A Proposed Plan of Action for State Employee Compensation
Offered by the
Virginia Governmental Employees Association

Background

Section 2.2-1202 of the Code of Virginia makes explicit that the goal of the State is to provide a *total compensation package* (emphasis added) that is comparable to the private sector and the State's peers.

The last review of state employee total compensation to measure whether this statutory goal was being met occurred in the JLARC review of 2011. They retained Mercer Consulting (a nationally recognized HR consulting firm) to conduct the analysis.

Mercer found that the State total compensation (salary and benefits) was *only marginally competitive*, falling at the bottom of the competiveness range. Total compensation lagged the market by 6-10 percentage points, depending on whether the employee was in VRS plan 1 or plan 2 (employees in plan 2 are further behind due to its less generous benefit structure) and placed Virginia last in a ranking of total compensation among 16 large Virginia employers that compete for the same workforce.

JLARC's analysis showed that the cash compensation component of this mix is *not competitive* when compared to the market. The competitiveness of the state's cash compensation had fallen from 88 to 82 percent of the market median for plan 1 employees and to 79 percent of the market median for plan 2 employees. JLARC noted in its 2011 report that the Commonwealth could fall even further behind should salaries continue to be frozen or should benefits be further reduced. Since that time, both have occurred. JLARC stated that uncompetitive salaries not only diminish the competitiveness of the state's overall compensation package, but they also decrease the value of other aspects of total compensation, such as retirement (which is tied to the last few years of compensation.)

It is important to note that this analysis was conducted prior to adoption of the hybrid retirement plan system. The hybrid plan guarantees far less at retirement than either plan 1 or plan 2, and any subsequent analysis of total compensation will in all likelihood find that the Commonwealth is now totally non-competitive in both salary and total compensation.

The State employee compensation system is broken. The implications for attracting the best and brightest to replace our aging work force are clear. This is not the way forward if we are to continue to be one of the nations' "best-managed" states. Absent any exponential change, the total compensation picture is only going to get worse. In this worsening picture, cash compensation becomes far more important.

Recent Pay Actions

State employees have received only one across-the-board adjustment that actually increased net base pay in the past 10 years. A two percent market pay increase was provided in 2013 but it *was offset by a 2% increase in social security taxes* that went into effect in January of that year, so there was no net increase. An additional increase of $65 per year of service was also provided in 2013 to employees with more than five years of continuous service to alleviate the effects of pay compression, a practice wherein new employees are hired at competitive pay rates equal to or higher than long time employees. The budgets initially approved by the two money committees in 2014 included similar increases. However those budgets were not adopted as the year-end general fund revenue collections unexpectedly fell precipitously with no pay actions being approved. A two percent market adjustment and compression pay action was provided in 2015 along with additional targeted increases for certain job classes experiencing extraordinarily high turnover rates. This resulted in the *first across-the-board adjustment* that actually increased net base pay for state employees since 2007. A three percent general pay increase was approved for 2016 with funding contingent upon revenue collections being within one percent of the official estimate. The revenue collection threshold was not met so the pay increase did not go into effect.

The 2015 pay actions were well received by employees who had seen their take home pay chipped away in small bites over the past decade from things such as health insurance premium increases, increases in health insurance co-pays, and even increases in state parking fees, while watching new employees get hired at salaries comparable to or in excess of their own.

Proposed Actions

Fixing the employee compensation problem will take time. The Commonwealth did not get in this situation overnight. However, by undertaking a number of *concerted actions on a consistent basis*, we can make significant progress. As the representative of the VGEA, I am offering solutions that we believe will allow the General Assembly and Governor to move forward to improve this issue.

1. Every employee of each state agency and institution, regardless of the funding source or type of employment, should be provided an annual written statement informing them of the value of their total compensation with the results compiled in a statewide database. Currently, an annual statement of total compensation is made available electronically to all employees in the classified personnel system. It should be expanded to include all employees of every state agency or institution and be provided in hard copy form in conjunction with the annual W-2 tax statement. The current statement includes a breakdown between cash compensation and non-cash benefits as the components of total compensation. The benefits side of this compensation statement details the annual dollar value of employer contributions for retirement (including matching funds for deferred compensation program participants), sickness and disability insurance, health insurance, paid leave and life insurance. This statement should be expanded to include all non-cash compensation provided to certain types of employees such as housing, uniform related allowances, vehicle allowances and others. To ensure consistency in reporting, the Department of Human Resource Management should establish reporting standards. This would go a long way toward helping employees understand the full monetary value of the benefits they receive in addition to their state salary. This requirement should include every state employee, regardless of funding source, and the results should be compiled in a statewide database. This database would provide the General Assembly and Governor with valuable information to be used in workforce planning.

2. The Department of Human Resource Management's (DHRM) Annual Salary Survey should be expanded to include total compensation. We recommend a survey of *total compensation* be conducted *biennially* – with the survey limited to looking only at *salary in the intervening years*. In addition, the survey should be completed and published according to a schedule that allows consideration of its findings as part of the executive branch budget development process, which begins in earnest around September 1. The survey should compare the total compensation between state employee classes and comparable classes of private employers in Virginia and surrounding states with whom the Commonwealth competes for employees. This will likely require additional funding for the DHRM to obtain this expanded comparative information.

3. Employees should be surveyed periodically to determine the value they place on each component of their total compensation. Better informing employees about the value of their total compensation is the first step toward striking the appropriate balance between cash (salary) and non-cash (benefits) compensation. The second step is determining the value that employees place on each element of their total compensation. This information can provide the basis for rebalancing cash and non-cash compensation in response to the needs of a changing workforce. The Workforce Working Group received a presentation highlighting the value of a periodic employee satisfaction survey. The last such survey of state government employees was conducted at the direction of Governor Jim Gilmore in 2000. We recommend reinstating this survey on an annual basis and ensure that it includes questions to assess the value that employees place on the various elements of their total compensation. The survey should be completed and published according to a schedule that allows consideration of its findings as part of the executive branch biennial budget development process.

