CHAPTER 4

Methods of making market adjustments need fine-tuning

The current approach to market-based pay has been in use for only 18 months.

The turn to a market approach began in the late 1990s, and the Legislature began directly funding wage adjustments according to "market" in 2000. System changes continued to be made over the next four years, so that the current approach to market-based pay has been in use for only about 18 months.

Our analysis of December 2005 salary and market data revealed that some progress has been made towards the goals announced in September 2004. However, employee salaries continued to vary widely within individual classifications; many employees, even after years in their jobs, were not yet earning a competitive salary; and some individuals were still being paid below the current minimum market entry rate.

We found employee salaries continue to vary widely within the same classifications.

Our analysis also suggests that the methods used to grant employee increases (across-the-board raises and inequity adjustments) have not been effective in promoting internal equity. We identified those and other policy decisions that appear to undermine efforts to achieve the announced goals.

Chasing the current market may not be the best approach.

Both the Legislature and HRD can make changes geared to improving the new pay system's salary competitiveness and internal equity. The Legislature should consider adopting a more effective approach to providing salary increases, at least for the transition period during which the state is completing its move to market-based pay. HRD needs to modify its definition of and approach to market. Chasing market puts the state in a no-win situation that requires constant adjustments, is confusing and frustrating to employees and legislators alike, and undermines the important goal of internal equity.

"Fair and equitable pay" is a range of wages

In place of EJX for each classification, the current system sets "entry" and then a range.

The goal of the state's compensation system is to implement a pay plan that provides competitive, fair and equitable compensation to all employees, a plan that supports the state's need to recruit and retain qualified state employees. The compensation policy introduced in September 2004 aimed to achieve these goals by raising salaries to competitive levels, while reducing salary inequities between agencies and within job classifications. The Governor stated that employees could look for initial signs of success through two outcomes: minimum earnings that would rise above 100 percent of market entry levels, and improved equity within and across state agencies.

Salaries within a certain range are deemed competitive

This range extends approximately 25 percent around the market average.

In addition, HRD defines a "fair and equitable" wage range around market — from market minus 10 percent to market plus 15 percent. HRD considers salaries anywhere within this range to be competitive. As far as we can tell, within that range, an individual's relative standing is determined by agency decision. At present, the Division's transitional goal is that full-time permanent employees with two years' tenure and up (similar to journey level under the earlier EJX system), should be paid a benchmark average wage.

The Legislature has committed considerable funding to move employees to competitive, equitable salaries

Between 2000 and 2005, the Legislature appropriated $29 million for market adjustments; these funds were applied either to all employees or targeted to specific classifications, such as nursing. In the '06 Session, the Legislature appropriated an additional $31 million for salary adjustments. The bulk of these funds, $23 million or 73 percent, were appropriated to fund external cost adjustments (ECAs) of 3.5 percent, the first of which will go into effect in July 2006. The remainder, $8.4 million, is for market inequity adjustments, the first set of which will also become effective in July. Additional funding was appropriated for "hot spots" and X-band employee wages.

Partial progress has been made

Our analyses compare payroll data for each year to the CSSS market data for that same year.

The new market-based pay system has been in place for only about 18 months and the move to competitive, fair and equitable salaries is not yet complete. Although the long-term effects of these factors on recruiting and retaining quality state employees cannot be measured at this point, we can assess the extent to which progress has been made to date.

Salaries analyzed are those of employees with two years' tenure.

To do this, we used salary and market data to analyze the effectiveness of HRD's current methods of moving employees to competitive and equitable salaries. Unless otherwise indicated, we focused on employees with two or more years' tenure, and we compared payroll data for each year to the market for that year as defined by CSSS. Thus, the analyses and charts that follow compare 2001 wages to 2001 market data, 2002 wages to 2002 market data, etc., regardless of whether that was the market used at the time. Throughout the '05/'06 biennium, HRD used the 2004 market, but we used the most current information available at the time, which was the 2005 market.

The most recent market applied by HRD was the 2004 CSSS market.

Generally, the Legislature appropriates funding and then allows the executive branch discretion in making wage adjustments and in determining which market to apply. As of this writing, 2004 market (based on 2003 salaries) is the functional market and will remain so until July 2006.

