Arizona
HUMAN RESOURCES

State of Arizona
Advisory Recommendation

2011

Janice K. Brewer
Governor

Scott A. Smith, 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 Russell Pearce
President, Arizona State Senate
The Honorable Andy Tobin
Speaker, Arizona House of Representatives
1700 West Washington
Phoenix, Arizona 85007

Dear Governor Brewer, President Pearce and Speaker Tobin:

Pursuant to Arizona Revised Statutes section 41-763.01, the 2011 Advisory Recommendation is intended to provide information concerning the compensation of state employees and an objective assessment of the job market.

The average state employee's salary had previously been almost 22% behind the market; a discrepancy that was significantly affecting the ability to attract and retain quality talent. After increases in 2006 and 2007, that gap closed to almost 7%, and the state had nearly achieved 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, 2009, and 2010. Subsequently the state lost ground to the prevailing job market and salaries are now estimated to be 13.6% behind the market. The elimination of the required furlough days helped alleviate the fiscal impact to the average employee; however it is expected that state salaries may lose further ground compared with the market.

Given the realities of the state's current budget situation and considering the uncertain health of the economy at the state and national levels, the Department recommends deferring any salary increases until budget conditions improve.

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

Sincerely,

Scott A. Smith
Director

2011 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 2011. The guidelines contained herein are provided as a resource to guide statewide budget considerations during the preparation of the Fiscal Year 2013 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 was available to state employees if the governmental unit met or exceeded prescribed performance measures. If the measures were not met, the employees in that unit were 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 FY 2011 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.

In 2010 the state was still addressing fundamental budget challenges although the first signs of economic recovery were beginning to appear. Nevertheless, economists were uncertain if the state and the nation would experience a recovery or if a double-dip recession was in the future.

As a result of the economic uncertainty, the Department of Administration did not recommend salary increases in September 2010, although there was recognition that state salaries would likely be falling further behind the market. The FY 2012 budget did not provide for any salary increases, however the requirement for employees to observe six mandatory furlough days was eliminated.

Figure 1
History of the State's Compensation Adjustments

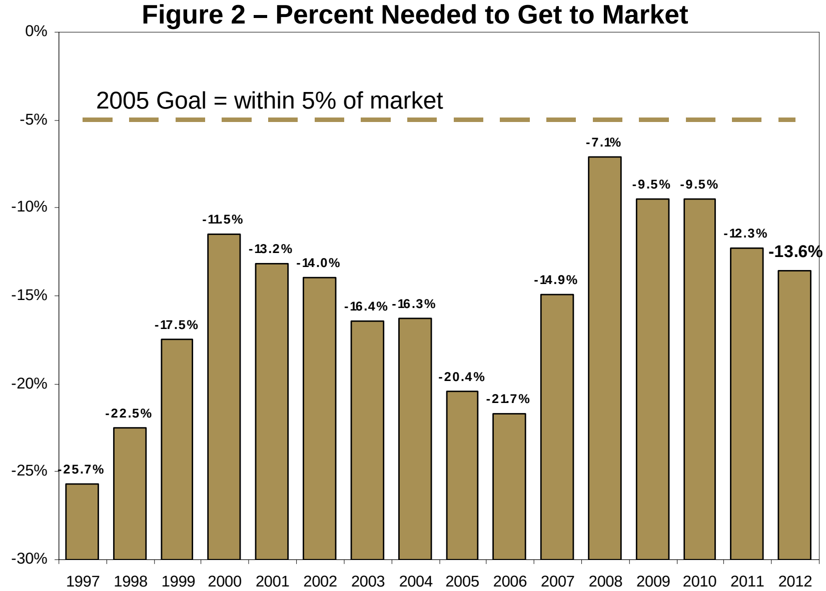
Recommendation Year (Calendar Year)	Budget Year (Fiscal Year)	Average Covered Salary	General Salary Adjustments	Merit or Performance	Allocations for Selected Classes
1996	1998	$26,874	2.5%	2.5% Merit	Yes
1997	1999	$28,249	-0-	2.5% Merit	Yes
1998	2000	$29,208	-0-	2% Merit	Yes
1999	2001	$29,725	-0-	2% 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	
2010	2012	$37,535	-0-		

Source: Joint Legislative Budget Committee FY 2012 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 and FY 2012 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). Figures for 2011 were corrected due to the public sector lagging behind the private sector more than projected.

