Idaho Division of Human Resources, October 1, 2003

Change in Employee Compensation Report

Report to the Governor

State Employee Compensation

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I. Executive Overview

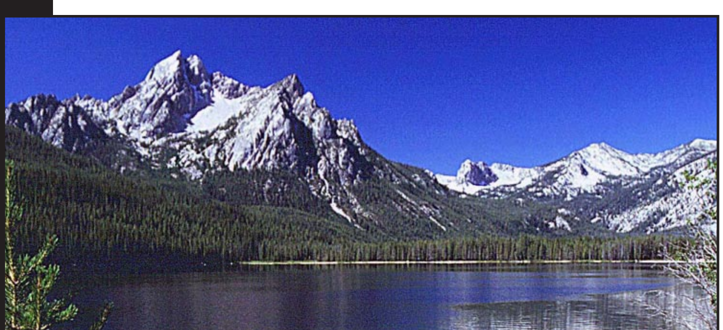
The Project

On October 1st each year, the Administrator of the Division of Human Resources provides the Governor with a report on state employee salaries and recommendations for change. This report typically opens the discussions regarding state employee salary issues and potential impact to the next fiscal year budget development. The report is provided to fulfill the requirements of Idaho Code 67-5309B(c), which requires the Administrator to:

- conduct or approve salary surveys;
- compare state wages to average labor market rates within the public and private sectors;
- report changes in the cost of living as measured by the CPI;
- report anticipated adjustments in the average weekly wage in the State of Idaho; and
- recommend changes in salaries, together with their estimated costs of implementation.

Idaho Code also expressly states the intent of the Legislature that state employees may expect to advance to market rate averages for their job's salary range. "Market rate" is a key concept in this report.

To provide a market average pay rate, a salary schedule needs to be funded each year to reflect the increase in the market. Funding also needs to be provided to mirror the average increase for current employees to keep salaries at market. When funding is not available to keep the salary schedule reflecting a market midpoint, and/or funding for market average increases, the concept of market pay policy begins to collapse. The challenge regarding adequate funding seems to have first surfaced in 1980. Each year of less than market average funding compounds the problem.



Careful analysis of market pay is the starting point for quantifying salary issues. This year, DHR used the following four third-party salary surveys to establish labor market rates.

1. Idaho Compensation and Benefits Survey
2. Western States Salary Survey
3. Hay Group Salary Survey
4. The Northwest Health Care Industry Salary Survey

Each salary was weighted according to the number of employees in a given job. The weighted averages as reported by respective salary surveys were compared to wages of employees who hold benchmark positions.

This year, DHR's market analysis covered 8,335 (65 percent of the classified workforce) employees assigned to 203 different jobs.

The study found that Idaho state employee wages currently lag labor market average rates by approximately 14.6 percent. To make state employees average wage catch up with market average rates in FY2005 would require a 17.1 percent increase, an incredible $85 million plus price tag. In a time of extraordinary stress on the state budget, the challenge seems almost insurmountable.

A Closer Look

When matched with other like jobs in the salary surveys, state jobs average pay compared as follows:

Occupation Group	Market Postion
Information Technology	-19.9%
Finance and Accounting	-7.9%
Science/Environmental	-5.4%
Health Care - Services	-10.7%
Nursing Sub Group	-22.3%
Professional Services	-9.4%
Para-Professional Sub Group	-19.9%
Management Sub Group	-25.7%
Protective Services	-16.2%
Labor Trades and Crafts	-15.3%
Administrative	-8.7%
Engineering	-20.2%
Statewide Weighted Average	*-14.6%*

The nationwide nursing shortage continues to drive up nursing salaries. Last year, employees in nursing occupations who worked for the state earned an average of 16.7 percent less than market rates. This year they earn 22.3 percent less. The turnover within these jobs is 28 percent compared to a statewide average of 13 percent.

The advancement to the market average rate seems too slow to be considered in compliance with the Legislative intent. Only 16.6 percent of state classified employees are paid at or above the policy point. It currently takes a classified employee an average of 19 plus years to achieve the pay grade policy point. One system design issue that needs further analysis is the assumption that the pay grade policy point still is the market goal for each different job in that salary range.

Even if generous funding was available, equal funding to all positions is not advised. Some occupations are in greater need of an increase than others. For example, nursing occupations need a 28.7 percent pay increase to achieve market, but finance and accounting occupations only need 8.5 percent.

Recommendations

To achieve a more competitive pay environment, state decision makers need the flexibility to differentiate appropriations based on the specific needs of the different occupational groups. The state needs a strategic plan to achieve market parity. The market will not stop moving and wait for state salaries to catch-up. The market has slowed over the past two years, but conservative forecasts project between 3.5 and 4 percent annual U.S. wage growth. Demographics for the labor market, especially with the skills required for many state jobs, project competition for talent will be increasing, and market competitive pay taking on greater significance in recruiting and retaining staff.

Much work still needs to be done in terms of revenue forecasting, prioritizing agency requests, and finalizing the Executive Budget, but based on the information available in the summer of 2003, the DHR Administrator recommends the following:

1. No increase to the current salary schedule.
2. Code change to allow for pay schedules unique to occupational groups.
3. Provide an average of 10 percent permanent merit raises for nursing occupations.
4. Adopt a strategy to address market salary competition.
5. Provide 6.8 percent CEC to fund the first step of a 5 year plan toward current law requirements OR
6. Provide as much permanent CEC money as possible and refine the current law to specify the goal of average market pay targets.
7. If no ongoing CEC is possible due to revenue projections and other budget issues, provide 2 percent one-time money to support a retention and recognition award program for FY05 only. These funds would be used for one-time awards up to 10 percent of an employee's salary in recognition of their contributions and performance, and promote retention through these difficult times. This special appropriations bill should also allow additional funds to be used in personnel if savings can be found in operating budgets for FY2005 only.

