Arizona
HUMAN RESOURCES

State of Arizona
Advisory Recommendation

2010

Janice K. Brewer
Governor

David Raber, Interim Director
Department of Administration

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ARIZONA DEPARTMENT OF ADMINISTRATION

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The Honorable Janice K. Brewer
Governor, State of Arizona
The Honorable Robert Burns
President, Arizona State Senate
The Honorable Kirk Adams
Speaker, Arizona House of Representatives
1700 West Washington
Phoenix, Arizona 85007

Dear Governor Brewer, President Burns and Speaker Adams:

Pursuant to Arizona Revised Statutes section 41-763.01, the 2010 Advisory Recommendation is intended to provide information concerning the compensation of state employees and an objective assessment of the job market.

Salary increases provided in 2006 and 2007 significantly reduced the gap between our state employee salaries and the market. The state had previously been almost 22% behind the market; a discrepancy that was significantly affecting agencies' ability to attract and retain quality talent. After the increase in 2007, that gap had been closed to almost 7%, and the state was close to achieving the previously established goal to be within 5% of the market.

Unfortunately, the economy at both the national and local levels suffered severe setbacks. In 2008 a hiring freeze was implemented and agency budgets were reduced along with other measures necessary to balance the state's budget. These conditions precluded providing salary increases in 2008 and 2009. Subsequently the state lost ground to the prevailing job market and salaries are currently estimated to be on average 13.6% behind the market. The negative impact on employee salaries will be further exacerbated in FY2011 with the elimination of the performance pay program (2.75%) and the introduction of six furlough days each of the next two fiscal years. Comparing these negative pressures on employee salaries with the projected increases to the market, it is expected that state salaries will lose further ground compared with the market.

Nevertheless, given the realities of the state's current budget situation and considering the health of the economy and the estimated movement of employee salaries in the market, the Department is recommending to defer any salary increases until budget conditions improve. As soon as it is fiscally possible, addressing issues of state employee compensation should be a priority and the goal of bringing salaries within 5% of the market should be addressed.

We hope that the Annual Advisory Recommendation will provide the information you need when making decisions regarding Arizona state government and its employees' compensation.

Sincerely,

David Raber
Interim Director

2010 Advisory Recommendation on State Employee Salaries

Every September, the Arizona Department of Administration (ADOA) provides an Advisory Recommendation to the Governor and the Legislature pursuant to A.R.S. §41-763.01. This document provides an analysis of the state's current compensation levels compared to other public and private sector employers, and a review of the critical factors that must be considered when reviewing compensation strategies. These factors include turnover rates, retirement projections, economic forecasts, and projected market movement. The report concludes with a recommendation to the salary plan for employees in state service.

> *This report reflects the current status of Arizona state employee compensation as it relates to market conditions at the end of Fiscal Year 2010. The guidelines contained herein are provided as a resource to guide statewide budget considerations during the preparation of the Fiscal Year 2012 budget.*

HISTORY OF COMPENSATION

Over the past several years, the state has implemented a number of different strategies to adjust employee salaries. These strategies included general salary adjustments, merit adjustments, special market adjustments, and other miscellaneous adjustments specifically targeted by the legislature. However, there have also been years where no salary adjustments were funded.

In 2005, the Department of Administration recommended a 5-year plan to bring employee salaries to within 5% of the prevailing job market. The plan developed in 2005 was used to guide the development of the FY 2007 budget, a budget that included an appropriation of a flat dollar amount ($1,650) to increase employee's base salary, and the introduction of a pay practice for Arizona state government employees called "performance pay". Performance pay is available to state employees if the governmental unit meets or exceeds prescribed performance measures. If the measures were not met, the employees in that unit are not entitled to receive performance pay.

In 2006 the Department of Administration recommended continuation of the original 5-year plan. The FY 2008 budget included an appropriation that provided for a 3.0% increase to base salaries, and an increase in the funding authorized for performance pay, bringing the total amount of performance pay available up to 2.75%.

In 2007 the state was experiencing the beginning of a budget crisis. The Department of Administration did not recommend a specific amount for salary increases due to the uncertainty of the budget situation in September 2007. The FY 2009 budget did not provide for any salary increases.

In 2008 and 2009 the state was deep in the throes of the worst budget crisis in recent history. The Department of Administration did not recommend salary increases due to the uncertainty of the budget situation in September 2008 and 2009. The FY 2010 budget did not provide for any salary increases, and the FY2011 budget included the elimination of the performance pay program (2.75%) and the introduction of six furlough days each of the next two fiscal years.