External inequities still exist

After the July 2001 EJX adjustment, nearly as many employees were above a fair and equitable range as were within it.

Some progress towards competitive market wages, as defined for each year by the then-current CSSS, has been made in recent years. To assess the impacts of market adjustments, we used the adjustment made in July 2001 as a baseline. The month before it went into effect, roughly 24 percent of employees with two years' tenure were *below* the fair and equitable range for their classifications, and an almost equal proportion were *above* it. After the adjustment (based on July 2001 payroll data), the proportion of employees below the fair and equitable range had declined substantially, but the proportion above the range nearly doubled. The result was that almost as many employees were above the range as were within it.

The current plan aims to counter salary disparities within the same classifications created by the EJX system.

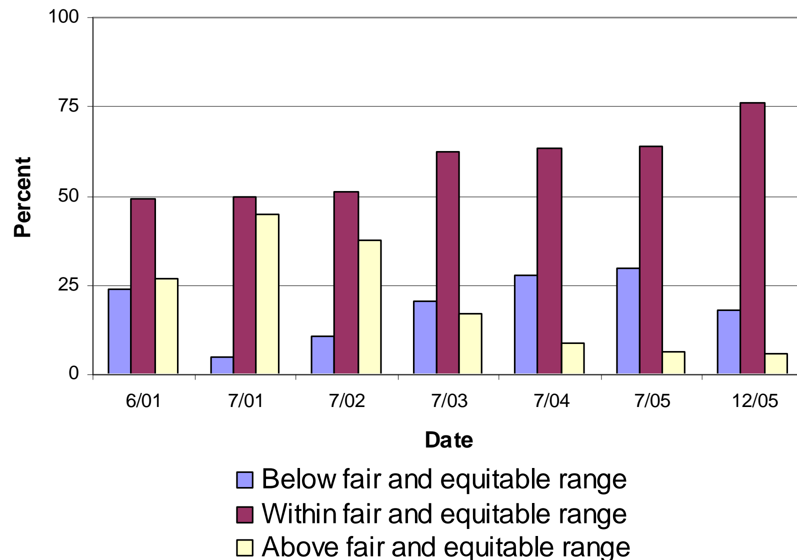
Subsequent adjustments, then, needed to counter those effects and move even more employees to within the fair and equitable range. Our analysis shows it took some time to make changes. In July 2005, when the new pay system had been in effect for nine months, 3,087 individuals or 42 percent of state employees were still either above or below their fair and equitable ranges, although a September 2005 adjustment did bring more employees within the 2004 market range (see Appendix D comparing December 2005 salaries to 2004, 2005, and 2006 markets).

Overall, between July 2001 and December 2005, positive effects can be seen but the progress is mixed. The proportion of employees whose salaries were within the fair and equitable range increased from 49 to 76 percent, and the proportion whose salaries were above the range decreased from 26 to 6 percent. However, the proportion below the fair and equitable range changed less dramatically, decreasing from 25 to 18 percent. Figure 4.1 illustrates changes at selected points.

By 12/05, more employees had fallen into the "fair and equitable" range than had moved up to it.

Figure 4.1

Experienced employees in the fair and equitable range On selected dates



Source: LSO analysis of HRD and LSO fiscal data

Internal inequities remain among state employees

We identified several kinds of internal inequities in the current pay system. These include inequities within the same job classification, among different classifications, and among agencies.

Within classifications. During the current transition period, the salary targets for all experienced employees are the benchmark averages for their job classifications. However, large variations exist in wages for experienced individuals in the same job classifications — i.e. doing the same work.

In 12/05, salaries ranged within classifications from 40 percent below benchmark average to 60 percent above.

We reviewed the range in salaries within individual classifications that had more than 20 incumbents in December 2005, and found discrepancies still existed and were substantial. Looking at all classifications, salaries ranged from 40 percent below benchmark average, to 60 percent above. Within these classifications, the range in wages varied from a 5 percent difference in salaries between the lowest- and highest-paid individuals in one classification, to a 90 percent difference in salaries in another. Figure 4.2 lists the range of ratios of highest to lowest paid salaries for experienced employees in six selected classifications.