Summary

Career state employees are primarily motivated by their desire to serve others. The mission of their state agency provides the fuel for them to commit themselves to their work and their fellow citizens. But no matter how dedicated the workforce is, the economics of the job market exert a powerful influence. The concept of market-average pay expectations, as designed by the Legislature in 1994, and advancement through pay for performance only, is sound compensation philosophy on its face. The pivotal concept of "market average rate for the pay grade" may be too broad a goal. The inability of the state to adequately fund such a program has caused challenges that have grown exponentially. The costs to catch up to the market, to keep up with the market, and to pay up – that is reward extraordinary performance— have risen beyond the imagination of reasonable people. It is time to rethink the principles and policies underlying state employee compensation.

II. Purpose

This report is provided to the Governor on October 1st to fulfill the requirements of Idaho Code 67-5309B(c). Idaho Code requires the Administrator to:

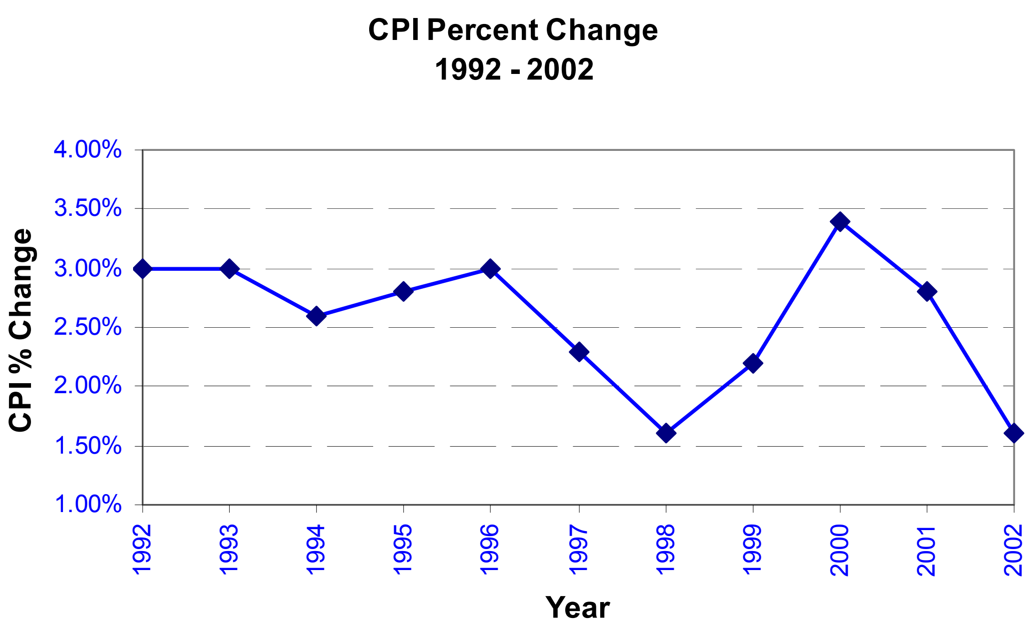
- conduct or approve salary surveys;
- compare state wages to labor market average rates within the public and private sectors;
- report changes in the cost of living as measured by the CPI;
- report anticipated adjustments in the average weekly wage in the State of Idaho; and
- recommend changes in salaries, together with their estimated costs of implementation.

III. Economic Indicators

The state of the economy has an impact on the labor markets. Economic factors such as inflation and unemployment are important to consider when performing job market and wage analysis.

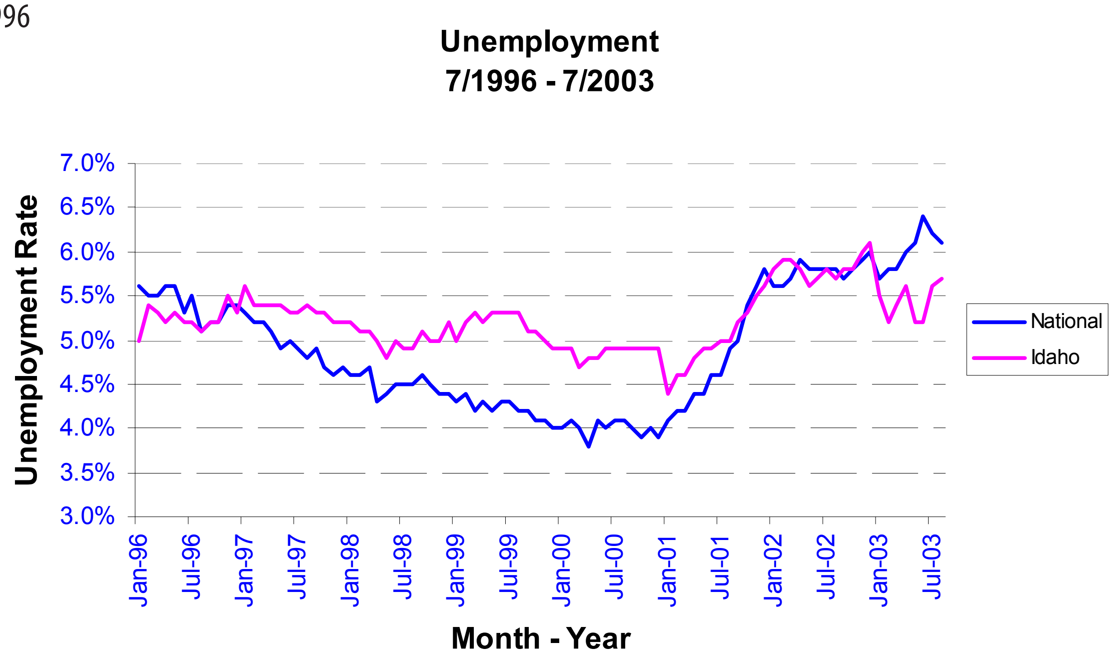
Cost of Living

The change in the cost of living, as measured by the Consumer Price Index (CPI), increased by 1.6 percent in 2002. The following graph illustrates changes in the CPI since 1992.