Figure 1
History of the State's Compensation Adjustments

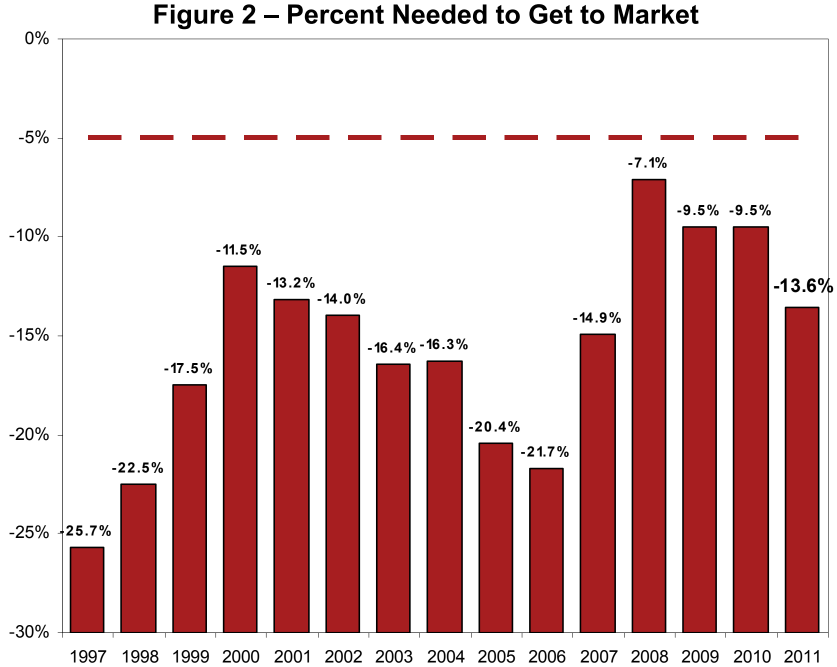
Recommendation Year (Calendar Year)	Budget Year (Fiscal Year)	Average Covered Salary	General Salary Adjustments	Merit or Performance	Allocations for Selected Classes
1996	1998	$26,874	2.5%	2.5% Merit	Yes
1997	1999	$28,249	-0-	2.5% Merit	Yes
1998	2000	$29,208	-0-	2% Merit	Yes
1999	2001	$29,725	-0-	2% Merit	Yes
2000	2002	$30,331	$1,450		
2001	2003	$31,824	-0-		
2002	2004	$31,859	-0-		
2003	2005	$32,059	$1,000		Yes
2004	2006	$32,897	1.7%		Yes
2005	2007	$36,195	$1,650	2.5% Perf Pay	Yes
2006	2008	$38,023	3.0%	0.25% Perf Pay	Yes
2007	2009	$38,097	-0-		
2008	2010	$38,478	-0-		
2009	2011	$37,684	-0-	2.75% Perf Pay Eliminated	

Source: Joint Legislative Budget Committee FY2008 Appropriations Report. Merit Adjustment figures represent the percentage allocated to an agency's personnel services base. Allocations for Selected Classes are provided to address specific job classes or specific agency needs addressed by legislation. Average Covered Salary data are based on regular covered employees in agencies within the ADOA Personnel System calculated as of the end of July; figures for FY 2007, 2008, 2009, and 2010 have been adjusted to account for performance pay. Average salary for FY 2011 does not include performance pay.

CURRENT STATE OF COMPENSATION

The job market is a constantly moving target, and state salaries must continually be analyzed to assess the competitive position of the state with respect to the market. The most recent analysis of market competitiveness suggests the market exceeds state salaries by an estimated 13.6%. Figure 2 below illustrates the relative difference between state salaries and the market.

Figure 2 – Percent Needed to Get to Market



Source: Percent Needed to Get to Market is based on a suite of compensation surveys, including the Arizona Compensation Survey (previously referred to as the Joint Governmental Salary Survey). Average State Employee Salaries are based on employees in the ADOA Personnel System calculated as of the beginning of the fiscal year (July 1).

FUTURE CONSIDERATIONS

There are a number of factors that must be considered in developing a strategy to ensure state salaries become competitive, including predictions of future market movement.

Market Movement

When reviewing information from compensation consulting firms, employers are asked to predict or project the increases that will occur in the future. Several surveys were analyzed to estimate market movement in the coming year (Figure 3). It is worth noting that in 2007 and 2008, salary increases were typically in the range of 3-4%. Salary increases in 2009 were closer to 2%. While organizations nationally and regionally estimate increases averaging 2.5% in 2010, of particular importance to this report, the estimated increase for public sector organizations in 2010 in Arizona is 0%.