Figure 4.2

Ratio of highest to lowest salary in selected classifications
Experienced employees, December 2005

Classification	Ratio of highest to lowest paid salary
A	1.00
B	1.21
C	1.38
D	1.51
E	1.77
F	1.90

Source: LSO analysis of HRD and LSO fiscal data

In some classifications, most employees are well below market.

Among classifications. HRD defines "competitive" as the benchmark average, and "equitable" more broadly as the fair and equitable range around benchmark average. Some classifications are populated primarily by employees who are

paid well below market, while others, though fewer, are above market. In the December 2005 payroll data, all individuals in one classification were paid below the fair and equitable range.

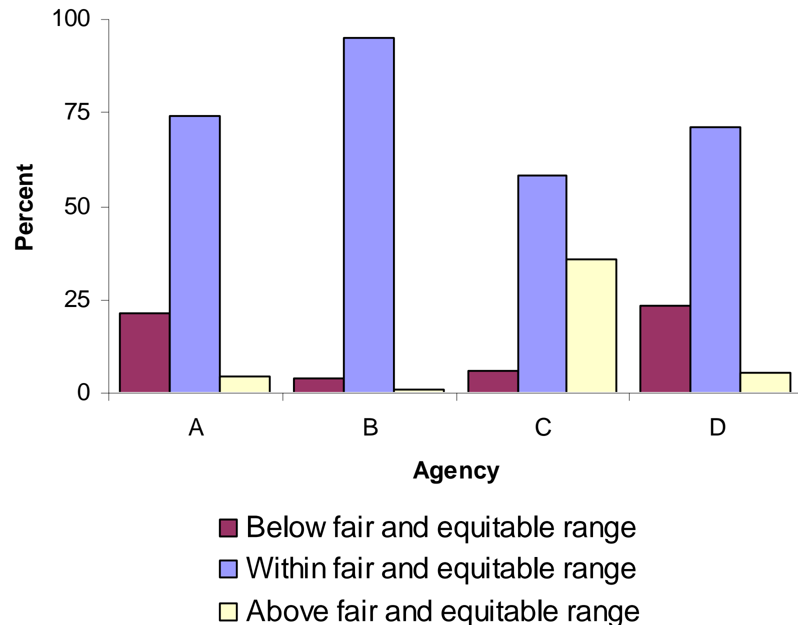
Agencies are differently able to fund salary increases for their employees.

Among agencies. Prior to the 2004 issuance of the compensation policy, there was a perception of "have" and "have-not" agencies. It was widely believed that employees in self-funded agencies or federally funded agencies with relaxed funding guidelines would be offered salaries higher than employees in the same classifications in agencies funded primarily with General Funds, or agencies whose federal funding was tightly controlled. Our analysis of wage ranges among agencies supports this perception, and although the problem is less extreme at present because HRD exerts more control over agency compensation actions, such discrepancies persist. Figure 4.3 shows that wide discrepancies still exist in the proportion of experienced employees paid within the fair and equitable range.

Some agencies have proportionately more employees in the fair and equitable ranges for their classifications than do others.

Figure 4.3

Distribution of salaries relative to the fair and equitable range
Four selected agencies (A – D), December 2005



Source: LSO analysis of LSO fiscal and HRD market data

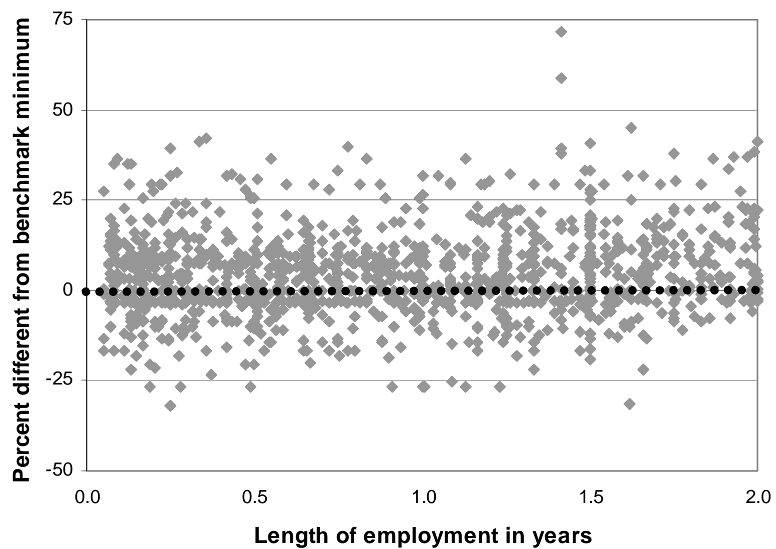
Entry salaries are critical in attracting new employees.