Unemployment

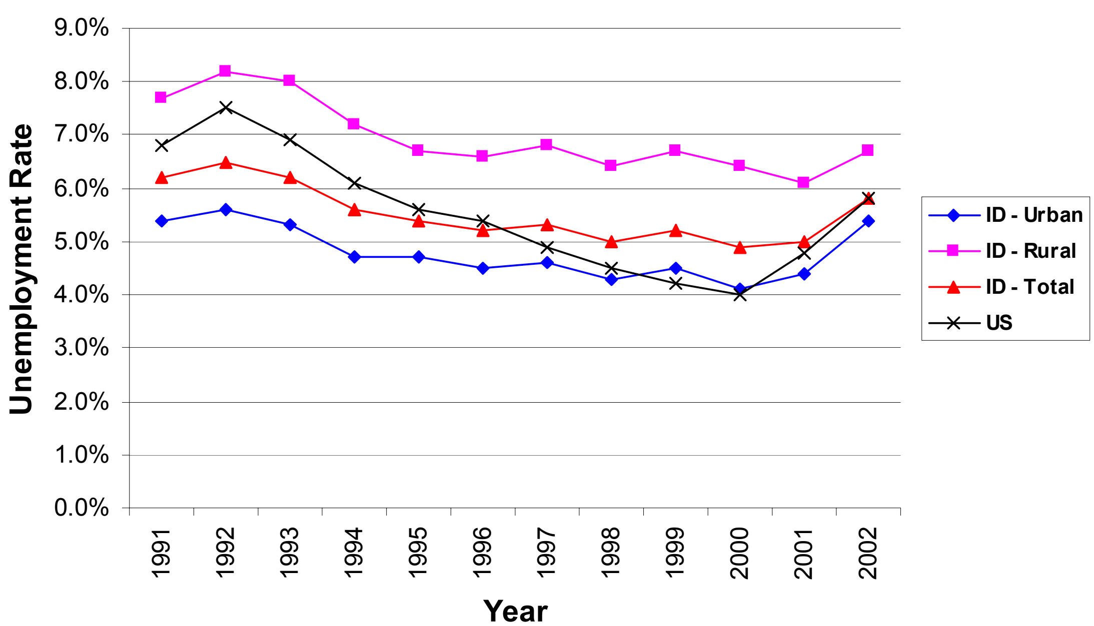
The national unemployment rate in August was 6.1 percent. Idaho's unemployment rate in August was 5.7 percent , equal to the August 2002 rate. The following graph illustrates changes in national and Idaho unemployment since 1996



The following chart shows the Idaho rural average unemployment rate was 1.3 percent higher than the Idaho urban rate in 2002. However, the state continues to experience highly competitive employment markets for skilled jobs that are in short supply even in markets where unemployment is high.

Unemployment Rates

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
ID - Urban	5.4%	5.6%	5.3%	4.7%	4.7%	4.5%	4.6%	4.3%	4.5%	4.1%	4.4%	5.4%
ID - Rural	7.7%	8.2%	8.0%	7.2%	6.7%	6.6%	6.8%	6.4%	6.7%	6.4%	6.1%	6.7%
ID - Total	6.2%	6.5%	6.2%	5.6%	5.4%	5.2%	5.3%	5.0%	5.2%	4.9%	5.0%	5.8%
US	6.8%	7.5%	6.9%	6.1%	5.6%	5.4%	4.9%	4.5%	4.2%	4.0%	4.8%	5.8%



Average Weekly Wages:

According to the Idaho Department of Labor, average weekly wages in Idaho increased by 2 percent in 2002.

	2001	2002	% Change
Total Covered	**$533**	**$541**	**2%**
Natural Resources	$677	$697	3%
Construction	$597	$597	0%
Manufacturing	$725	$735	1%
Trade, Utilities, & Transportation	$487	$487	0%
Information	$634	$640	1%
Financial Activities	$623	$637	2%
Professional and Business Services	$626	$636	2%
Educational and Health Services	$529	$544	3%
Leisure and Hospitality	$203	$220	8%
Other Services	$376	$381	1%
Government	$559	$576	3%

IV. Salary Survey Findings

CEC Salary Surveys

A salary survey provides wage data for a defined geography, industry, occupational group or level of job. Salary surveys need to be reputable, scientific, unbiased and have job descriptions detailed enough to accurately match jobs. DHR does not use any salary survey information produced by special interest groups such as trade groups, employee associations and organized labor. Wages are primarily driven by large established organizations. Survey data is not readily available for small independent businesses. Small businesses are often owner-operated, may employ family members and often do not use standardized compensation plans. This year, DHR used the following four third-party salary surveys to establish labor market rates.

1. The **Idaho Compensation and Benefits Survey**, prepared by 4HR, surveys 144 jobs with data compiled from 36 medium to large Idaho organizations. This is the most relevant survey because it studies the state's direct competition for labor. A list of participants is included in the FY2005 CEC supplement[1].
2. The **Western States Salary Survey**, prepared by the Central States Compensation Association, surveys 214 state government jobs with data compiled from 9 states (WA, OR, NV, UT, NM, AZ, CO, WY and MT). This survey only provides state government data.
3. The **Hay Group Salary Survey** provides national and regional data for more traditional "benchmark" jobs. This particular survey shows the largest pay disparities because of the private sector focus and most data comes from major metropolitan areas. Only 17 jobs were matched to this specific survey.
4. The **Northwest Health Care Industry Salary Survey**, prepared by Milliman USA, surveys 240 jobs with data compiled from134 major northwest hospitals.