Figure 3 – Actual and Projected Salary Increases

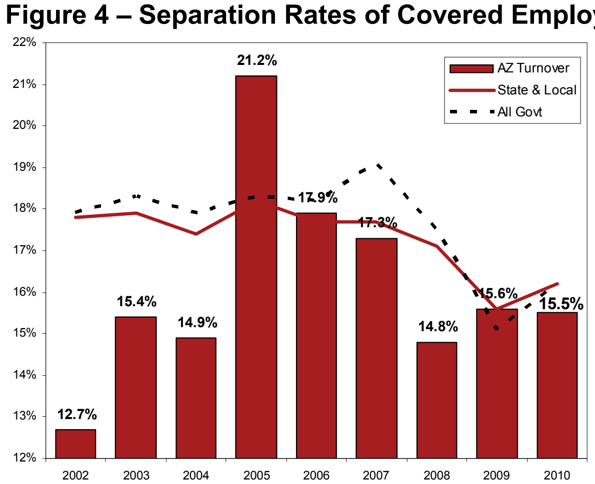
Reference	2008 Actual Increase	2009 Actual Increase	2010 Estimated Increase	2011 Projected Increase
National - Hay		1.9%	2.6%	2.9%
National - WorldatWork	3.9%	2.2%	2.5%	2.9%
Local (Phoenix) - WorldatWork	N/A	1.8%	2.5%	2.9%
Local (Public & Private) AZ Compensation Survey	N/A	1.9%	1.5%	2.2%
Local (Public Sector Only) AZ Compensation Survey	N/A	1.1%	0.0%	0.4%
State of Arizona	**0%**	**0%**	**-2.75%**	**TBD**

Source: National data from Hay and WorldatWork websites; Arizona data from 2010 Arizona Compensation Survey; FY2011 estimates for State of Arizona include the reduction of Performance Pay and the impact of 6 unpaid furlough days.

Turnover

The separation rate of covered employees remained essentially unchanged from 2009 (Figure 4), and appears to indicate a general downward trend over the past 5 years. This figure makes an interesting supplement to Figure 2 on page 3, which shows the trend of state salaries compared to the market. When state salaries were furthest off the market (2005-2007), the turnover rates were the highest. When state salaries were closest to the market (2008), the turnover rate was the lowest it has been in recent years. It remains to be seen if state salaries continue to fall significantly below the prevailing market, whether turnover rates will increase.

Figure 4 – Separation Rates of Covered Employees



Source: 2010 State of Arizona Workforce Report. Separations are defined as covered employees leaving state service during the fiscal year (July 1 to June 30). Comparative data from the national Bureau of Labor Statistics, U.S. Department of Labor, seasonally adjusted turnover rates. State and local includes State and local government entities in the 50 States and the District of Columbia. All Government includes Federal, State, and local government entities in the 50 States and the District of Columbia.

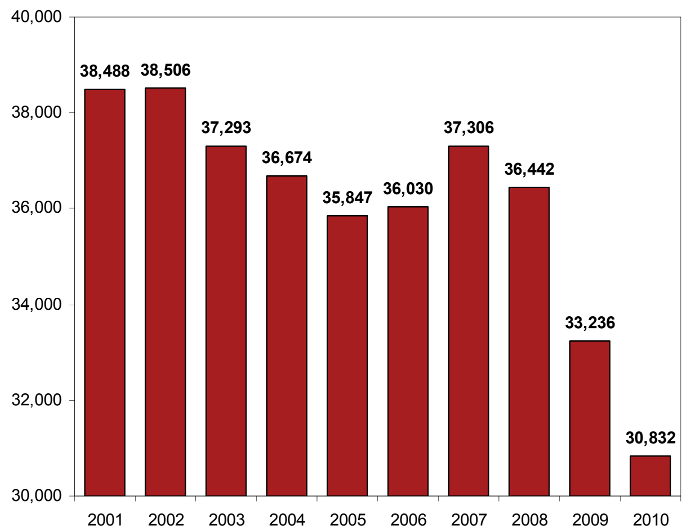
There is still debate about whether the economy remains in a period of recession, or if the recovery has started. What is clearer, however, is the likely impact of economic conditions on the mobility of the workforce. A recent study[1] reports that 37% of employees reported feeling they are not being fairly compensated for assuming a greater workload during the recession. The same study goes on to reveal that 4 out of 10 professionals polled said they are more inclined to look for new opportunities outside their firms as a result of the recession.