New employees are being paid less than100 percent of entry. The market pay system has not yet achieved the goal of paying all employees at least 100 percent of entry using current survey data. Figure 4.4 below shows the distribution of new employees (those with less than two years' experience) around the benchmark minimum, with some being paid less than that. A separate analysis shows that even some experienced employees are still below entry.

In 12/05, 43 percent of new employees were paid less than the current market entry wages for their classifications.

Figure 4.4

Distribution of new employees around 2005 market entry December 2005



Source: LSO analysis of LSO fiscal and HRD market data

The history behind a recent adjustment may help explain why this is occurring. While an adjustment was slated for July 2005, it was not actually implemented until September 2005. When it made that adjustment, HRD made it based upon 2004 market numbers rather than 2005 market wage rates. As a result, December 2005 payroll data shows improvement compared to the current market, but 43 percent of new employees were still paid less than entry.

The manner of funding adjustments, and the amounts, influence progress towards goals

Both external cost adjustments (ECAs) and targeted market adjustments have had the effect of moving employees toward market.

The Legislature and HRD have used two primary methods to move employees to a competitive and equitable compensation rate as defined by market:

- External cost adjustments (ECAs): These are across-the-board increases paid to all employees. With recent ECAs, the Legislature has granted percentage increases, rather than set dollar amounts, to all employees.
- Market inequity adjustments: These are adjustments targeted to specific classifications, intended to bring experienced employees in those classifications to a competitive salary level. To date, they have been applied only to those employees in high-impact occupations who had two years' tenure.

ECAs have not been efficient in moving employees into their fair and equitable ranges.

Our analysis of the effects of ECAs suggests that they have not been an efficient means of moving all state employees into the fair and equitable salary range. On its face, an ECA looks fair, but in practice, it brings employees up in proportion to their base salaries. This means lower-paid employees within a given classification get relatively small dollar increases while higher-paid employees in the same classification get larger ones. This disrupts whatever internal balance a pay system may have had and thereby undermines the principle of internal equity. Further, it slows the upward movement of employees who are below market, and slows the downward movement of employees who are above the fair and equitable range.

An ECA based on a salary well below market does relatively little to move it upwards.

For example, we found that in 2005, wages for employees with two years' experience in a classification found across multiple agencies, ranged from 30 percent below market (benchmark average) to 34 percent above. This is the equivalent of 20 percent below the fair and equitable range to 15 percent above it.

If a 3 percent ECA were applied in this circumstance, the low-end individual would still be 27 percent below market (if it remained unchanged) and 17 percent below the fair and equitable

range. On the other hand, the individual already earning above the fair and equitable salary range would move to 37 percent above market.

An employee already above the fair and equitable range moves even further above.

The rationale behind ECAs is to "keep people whole," but it is not clear, "whole relative to what?" An ECA of 3 percent in 2005 did not keep employees whole relative to Wyoming's higher increase in cost of living, which was 4.3 percent. On the other hand, it exceeded the increase in the regional cost of living, the CSSS region being what defines Wyoming's market.

The Legislature's intent in granting ECAs is not clear.

Only the Legislature can grant an across-the-board pay adjustment, and when it does so, there needs to be assurance that such funds are having the desired effect. When appropriating funds to ensure that all employees are being compensated at a competitive and equitable rate, the Legislature can clarify what the purpose is of any ECAs. For example:

ECAs could be used in a variety of ways.

- Are ECAs intended to bring all employees to market, or to bring individuals who are below market up to that level, while giving those above market a raise?
- Are ECAs meant to have a differential impact on employees depending on where each stands in relation to market?
- Are ECAs meant to improve the system's internal equity, or its market competitiveness?
- Are ECAs meant to maintain employees' buying power regardless of their standing in relation to market?

The executive branch will use the '07/'08 Biennium ECA to move state government toward its compensation goals.