1. In years past DHR used the Idaho Cross Industry Survey prepared by The Western Management Group to evaluate the in state wage market. This year the Compensation Consortium of Idaho (an association of public and private compensation managers) chose to use a new vendor named 4HR to produce the Idaho Survey. For the most part it is the same survey, just produced by a new vendor.

Methodology

Relevant Labor Market Identification

Market analysis focuses on pay practices of public and private sector organizations within the state, surrounding states and the nation. The state competes in different labor markets for different types of work. Most of the state's labor is hired from local markets; however, if a position is very specialized or high level, the state may compete in regional or national markets.

Benchmarks

Benchmark jobs are used as anchors for comparing internal pay levels to the external labor market. Strong survey data needs to exist for a job to be considered a benchmark. State jobs are matched to jobs in the third-party surveys by reading job descriptions, evaluating work and making comparisons. Benchmark jobs need to accurately represent the organization's entire job population or survey error can occur. This year's market analysis fulfills this requirement by covering 8,335 (65 percent of the classified workforce) employees assigned to 203 different jobs. A complete list of benchmarks can be found in the FY2005 CEC Supplement.

Analysis

Each salary is weighted according to the number of employees in a given job. The weighted averages as reported by respective salary surveys are compared to wages of employees who hold benchmark positions. The overall competitive position is calculated as follows:

Overall Competitive Market Position = (sum of actual employee salaries – sum of survey salaries)/ sum of survey salaries

The most accurate method of performing market wage analysis is at the employee level to account for a job's relative weight. This prevents jobs with few employees from over-influencing the results.

Market Pay Analysis Results

Idaho state employee wages currently lag average labor market rates by approximately 14.6 percent. A full market adjustment in FY2005 would require a 17.1 percent increase, approximately $85.5 million [2].

		FY2005		
	Weighted			
	Idaho State	Market	Market	Market
Occupation Group	Avg Salary	Avg Salary	Postion	Adjustment
Information Technology	$42,799	$53,420	-19.9%	24.8%
Finance and Accounting	$33,276	$36,114	-7.9%	8.5%
Science/Environmental	$39,494	$41,763	-5.4%	5.7%
Health Care - Services	$36,219	$40,558	-10.7%	12.0%
Nursing Sub Group	$35,419	$45,577	-22.3%	28.7%
Professional Services	$40,404	$44,619	-9.4%	10.4%
Para-Professional Sub Group	$32,270	$40,271	-19.9%	24.8%
Management Sub Group	$65,011	$87,547	-25.7%	34.7%
Protective Services	$31,974	$38,135	-16.2%	19.3%
Labor Trades and Crafts	$24,605	$29,049	-15.3%	18.1%
Administrative	$24,195	$26,514	-8.7%	9.6%
Engineering	$33,733	$42,283	-20.2%	25.3%
Statewide Weighted Average	*$31,444*	*$36,835*	*-14.6%*	17.1%

2. The state's market position (in percentage terms) was communicated in FY2004 CEC report. The market position is again being used this year in order to maintain continuity. This is calculated as follows: (actual average pay – market average pay)/market average pay

The market position is not the amount that wages would need to increase to achieve market parity. The increase percent to achieve market parity is calculated as follows: (actual average pay – market average pay)/actual average pay

Example: Employee A has $10 and Employee B has $8 – Employee B has 20 percent less than Employee A, if Employee B were to increase her $8 by 20 percent that would only equal (1.20 * $8) $9.60. Employee B would have to increase her $8 by 25 percent in order to equal Employee A's $10.

World at Work Total Salary Increase Budget Survey

World at Work (formerly American Compensation Association) conducts an annual salary increase survey. This year's survey includes 2,849 US organizations representing 15.8 million employees from a diverse cross-section of industries, including construction, manufacturing, transportation, publishing, information services, utilities, mining, health care, wholesale trade, retail trade and public administration. This is the most widely used report for tracking annual movements in salaries and salary structures.

The state's overall market position is 3.5 percent less this year than the 11.1 percent behind market reported last year. This is a solid reflection of the reported wage market movement over the last two years. According to the World at Work Annual Salary Increase Budget Survey, wages increased 4.1 percent and 3.5 percent in 2002 and 2003 respectively.

Major Trends in 2003-04:

- US salary increases to average approximately 3.5 percent.
- 83 percent of US employees will receive a base salary increase.
- Employers are providing pay increases approximately every 12.6 months on average.
- Pay schedules will increase an average of 2.1 percent in 2003, with more than one-third of the respondents reporting no increase in their salary structures.

