the Canadian federal government also provides a textbook example of how contrived and politically motivated this measure was. In 1997, one week before a federal general election was called, then Minister of Labour, Alphonse Gagliano, announced that the Government of Canada would reintroduce wage schedules for federal construction projects. That announcement took many in the industry by surprise for two reasons. First, it was learned that the Minister had only discussed the issue with international building trades' union leaders. Second, his announcement came after a 10-year moratorium on wage schedules. What followed was a clear indication that the federal government had committed to this policy direction even before the consultation and research process had begun.

Perhaps thinking this was a “slam dunk”, the Minister announced that a negotiating process would be used to set wage schedules. To this end, a pilot project was established in Alberta. Stakeholders, including unions and employers' organizations, were engaged by Human Resources Development Canada (HRDC) officials to agree on wage rates. The Merit Contractors Association and the Alberta Construction Association opposed this approach. Their position was that a current wage rate, is not the same as a negotiated wage rate. The Federal Court of Appeal essentially upheld that position in a separate action taken by the Independent Contractors and Business Association of B.C. Their action successfully challenged the federal government's adoption of the provincial wage schedule for all federal public works construction across B.C. The Alberta pilot project was a dismal failure.

Undaunted, in 1998, the government appointed Mr. Douglas Stanley to undertake a comprehensive review of the Act. The third labour minister in as many years immediately embraced his final report and

announced that wage schedules would be developed.

What did Mr. Stanley say about the impact of the Act on wage rates and construction costs? In the single paragraph devoted to this issue, he indicated he was unable to determine what the impact would be. Despite his inability to address this issue, his report became the foundation upon which national wage schedules were re-introduced.

#### Additional Problems Due to Poor Methods

Construction market dynamics are significantly different and more complex than in previous times when prevailing rates were largely determined by consulting collective bargaining agreements. The regulatory challenge today is thus far greater. And, without proper methodologies to test for the reliability and validity of data, the process of determining rates can fall prey to mischief.

Writing in the *Journal of Labor Research*, published by George Mason University at Fairfax, Virginia, A.J. Thiebolt noted that the absence of verification or audit procedures has left the door open for fraud or deliberate misinterpretation by biased administrators. Without checks, the methods can be systematically manipulated resulting in overstated wage rates. For example, one particular unionized project in Montgomery County, Maryland with a value of \$30,000 claimed to have employed four carpenters, one sheet metal worker and 50 electricians. Yet, another non-union project was said to be worth \$900,000 but employed only a single labourer.

Deliberate fraud was also uncovered. Forms submitted to the Department of Labor in Oklahoma contained phony projects and non-existent workers with overstated wage rates. Investigations revealed these were deliberate attempts to manipulate the wage data used to establish prevailing wages. As a result, a union business agent was convicted of 14 felony counts for filing false wage and employee count information to the local Davis-Bacon administrator in

1997.

In the same year, the U.S. Department of Labor's Inspector General's Office found that two-thirds of the wage surveys used to calculate wage rates contained inaccuracies. In January 1999, a U.S. General Accounting Office report indicated that errors were found in 70% of the wage forms submitted.

While similar investigations were not undertaken in Canada, Labour Canada's 1986 study concluded that the schedules were flawed and statistically unsound. A review of the recent survey questions and methods Statistics Canada used to develop the current wage rates also revealed problems. Many of the problems stemmed from the inability of regulators to understand how the industry operates.

Initially, the survey on which HRDC based its wage determinations only asked for the "gross rate of pay excluding overtime, commissions and bonuses". Unless qualified, many contractors would report an all-inclusive rate that included both statutory and non-statutory benefits. While this error was pointed out and acknowledged by HRDC, no remedial action was taken to rectify wage rate schedules in Saskatchewan, Manitoba and the Maritimes.

Initial results of an amended survey done in Alberta that was posted on HRDC's website prior to a scheduled industry review, also suggested that respondents included statutory benefits from their reported wage rates. Many may have also failed to distinguish between industrial and commercial construction wage rates – two very separate and distinct construction markets in Alberta.