The Legislature has committed funds for an ECA to be given in each year of the '07/'08 Biennium. It did not specify this as a market adjustment and the executive branch will use it in whatever manner it believes best moves the state toward its compensation goals. In future ECA salary adjustment appropriations, the Legislature might consider clearly communicating its intent about their use with regard to market pay.

Recommendation: The Legislature should consider adopting a more fine-tuned approach to funding employee pay increases.

A more selective approach in making salary adjustments may be desirable.

According to our analysis, as of December 2005 about 20 percent of state employees were being paid below the fair and equitable salary ranges identified for their job classifications. An across-the-board raise gives a disproportionately large share of funds to individuals who may already be above the fair and equitable range, while giving a disproportionately small share of funds to individuals who are receiving wages below the market level and who need to be brought up. In order to avoid a situation in which future ECAs may exacerbate this problem, and at least for the duration of this pay system's transition period, a more selective approach to making pay adjustments may be desirable.

Graduated percentage increases or increases based upon a percentage of market average would do more to achieve market pay.

Rather than granting the same percentage across-the-board increase to all employees, the Legislature could consider appropriating funds to be awarded on a graduated basis. For example, percentage increases could be tied to benchmark average, or they could be based on an employee's salary relative to market. Graduated adjustments such as either of these could give those who are the farthest below market the biggest percentage increases. Those who are above would receive a smaller percentage, or by legislation or policy they might receive no increase. A method of awarding graduated increases is likely to promote a more rapid movement to the fair and equitable range for the bulk of employees than flat percentage ECAs can.

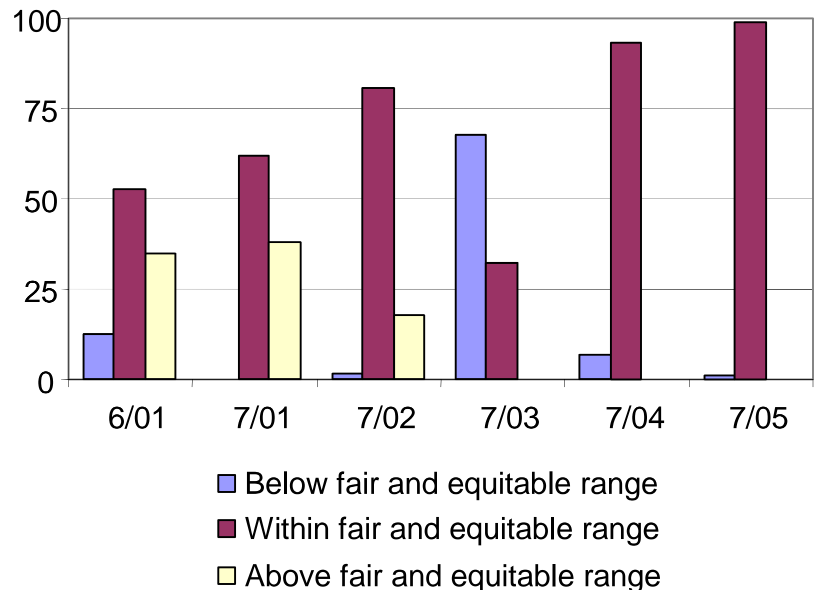
Targeted adjustments prove more effective at bringing employees into the fair and equitable range

Nursing salaries have been successfully targeted for adjustments.

In 2004 and 2005, $2.3 million in legislative appropriations for market adjustments was used for targeted adjustments for specific nursing classifications. Salary increases for four nursing classifications were funded to go into effect in July 2004 and again in July 2005; the Legislature targeted these classifications because of chronic turnover problems. Figure 4.5 illustrates that these targeted adjustments were successful in bringing experienced nurses into the fair and equitable salary range.