V. Challenges

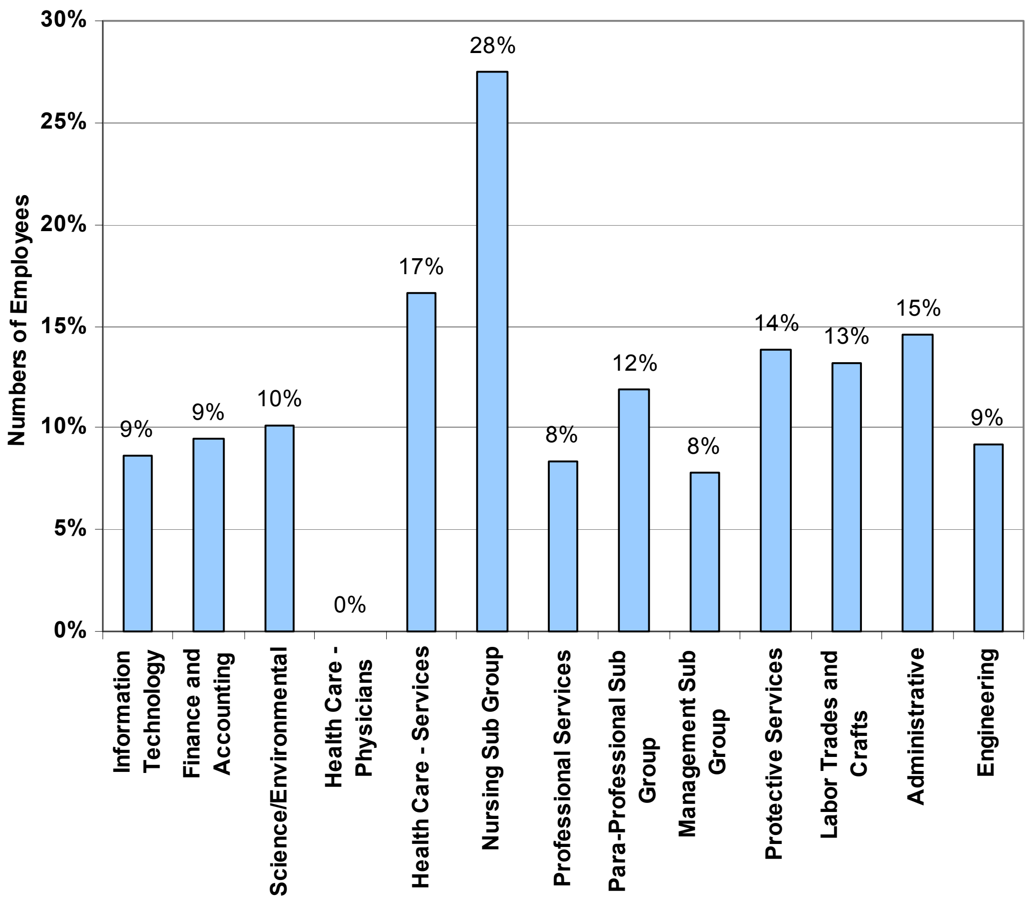
A CEC increase has not been funded since July of 2001. Since then prices (as measured by the CPI) have increased a total of four to five percent. State employees are paying more for gasoline, healthcare, groceries and utilities, but most are not making any more money. Pay increases based on performance are assumed to include a cost of living increase. The biggest factor influencing state employee wages is the lack of consistent funding.

Nurses

The nationwide nursing shortage is continuing to drive up wages. Last year state nursing occupations wages were 16.7 percent behind the average labor market rates and this year they are 22.3 percent behind. The turnover within nursing classifications is 28 percent compared to a statewide average of 13 percent. Based on DHR's survey analysis, the average market wage for a registered nurse is approximately $26 per hour and the state pays an average of $18.5 per hour. According to the Bureau of Labor Statistics, the market will demand over half a million new nurses between 2000 and 2010. This will continue to be one of the hottest occupations in the nation for the foreseeable future.

Turnover

Over the past year the state has experienced turnover of 13 percent compared to a historical average of 11 to 12 percent. Turnover is usually lower during times of economic uncertainty. The state could see a spike in turnover when the economy turns and the labor markets loosen, especially if wages are drastically behind market. Statewide turnover could also be compounded by the age of work force and movement of the baby boomer generation to retirement. The average state employee is 46 years old. The following chart illustrates turnover rates by occupational group. An array of turnover and age demographic data can be found in the FY2005 CEC Supplement.



Compression

Wage compression occurs when a new employee's entry wage is the same, or close to the salary of a current employee in the same job. This is the result of external market wages growing faster than existing state employee wages.

<u>Example of wage compression:</u>

The State of Idaho hired a recent nursing school graduate as a Registered Nurse at a starting salary of $38,000. There are currently two other staff employed as Registered Nurses who have been at the state for 3 and 5 years respectively. One makes $35,500 and the other makes $37,000. This is not reasonable given that the current two staff members (all other things being equal) have more experience, and thus are worth more than the new nurse, but because market wages have moved so quickly the state cannot hire a new nurse at less than the $38,000.

Hiring wages are determined by the external labor market which is primarily driven by the laws of supply and demand. An employer needs to pay the market wage to hire a qualified and competent new employee.

Wage compression is a double edge sword. If compression exists and an organization can only hire an employee willing to work for a wage less than the average market rate they will most likely attract an employee who is not as experienced and might require a longer training period.

On the other hand if an organization hires a new employee at the market wage and cannot address the internal pay levels, it will result in dissatisfaction and dissention among the current employees who are more experienced and valuable than the new employee.