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

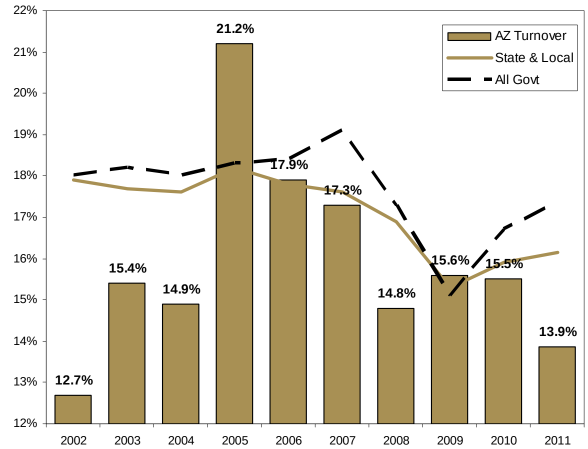
Reference	2010 Actual	2011 Actual	2012 Projected
National - Hay	2.6%	3.0%	3.0%
National - WorldatWork	2.5%	2.8%	2.9%
Local (Phoenix) - WorldatWork	2.5%	2.8%	3.0%
Local (Public & Private) AZ Compensation Survey	1.5%	1.9%	2.3%
Local (Public Sector Only) AZ Compensation Survey	0.0%	0.6%	1.0%
State of Arizona	**0%**	**0%**	**TBD**

Source: National data from Hay and WorldatWork websites; Arizona data from 2011 Arizona Compensation Survey.

Turnover

The separation rate of covered employees decreased to the lowest level since 2002 (Figure 4), and continues the general downward trend over the past six years.

Figure 4 – Separation Rates of Covered Employees



Source: 2011 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.

While there is no longer any debate that the economic recession has formally ended, the strength of the recovery is still very much in question. In fact, continuing analysis by economists has revealed an economy harder hit by the recession than previously thought, and a recovery that has stalled out, spurring more debate about the possibility of the dreaded double dip recession[1]. The impact of economic conditions directly affects the mobility of the workforce. The relationship between unemployment rates and voluntary turnover suggests that turnover will increase once the economy recovers. This will force corporate leaders to face a new challenge; replacing lost employees as the economy recovers and talent is once again a scarce commodity[2]. A recent study[3] reports that 37% of employees reported feeling they are not 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.

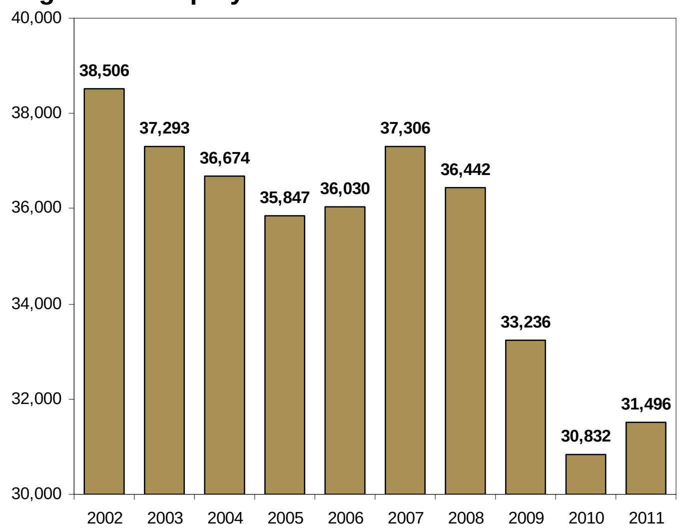
Many employers are anticipating an increased need to attract and retain talent in the near future. Despite efforts to engage employees during the past year, organizations have growing concerns about whether their valued employees will stay once the economy recovers. Nearly two-thirds of companies believe that voluntary turnover will increase as the economy and job market continue to improve.[4]