Figure 4.5

Nursing salaries relative to the fair and equitable range



Source: LSO analysis of LSO fiscal and HRD market data

Tying salaries tightly to a single market wage may actually undermine some of the state's goals

HRD maintains that once all employees are moved to current market as defined by CSSS, the cost of future adjustments will be minimal. However, this prediction may be based on

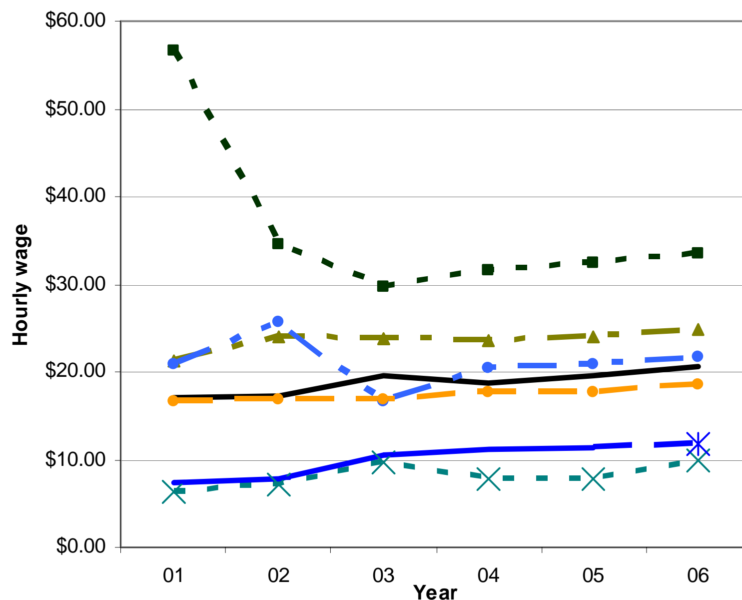
assumptions about how the market as a whole will move, when in fact, the cost of adjusting salaries will depend on how the market for each of the state's 474 classifications moves.

In any year, market average for a classification can move up or down.

While market movement overall has been up, averaging just over three percent per year over the past five years, the same does not hold true for any single classification. From 2001 to 2006, the benchmark average overall increased just over three percent, but individual job classification benchmark averages moved both up and down, sometimes to extremes. Figure 4.6 compares changes in the benchmark average for combined classifications, with changes in benchmark averages for several individual classes.

Figure 4.6

Benchmark averages for all classifications combined and for selected individual classifications, June 2001 to January 2006



All classifications combined

Source: LSO analysis of LSO fiscal and HRD market data

Adjustments put employees at benchmark average only temporarily.

Limited experience also suggests that the buffering effect of moving individuals to benchmark average is temporary. For example, in July 2003, about 500 employees in 65 classifications within 11 agencies were moved to exactly benchmark average for their classifications. Two years later, depending on how the

markets for these classifications moved, salaries for the same employees ranged from well below to slightly above market. Seven percent of these individuals had fallen below the fair and equitable range, and another ten percent were on the verge of doing so.

A market pay system has volatility

With market-based pay, adjustments are tied to uncontrollable factors.

Movement of all employees to current benchmark average (2005 market in July 2005, 2006 market in July 2006) has not consistently occurred in the past. In a system tied directly to market, keeping salaries competitive means adjustments are tied to factors outside the control of the system itself. Because the market is volatile, in constant movement, the more frequent the adjustments and the narrower the definition of market, the more frequent and extreme will be the adjustments needed to maintain it.

Both market and entry levels are moving targets, and are independent of the peculiarities of Wyoming's economy and workforce, the goals of the pay system, and to some extent, of each other. Since market as HRD defines it is a function of economic and labor circumstances in the comparator states rather than those in Wyoming, the actions of those states may not always serve this Wyoming-specific purposes.

Not adjusting wages down when their market value drops means compensating effects are lost.

Market volatility combined with HRD's practice of not adjusting individuals' wages, or even whole classifications, downward when their market value declines, increases the overall costs of adjustments; this is because any compensating effects of market declines are lost. In addition, not adjusting some salaries downward means that in effect, a fair and equitable approach is applied only for those employees in classifications with increasing market value. The market signal that a job has a set value to the state, one of the principles in setting wage ranges, is lost.

Agency budgets strain to accommodate system goals

In general, individual agency personnel budgets are not constructed with the flex needed to accommodate annual adjustments of all employees to changing benchmark averages. The goals of maintaining internal equity and externally

At times, the goals of maintaining internal equity and external competitiveness are incompatible.