Pay Grade Progression

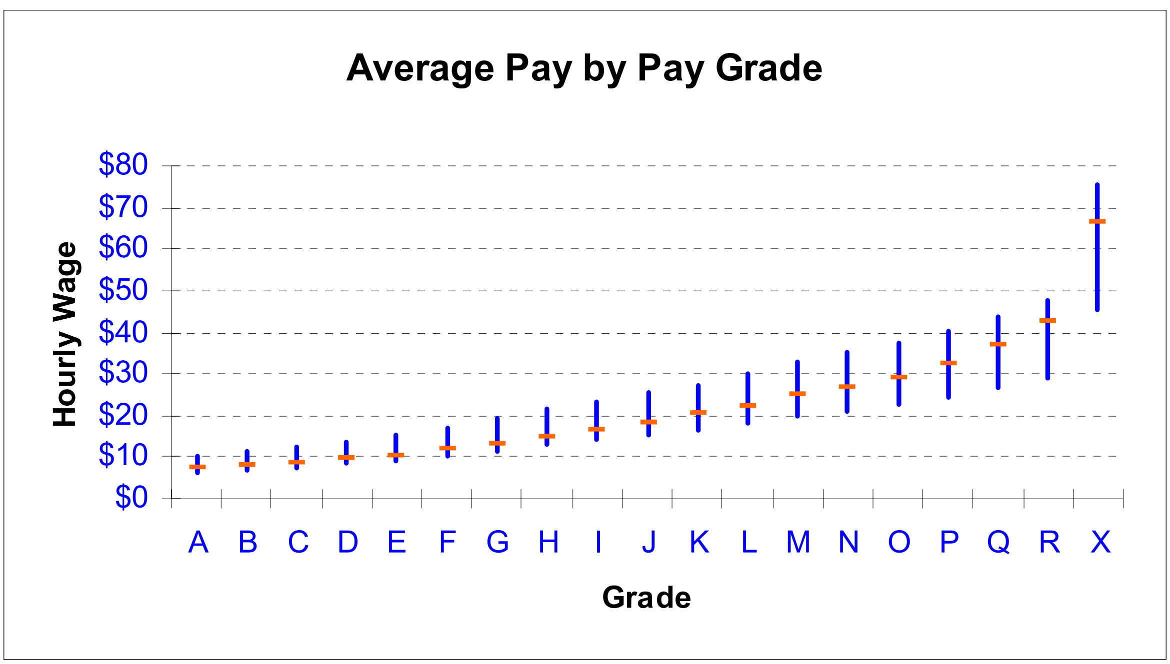
One strong indicator of compression is low pay grade progression. Pay grade progression is measured using a comparatio (actual wage/pay grade policy point). The state pay grades are 75 percent to 125 percent of the policy point. The state overall comparatio is .89, which means that on average state employees have only advanced 28 percent into their pay grades.

Only 16.6 percent of state classified employees are paid at or above the policy point. It currently takes a classified employee an average of 19 plus years to achieve the pay grade policy point.

Classified Employees Comparatio

Comparatio Category	Number of Employees	Percentage of Employees	Average Yrs of Service
.75 to .874	6,277	49.5%	5.9
.875 to .99	4,293	33.9%	13.7
1.00 to 1.124	1,688	13.3%	19.8
1.125 to 1.25	411	3.2%	23.3

The following graph illustrates slow pay grade progression and shows the average wage for each pay grade (designated by the dash). The average wage is less than the policy point in all but three grades (Q, R, and X). In Q and R the average years of service is 22 and 29 years respectively. Physicians and Physician Specialists are the only classified employees in grade X. There are currently no classified employees in pay grades S through W.



Federal Pressure

Many state employees who have left for jobs at the federal level have cited pay as their primary reason for leaving.

Most federal jobs qualify for regimented pay raises called step increases. There are 10 steps for each pay grade. Each step increase is approximately 3 percent. The timing of a step increase is based on years of service (Step 1 – 4: Increase Annually, Step 5 – 7: Increase Every 2 Years and Step 8 – 10: Increase Every 3 Years) and acceptable job performance.

In addition to step increases each year, federal employees receive an across the board pay adjustment. This pay adjustment is not performance based. The increase is announced by the President and is based on the increase in the Employment Cost Index, which is a measure of national employee wage increases.

The following chart provides a salary comparison between state and federal jobs.

Description	State of Idaho Jobs Annual Avg Pay*	Federal Jobs Annual Avg Pay*
Custodian	$15,900	$22,800
Nursing Asst, Cert	$18,500	$23,600
Admin Asst	$29,200	$33,100
P&R Ranger	$31,000	$41,900
Carpenter	$26,300	$42,300
Electrician	$30,900	$42,300
Biologist, Fish Resrc	$44,600	$54,200
Social Worker	$36,600	$55,100
Biologist, Wildlife	$42,100	$56,800
Nurse, Reg	$38,600	$57,400

The state is at a disadvantage when competing with the federal government for skilled employees. The timely distribution and the magnitude of pay increases given both the step increase and the annual pay adjustment compound to keep federal salaries increasing much faster than relatively equivalent state jobs.

One-Size-Fits-All Compensation System

The state currently maintains a "one-size-fits-all," compensation system for 1,200 different jobs and 12,000 classified employees. Additionally, many non-classified jobs also use Hay point factoring and the state pay schedule. The Hay point factor system evaluates jobs with respect to know-how, problem solving and accountability, but does not address the impact supply and demand has on job market prices. Jobs with the same Hay points are not always priced the same in the marketplace.

Consider the following example: both IT Programmer Analyst and Financial Specialist (Accountant) fall into pay grade J with 332 Hay points. On average, the state pays both jobs almost equally, however the market wage for the IT Programmer Analyst is 45 percent higher than the Financial Specialist.

Class Title	Hay Points	Pay Grade	Id Avg Pay	Mkt Avg Pay
IT Programmer Analyst	332	J	$38,364	$50,584
Financial Specialist	332	J	$36,703	$37,094

The pay schedule and policy points can also impact employee morale. For an employee to expect to advance to the policy rate may be confusing if the market rate for his/her job is not consistent with the pay grade policy rate. The policy rate is merely the mid point of the pay grade. The assignment of so many job classifications into one pay schedule tends to dilute the relationship of actual market rate compared to the policy point. Employees who are 30 percent behind market might be frustrated by the appearance that their jobs are undervalued because their pay level is close to the policy rate. On the other hand employees who are being paid close to actual market but are paid well below the policy rate may be demoralized thinking that their pay is below market when in reality their pay is right on target.

VI. Potential Solutions

Focused Merit Increase for Nursing Occupations

To address overly competitive pressures, turnover and a sizable market pay lag a special merit increase could be distributed to approximately 500 employees in the nursing occupational group. These additional funds would be allocated by agency for these classifications. A 10 percent focused merit increase would cost a total of $1.74 million.