[1] "The Glow is Gone from Growth." Lee McPheters. Knowledge@W.P.Carey School of Business. ASU. August 4, 2011.
[2] "Where Did Our Employees Go? Examining the rise in voluntary turnover during economic recoveries." Deloitte Review. January 2011.
[3] Workplace Redefined – Shifting Generational Attitudes During Economic Change. Robert Half. 2010
[4] Global Attraction and Retention Survey, Mercer, 2010

Size of the Workforce

The size of the workforce was dramatically decreased in 2009 and 2010 as a result of personnel reductions, attrition, and limited hiring beginning in 2007. Although there was a slight increase in staffing levels in 2011, the workforce remains much smaller than in previous years. Compared to the workforce of 2007, the reduction has been 15.6%, accounting for the loss of over 5,800 filled positions.

Figure 5 – Employee Headcount – ADOA Personnel

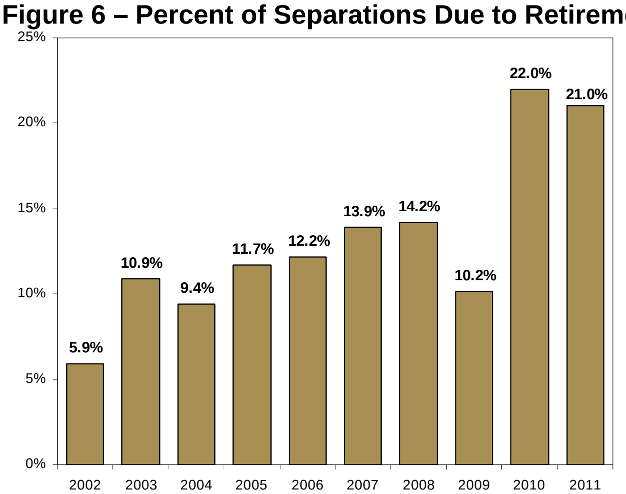


Source: 2011 State of Arizona Workforce Report. Includes covered and uncovered employees in the ADOA Personnel System, excluding limited, seasonal, and part-time of less than 0.25 FTE.

Retirement Rates

One of the critical issues facing the state is the ability to retain a skilled and effective workforce. This may be especially significant 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: 2011 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 89% of the larger state agencies are expected to have more than 25% of their active workforce eligible to retire in the next five years (2011 ADOA Human Resources System Annual Report), including fourteen agencies that are anticipated to have over 35% 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. The U.S. Bureau of Labor Statistics reports on voluntary turnover as a measure of workers' willingness or ability to change jobs. In June 2011, the number of employees who voluntarily quit (1.9 million) was nearly a million less than the 2.8 million who quit in December 2007 when the recession began[5]. Unfortunately, it appears that economic conditions in Arizona may be slightly worse than at the national level. The Arizona unemployment rate in July was 9.4%, up one tenth of a percentage point from 9.3% in June. The U.S. unemployment rate decreased from 9.2% in June to 9.1% in July.[6]

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 FY 2010. The impact on employee salaries was compounded in FY 2011 with the elimination of the performance pay program (2.75%) and the introduction of furlough days. Although the furlough days were eliminated in FY 2012, the market is projected to continue to move forward, albeit at a slower rate than in years past. It is expected that state salaries will remain below the market, or slowly lose further ground.

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 also taking into consideration the health of the economy at a national and regional level, the Department recommends deferring any salary increases until budget conditions improve.

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[5] Job Openings and Labor Turnover – June 2011. U.S. Bureau of Labor Statistics. News Release. August 10, 2011.
[6] Arizona Workforce Employment Report, Employment & Population Statistics. August 18, 2011.