Many employers are anticipating an increased need to attract and retain talent in the near future. Despite efforts to engage employees during the past year, organizations have growing concerns about whether their valued employees will stay once the economy recovers. Nearly two-thirds of companies believe that voluntary turnover will increase as the economy and job market continue to improve.[2]

Size of the Workforce

Of particular interest in 2010 was the second year of dramatic and significant reductions in the size of the government's workforce. The number of filled positions in the ADOA Personnel System decreased by 7.2%, to the lowest levels in the past decade (Figure 5). The overall reduction in the workforce since 2007 was a reduction of over 6,400 positions or 17.4%. As a result of budgetary constraints, in addition to implementing a statewide hiring freeze, many agencies were required to implement layoffs and reductions in force. Thus, although total turnover may have remained essentially unchanged from 2009, the overall size of the workforce has been significantly reduced.

Figure 5 – Employee Headcount – ADOA Personnel System



Source: 2010 State of Arizona Workforce Report. Includes covered and uncovered employees in the ADOA Personnel System, excluding limited, seasonal, and part-time of less than 0.25 FTE.

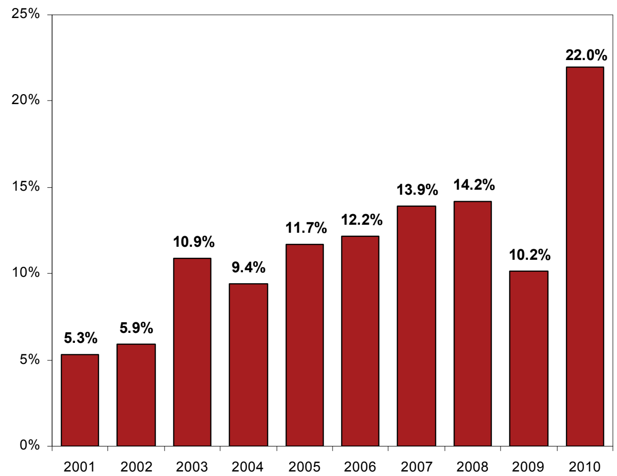
[1] Workplace Redefined – Shifting Generational Attitudes During Economic Change. Robert Half. 2010

[2] Global Attraction and Retention Survey, Mercer, 2010

Retirement Rates

One of the critical issues facing the state is the ability to retain a skilled and effective workforce. This may be especially poignant with the well-documented trend of increasing retirements and the subsequent loss of institutional knowledge (Figure 6).

Figure 6 – Percent of Separations Due to Retirement



Source: 2010 State of Arizona Workforce Report. Includes covered and uncovered employees in the ADOA Personnel System separating from state service during the fiscal year.

Current estimates suggest that over 93% of the larger state agencies are expected to have over 25% of their active workforce eligible to retire in the next five years (2010 ADOA Human Resources System Annual Report), including six agencies that are anticipated to have over 40% of their workforce eligible to retire in five years. The data further emphasizes the need for the State to be prepared to attract and retain an effective workforce in the near future.

Economic Forces

A key factor that must be taken into consideration when developing a compensation strategy to address employee salaries is the health of the economy. In June 2010, the Arizona unemployment rate remained unchanged from the month before at 9.6% and virtually identical to the national rate of 9.5%.[3] However, even though analysts are beginning to grow slightly more optimistic about the employment conditions for the nation and the Western states, job growth continues to be negative every month. Analysts have justified their optimism by describing current conditions as "worsening more slowly". Nevertheless, the consensus among economists is that 2010 will be another year of job losses for the nation and for Arizona[4].

[3] Arizona Workforce Employment Report, July 15, 2010.
[4] Economy, W.P.Carey School of Business. ASU. June 1, 2010.

CONCLUSION

The state made significant progress towards improving the position of state employee salaries relative to the market during FY 2007 and FY 2008. The Executive and Legislative branches sent a clear message to state employees that salary issues were important, and the gap between state employee salaries and the market was reduced to the lowest level in nearly two decades. Unfortunately, due to the economic challenges at the national and local levels, the state did not allocate funding for salary increases in FY 2009 or FY2010. The impact on employee salaries will be increased in FY2011 with the elimination of the performance pay program (2.75%) and the introduction of six furlough days each of the next two fiscal years. Comparing these negative pressures on employee salaries with the projected increases to the market, it is expected that state salaries will lose further ground compared with the market.

RECOMMENDATION

As soon as it is fiscally possible, addressing issues of state employee compensation should be a priority and the goal of bringing salaries within 5% of the market should be addressed.

However, the Department of Administration understands and appreciates the realities of the current economic situation of the state's budget. When taken into consideration along with the health of the economy, both at a national and regional level, and considering the estimated movement of employee salaries in the market, the Department is recommending to defer any salary increases until budget conditions improve.