Last year there was a focused recommendation for correction officers. This year the general CEC recommendations should be adequate to combat competitive pressures within the correctional officer market and other jobs with similar market pay lag and turnover rates.

Targeted Nursing Classifications
Nurse, Advanced Practice
Nurse, Licensed Practical
Nurse, Registered
Nurse, Registered Manager
Nurse, Registered Manager - Institution
Nurse, Registered Senior
Nursing Assistant, Certified
Nursing Assistant, Certified - Senior
Nursing Services Director
Nursing Services Director - SHN/ISVH

Compensation System Enhancements

CEC allocations should to be based on the unique needs of the occupational groups. Some jobs are closer to the market average rate than others, but our current pay schedule does not recognize occupational pay differences.

Some occupations are in greater need of an increase than others. Referring to the table below: Nursing occupations need a 28.7 percent pay increase to achieve market, but finance and accounting occupations only need 8.5 percent. To achieve a more competitive pay environment, the state needs to be able to differentiate appropriations based on the specific needs of the different occupational groups.

		FY2005		
		Weighted		
	Idaho State	Market	Market	Market
Occupation Group	Avg Salary	Avg Salary	Postion	Adjustment
Finance and Accounting	$33,276	$36,114	-7.9%	8.5%
Nursing Sub Group	$35,419	$45,577	-22.3%	28.7%

A change in Idaho Code is required to allow for the creation of multiple pay schedules that would reflect the market average pay and pay ranges for different occupational groups.

Pay Schedule Change

A general percentage increase to the current pay schedule is not advised given the proposed recommendation to analyze the state compensation system and adopt multiple pay schedules that more closely reflect the market rates and ranges for the assigned occupational groups.

Merit Increase Solutions - Ongoing

Idaho State Code 67-5309C(B) reads "It is hereby the intent of the legislature that an employee may expect to advance in the salary range to the labor market rate for the pay grade assigned to a classification."

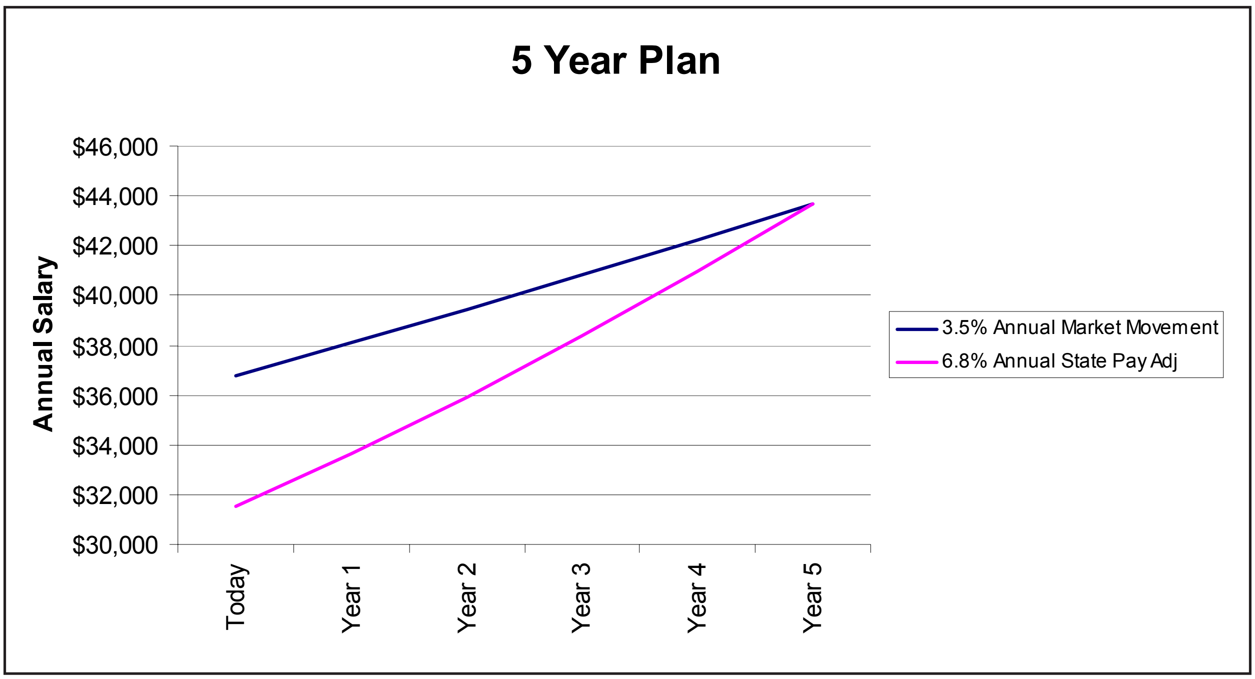
If the above code section is interpreted to mean the goal is to eventually achieve market parity, this would require $85.5 million in FY2005.

Lagging the market by 14.6 percent is a sizable challenge for any organization to overcome. Very few large employers would consider adjusting wages to overcome the entire 14.6 percent disparity in one year, most would stagger the increases out over a number of years. It would be unrealistic for the Governor and the Legislature to fund the entire $85.5 million necessary to achieve market parity in a single year.

The state eventually needs a plan to achieve market parity. The market will not stop moving and wait for the state salaries to catch-up. The plan needs to assume annual market movements. According to the World at Work Annual Salary Budget Survey, U.S. wages have increased an average of 4.16 percent annually since 1997. The market has slowed over the past two years, but conservative forecasts project between 3.5 and 4 percent annual U.S. wage growth.

Five Year Plan

Given a five year time horizon and U.S. wage growth of 3.5 percent annually, the State would need to increase wages 6.8 percent annually through FY2009 to achieve market parity. In FY2005 this would cost roughly $34 million.