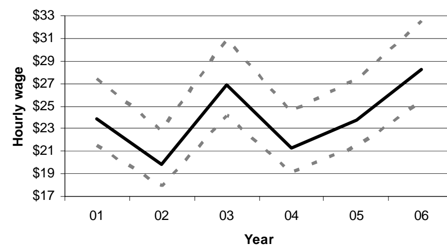
competitive salaries are not always compatible, and market volatility combined with agency funding constraints will likely continue to exacerbate existing problems.

Currently, HRD offers neither policy nor procedures to provide agency guidance on how to balance these conflicting values. These decisions will continue to be driven primarily by individual agency funding circumstances, absent a legislative decision to fund specific adjustments.

Adjusting benchmarks annually is a complicated process.

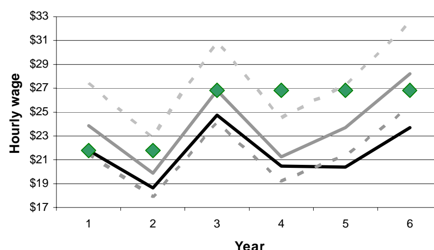
At best, adjusting large numbers of jobs and ever-changing staff to annual changes in benchmarks is an extremely complicated process. Some new employees are hired even in the most stable classifications, making for a constantly changing group who meet the definition of "experienced." To illustrate the challenges of making frequent adjustments while maintaining both internal equity and competitive salaries, we chose to describe one individual in one classification.

This chart shows changes in benchmark average and the fair and equitable range for one job classification, from July 2001 to July 2006.



An individual in one classification illustrates the challenges.

Depending on when an individual is hired and how much funding is available, the hiring agency may have a complicated and expensive set of considerations associated with both providing a competitive wage and maintaining internal equity. A person (◆) hired at entry in year 1 illustrates this problem: in year 2, because of market declines in his job classification, this individual finds his salary 10 percent above the benchmark average, or 10 percent above the wage an experienced employee could expect to be moved to — if the agency has adequate funding. In year 3 (after his second anniversary), this employee would be



considered experienced and thus should be moved to the benchmark average; in this example, the individual needs a 14 percent increase to get to benchmark average. In subsequent years, without further adjustments, he finds himself well above the fair and equitable range (year 4), then within the range (year 5), and in year 6 below benchmark average.

Benchmark average wage is a narrow goal

A look at any individual classification shows similar volatility, suggesting there is an inherent tension between external and internal equity. Adjusting to annual market changes means that each year, in each classification, employees are likely to need an adjustment upward to meet market, or conversely, they could be overpaid based on that year's market value for the job classification. It also means that every year, agencies must decide how to hire new employees at a competitive wage, and how to adjust salaries to promote equity for longer-term employees who may have been hired at previous market high or low points.

Market volatility affects the state's pay system each year.

Recommendation: HRD needs to develop more comprehensive guidance in rules and policy to clarify how and why future adjustments will be made.

The current definition of market, and methods of implementing it, leave legislators wanting to know why all employees have not yet reached their market rate of pay, and employees wondering why their salary is not what is shown on the HRD website as 2006 market. Further, human resources staff in agencies question how, given their budget constraints, they can fund movements of large numbers of employees to whatever the current goal is.

Market average may be too narrow a goal for the state.

Market average may be too narrow a goal for the state to adhere to: A single wage published as market sets up unreasonable expectations for employees and requires constant adjustments, some of which would cancel each other out over time. Although it has not yet been put into effect, the intention to adjust salaries

annually for each job classification is a narrower interpretation of market and competitive wage than is generally recommended in best practices. In other states, market information is used as a gauge of salary competitiveness, with other procedures and information factored in to ensure consistency in approach.

A more strategic approach might mean broadening some definitions.

HRD needs a more strategic approach to funding movement to market, if that is in fact the state's ongoing priority. It needs to consider broadening the definition of and approach to market adjustments. Using a rolling market average, or periodic rather than annual adjustments for classifications, will provide consistency and reduce annual market fluctuations.

Stakeholders need more involvement in system discussions.

In developing more complete guidance for agencies, HRD should promulgate rules and develop procedures to minimize misinterpretations and resentments among employees, inequities among agencies, and frustration among legislators. It can look for funding alternatives to address the inherent conflict between maintaining internal equity and paying competitive wages. HRD also needs to engage stakeholders in a review of system priorities and approaches; part-way through the transition to market-based pay, an open discussion regarding policy and implications is indicated.