4. The Commonwealth should ensure that if it cannot make progress on closing the market salary gap in a given year, then it should at least provide a salary increase sufficient to ensure that the gap does not grow even larger. The DHRM

Annual Salary Survey shows that cash compensation or salaries for State positions lags behind comparable private sector salaries anywhere from 1.4 percent to 81.2 percent with an average deviation projected at 24.82 percent. This gap is not going to be closed in one year, five years, or maybe even 10 years since private sector salaries continue to increase annually. Fixing it will require a long-term commitment to a series of regular, incremental steps over a period of many years, just as has been done with the commitment to fully fund the State's pension obligations. However, the Commonwealth should also ensure that if it cannot make progress on closing the gap in a given year, then it should at least provide – using information from the annual salary survey – an increase sufficient to keep the gap from growing even larger (in FY 14, the market movement was 2.88 percent.)

5. Initiate a phased program to eliminate the market gap between state employee non-cash compensation and private sector comparability for all employee groups. We would recommend an eight to 10 year effort that starts by focusing on those positions with the greatest labor market pay disparity and the highest rate of employee turnover. This approach would provide the fastest way to substantially reduce the overall market gap and provide the greatest initial return on investment as it addresses the most serious "hard-to-recruit" positions and reduces the cost associated with major employee turnover. The interaction between this action and our recommendation to alleviate pay compression should result in a rapid reduction of the overall market pay gap. This gap will shrink even more as efforts to reduce the difference for positions with lesser market disparity move forward in the later years of the program. It should also be noted that this effort must also proceed in conjunction with general pay actions that prevent that gap from growing even larger.

6. The DHRM should review salary compression by agency and report to the Governor and General Assembly on the extent of the problem, whether additional actions are needed to resolve the problem and the cost of any recommended actions. Salary compression occurs when newer employees make as much or more than senior employees in the same job. This occurs when the veteran employee's salary is frozen and the new employee is hired at a market competitive rate. The General Assembly began to address the salary compression issue in 2013 and 2015 but the extent of the problem and total cost to fix the problem remain unknown. The review should be completed and published in time to allow consideration of its findings as part of the executive branch budget development process.

7. Align base salary levels (cash compensation) with the appropriate competitive local and regional labor markets. The practice of recognizing local and regional labor markets long practiced by major private sector employers and adopted by the federal government should be expanded. Currently this practice is partially applied with the provision of a northern Virginia differential to state employees working in that area of the state. The annual DHRM salary survey should include this information. Other geographic areas of the Commonwealth may require additional consideration for the Commonwealth to be a competitive employer. This will enable the State to better establish "external equity."

8. Replace the current pay-for-performance program with a performance incentive bonus program structured similar to best practices used by large private employers. The current program was developed in 2001. It envisioned a permanent base pay increase annually, with amounts determined by the employee's annual performance appraisal. However it has been funded only once since that time due to the costs and their cumulative impact on base budgets. Money is a proven incentive to improve performance. But to be effective, it must be real and consistent… *and it is not a substitute for base pay increases that improve market competitiveness.* The VGEA is proposing to replace the current unfunded program with a performance incentive bonus program structured similar to best practices used by large private employers.

Under this program, an employee whose annual performance evaluation results in a rating of "non-performer" would not receive any payment. An employee receiving the rating of "Contributor" would receive a one–time lump sum bonus payment ranging from 2.4 percent to three percent while an employee receiving a rating of "Extraordinary Contributor" would receive a one-time lump sum bonus payment ranging from three percent to 7.5 percent. This performance incentive bonus payment would be paid to the employee immediately following the annual performance review. Since it is a lump sum one-time payment for performance, it would not result in an increasing base salary adjustment and the employee must continue to perform well to receive additional performance incentive bonus payments in each subsequent year.

Funding for the program would be appropriated in a central budget account with distribution proportionately to agencies (based on general fund employment and salaries.) The payments to employees are awarded based on the annual performance appraisal using long standing DHRM guidelines (that were developed for this purpose and have only been used the one time that pay-for-performance was actually funded). The amount of money available is the limiting factor on the bonus range but the goal would be to achieve a statewide average performance bonus of three percent each year. Once embedded in the biennial budget base, any increase in funding for the program would be entirely within the discretion of the General Assembly, thereby avoiding the compounding effect that results when performance increase payments are made part of an employee's base salary.

9. Strengthen the commitment to a plan for reducing the market compensation gap by requiring the Governor, by December 15 of each year, to prepare and submit to the members of the General Assembly an estimate of the appropriations or actions necessary to:

- provide a base salary increase sufficient to ensure that the total compensation market gap does not increase over the course of the applicable budget cycle;
- implement or continue a program to eliminate the total compensation market

gap;

- eliminate any systemic salary compression;
- maintain the alignment of base salary levels with the appropriate competitive local and regional labor markets within Virginia, and;
- initiate or continue a performance incentive bonus program.

This requirement strengthens the effort by making it a part of the annual cycle for the Governor's presentation of his budget proposal. While the approach does not remove the risk of underfunding compensation remediation efforts, it does provide a means to highlight the necessary commitment annually. Ideally, this information would be used by the Governor when taking compensation actions "off the top" during the budget development process. The General Assembly could also use this data in developing actions needed to reduce – and over time, eliminate – the market compensation gap.