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TIFs and Prevailing Wages

The government gives and the government takes away. A recent example: In August 2002, the economic and financial justification for Tax Increment Financing in Pennsylvania was effectively eliminated by a state Supreme Court decision. That ruling held that any project using Tax Increment Financing (TIF) is a public works project. As such, any TIF funded plan would be subject to the Commonwealth's statute that requires all public works construction projects valued at over $25,000 to pay workers "prevailing wage" rates.

In Pennsylvania, "prevailing wage" is, for all practical purposes, the local area union wage rate for various crafts. Typically, "prevailing wages" and benefits are 25 to 40 percent higher than non-union wages and benefits. As a result, prevailing wage construction in Pennsylvania, and other states that have been studied, cost in the range of 10 to 15 percent more than non-prevailing wage construction--depending on the ratio of labor cost to total project cost. Moreover, union work rules also add to costs and reduce efficiency of production compared to non-union jobs.

Meanwhile, in a typical TIF project, the amount of tax increment borrowing would not exceed 10 to 15 percent of the value of the total cost of the development. This must be true otherwise the taxes on the increased value of the developed property would not cover the debt service payment. That is the case for a high tax county such as Allegheny County with its average of about 26 mills. In counties with much lower effective tax rates, TIF borrowing would have to be far less than 10 percent of development costs in order for the incremental tax revenues to cover debt service.

Thus, we come to the nub of the issue. With tax increment borrowing typically representing 10 to 15 percent of the cost of a development project and prevailing wage requirements adding 10 to 15 percent to the cost of the development, the benefits of TIF are wiped out by the higher labor cost. To clarify that statement, consider the following hypothetical example (which is based on a composite of recent proposals). Let's say a project is slated to cost $20 million with non-union workers and wages. The developer asks for a TIF of $2.5 million. Because the development must now be built with union (prevailing wage) workers, the costs rise between $2 million and $3 million. In other words, the higher wage bill will eat up the TIF loan proceeds. No net benefit from TIF will be realized.

Likewise, if the project is budgeted at $20 million with prevailing wages already factored in, then it could be built at a savings of $2 million to $3 million with non-union labor. Of course TIF could not be used or those savings could not be realized. In either case, the non-TIF development is less expensive by roughly the same amount as the TIF-- and the cost of paying prevailing wages.

Nor would it be of any benefit to reduce the TIF share of the project. That would simply allow the higher labor costs to swamp the positive contribution of the TIF borrowing. Raising the share of the TIF is no good either. That would push the debt repayment costs beyond the ability of the tax increment on the finished project to retire the debt. In short, there is no way around it. Unless municipalities and school boards are knowingly and willingly determined to subsidize private developments in order to create union construction jobs, then TIFs should never be considered and certainly never approved.

Construction worker unions fought legal battles for eight years to get the Supreme Court ruling. The unions are not going to allow a TIF project that doesn't use prevailing wage labor to sneak through. And that is too bad. There are certainly some legitimate cases where TIF might have been appropriate absent the Court ruling. A win for the unions. A loss for Pennsylvania.

Finally, to the extent that any government aid to private development-- such as low cost loans, tax abatements, or other subsidies-- invokes the requirement that prevailing wages be paid, then there is a strong possibility that the extra costs will exceed the benefits provided by government assistance. In effect, the taxpayer is being forced to underwrite union wage costs even on private construction projects. This is detrimental to the state's ability to grow. And it goes hand in hand with the absence of a Right to Work law to keep Pennsylvania's economy in thrall to labor unions. It is time to get rid of prevailing wage laws. They are anti-free market and therefore anti-freedom.

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