Perhaps the most glaring example of these problems was evident in the rates set for the heavily unionized elevator constructor trade. The collective agreement wage rate for constructors was \$28.44 per hour. Yet, the wage set by HRDC for this occupation was \$30.46 per hour. Similar problems were found with rates set for metal building erectors and electricians. When asked about these anomalies, government officials argued that contractors, specifically unionized con-

tractors, were paying more per hour than called for in the various collective agreements. It comes as little surprise that independent surveys could not confirm this curious practice.

Statistics Canada finally contacted a number of the companies involved in the original survey to verify responses. Interestingly, 156 of the original 209 "verified estimates" – a staggering 75% – were different. Still, rather than recognize the flaws in the survey process, the government exercised its closure powers, concluded the consultation process and proclaimed wage schedules into effect for Alberta.

#### The Power To Do Good Is Also The Power To Do Great Harm

Setting aside the political dynamics, there are those who maintain that fair wage measures are justified and result in a greater good. However, as Milton Friedman noted, "The power to do good is also the power to do great harm."

This is supported by a 1999 study undertaken by Richard Vedder of the Mackinac Centre for Public Policy at Midland, Michigan, which suggested that fair or prevailing wage policies may in fact cause more harm than good. Dr. Vedder analyzed construction costs and employment data for a 30-month period while the State of Michigan's prevailing wage law was under a court-ordered suspension. Data from this period was compared to similar economic data from the 30 months prior to the suspension of the legislation. He also compared levels of employment activity in U.S. states with prevailing wage legislation against those that had no legislation.

Dr. Vedder's research found that the states with prevailing wage laws employed on average 25% fewer employees. From this, he concluded that prevailing wage laws result in reduced construction industry employment. After analyzing the Michigan data and adjusting for seasonal variations and economic cycles, he found that while the fair wage law was inoperative, the number of new jobs in the construction industry almost tripled when compared to the previous period when the law was operational.

Turning to construction costs, the study found that across the U.S., construction costs for schools and general public construction projects were virtually double the cost per square foot of commercial and manufacturing facilities. His analysis found that the savings to taxpayers for the projects undertaken during 1995 amounted to \$275 million. Putting this into context, this amount was equivalent to a 5% saving on individual income tax collected in Michigan in 1995. He also noted the frustration of public school officials who felt that, rather than have public monies transferred to construction workers to raise their wages, the funds should be spent on school programs for students.

The argument that increased wages improves productivity was also discounted. In fact, the output of construction workers in states without prevailing wage laws was 4% higher than the output in states which maintained prevailing wage laws.

Fair or prevailing wage laws also appear to inhibit minorities and potential newcomers from entering the industry. In Michigan for example, the percentage of blacks working in the industry was 40% lower than the national average. And, given the present ageing of the construction workforce, it is likely that mandated higher wages may impede the hiring of young people who need to gain work experience before deciding on a career.

Fair wage policies are also said to reduce poverty. Dr. Vedder's study suggested otherwise. With inordinately high wage rates being stipulated, workers with low incomes seem to have even greater difficulty finding work in the industry. If this wasn't the case, why would states with so-called "strong" prevailing wage laws have higher poverty levels than those without prevailing wage laws?

## Conclusion

It is readily apparent that most of the original motives for fair or prevailing wage policies, be they humanitarian principles or protectionist economic sentiments, are no longer applicable or appropriate for today's construction industry.

As Globerman et. al., noted, "The central objective of a fair wage policy is to raise wages above the level that would prevail in the absence of a policy." This "levelling up" results in economic inefficiencies because "output falls below the level which would be produced under competitive environments". Despite the seemingly cavalier dismissal of this fact by politicians and bureaucratic mandarins, paying for these policies means taxpayers receive less construction for their dollars.

When governments decide to use their fiscal tools as instruments to effect social change, they need to balance the certainty against the uncertainty that their actions will bring. The certainty is that fair or prevailing wage policies needlessly increase public works construction costs. The benefits of such policies, however, are less than certain.

More recent initiatives to revive regulated wage schedules have originated from the unionized sector in the hopes that these measures will shore up their diminishing market share. While governments may acknowledge that such regulations result in higher public works construction costs, this problem is frequently dismissed as trivial because it is argued that there is an overriding benefit to the public at large. A growing body of research certainly indicates otherwise. OM

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