Year	Market Movement	Market Salary	State Increase %	State Wage	*Estimated Total Cost
Today		$36,800		$31,500	
Year 1	3.50%	$38,088	6.7697%	$33,632	$33,848,500
Year 2	3.50%	$39,421	6.7697%	$35,909	$36,139,942
Year 3	3.50%	$40,801	6.7697%	$38,340	$38,586,508
Year 4	3.50%	$42,229	6.7697%	$40,936	$41,198,698
Year 5	3.50%	$43,707	6.7697%	$43,707	$43,987,727

** Annualy compounded - based on $5MM per every 1% increase*

Merit Increase Solution – One-Time Pay

Many organizations use bonuses and incentives as recruitment, retention and reward tools. This allows employers to address compensation needs without increasing ongoing payroll costs. This type of pay is usually used to compliment an already competitive market wage more than it is used as a substitute for a competitive market wage. Organizations occasionally use one-time pay to promote the retention of employees when faced with on-going financial challenges. Funding varies on the scope and need for intervention. Two percent one-time money would provide recognition and reward for employees and is far better than no funding.

Across-the-Board Pay Increases

An across-the-board pay increase appears to be fair, especially given that price increases affect everybody equally. However, an across-the-board pay increase runs counter to the state's pay for performance policy and can be very demoralizing for high performing employees. There is no financial incentive to over achieve if there is no reward differentiation.

A pay increase based on performance is assumed to include a cost of living adjustment (COLA). Employees appreciate additional compensation but an across-the-board increase further detracts from the already non-competitive market pay levels for certain skills and talents and may add to retention challenges.

VII. Recommendations

Based on current Idaho law, state employees should "expect to advance to market average rate" for their job classification's assigned pay grade. A clear, unopposable recommendation to address this is not possible, because the law does not specify conditions for advancement or time frames. The law also does not specify conditions for advancement beyond the market rate. Interpretations vary.

One viewpoint is that the CEC should be funded for 1) an increase to cover the pay schedule shift to reflect market – that is the cost to move those at entry to a new higher minimum, and then 2) merit raise money to move good performing staff to the market rate if they are fully trained and competent, and move great performers above the market rate to reward their outstanding work. The price tag for this interpretation is an annual market adjustment percentage increase to cover the move to new minimums, and merit money to cover the market differential. Costs for those that do not make market rates are balanced by those making more than market rates.

Another perspective is that job security and other benefits of state employment supplement a lower-than-market salary. With this view, some believe that a five year or longer time to advance to market is reasonable. The starting salaries do not have to be competitive because of the career stability, benefits and meaningful work.

Reality is probably somewhere in the middle.

An attractive benefits package, job security, and meaningful work do counter less than market salaries, because it takes a package to be competitive and meet the preferences of an individual. In addition, some job opportunities are only available in state government. But the tide is shifting. Outsourcing and privatization have moved some traditional state government jobs to the private sector. Many new recruits are not seeking long-term public service careers. The demand for certain skills and education is outpacing the number of workers with those skills in some areas. American values of competition for the best and brightest drives the market prices further.

The potential solutions discussed in the last section show a number of ways for the state to address the issue of competitive pay. Based on the information available in the summer of 2003, the DHR Administrator recommends the following:

1. No increase to the current salary range schedule.
2. No increase to the current "policy rate."
3. Code change to allow for pay schedules unique to occupational groups.
4. Provide an average of 10 percent permanent merit raises for nursing occupations.
5. Adopt a strategy to address market salary competition.
6. Provide 6.8 percent CEC to fund the first step toward current law requirements OR
7. Provide as much permanent CEC money as possible and refine the current law to specify market targets.
8. If no ongoing CEC is possible due to revenue projections and other budget issues, provide 2 percent one-time money to support a retention and recognition award program for FY05 only. These funds would be used for one-time awards up to 10 percent of an employee's salary in recognition of their contributions and performance, and promote retention through these difficult times. This special appropriations bill should also allow additional funds to be used in personnel if savings can be found in operating budgets for FY2005 only.

Another option for funding would be to propose tying an additional appropriation of CEC money to agencies based on the actual revenue receipts mid year in FY2005. The length of time between this recommendation, the budget development, Executive CEC recommendation, Legislative action, and the start of the new fiscal year is too long to respond to improvements in the state's economy and changes in the labor market. To delay permanent pay increases until the beginning of FY06 (July 2005) may be hoping that the fully-trained employees, Idaho's best and brightest, will not be recruited by more competitive employers.

VIII. Conclusion

Career state employees are primarily motivated by their desire to serve others. The mission of their state agency provides the fuel for them to commit themselves to their work and their fellow citizens. But no matter how dedicated the workforce is, the economics of the job market exert a powerful influence. Despite current unemployment levels in Idaho, state employee turnover rates remain at historically normal levels. State agency managers relate serious challenges with recruiting and retention of skilled staff.

The concept of market-average pay expectations, as designed by the Legislature in 1994, and advancement through pay for performance only, is a sound compensation philosophy on its face. The pivotal concept of "market average rate for the pay grade" may be too broad a goal. The inability of the state to adequately fund such a program has caused challenges that have grown exponentially. The costs to catch up to the market, to keep up with the market, and to pay up – that is reward extraordinary performance—have risen beyond the imagination of reasonable people. It is time to rethink the principles and policies underlying state employee compensation. Refining the target of market average pay is a critical first step.

Meanwhile, the importance of competitive pay is increasing. The Baby Boomer generation has a public service career orientation that the next generation does not share. The size of the skilled workforce in this next generation is smaller in numbers, causing competition for talent based on availability alone. The Governor and Legislature face the challenge of determining the "right size" of government, including the workforce. Once that size is determined, market competitive pay is essential for successful implementation of government initiatives and services.