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**A Biennial Report on Recommended**
**Adjustments to the Classification Salary Schedule**

August 1996

# Key Points Of Report

## A Biennial Report on Recommended Adjustments to the Classification Salary Schedule

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### Overall Conclusion

We recommend that the Legislature adjust the Classification Salary Schedule by 3.5 percent for each year of the 1998-1999 biennium. We base our recommendation on the analysis of the impact of inflation on the real earnings of classified employees, the compensation practices of other employers, turnover data, and the competitiveness of the State's benefits package. The salary structure adjustments would cost approximately $110 million in fiscal year 1998 and $114 million in fiscal year 1999.

### Key Facts And Findings

- The average classified employee has experienced a cumulative loss in real earnings, or purchasing power, of $1,057 since 1992. Even after including employee promotions, merit increases, and bonuses, average classified employees' salaries have increased by only 7.47 percent since 1992, while inflation has grown by 11.80 percent.

- Adjustments to the Classification Salary Schedule have not kept pace with national and local salary structure trends for three of the last five years, and will lag behind again in fiscal year 1997.

- Competitive salaries take on added importance in the recruitment of employees since the value of benefits provided to new state employees now lags behind the national average. While the benefits of state employees eligible for benefit replacement pay equal 45.5 percent of payroll, benefits for new state employees (who are not eligible for benefit replacement pay) equal 33.8 percent of payroll. Nationally, benefits average 40.7 percent of payroll.

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*The salary studies, findings, and recommendations in this report have been conducted in accordance with the Position Classification Act, Texas Government Code, Chapter 654.*

Section 1:

## The Legislature Should Adjust the Classification Salary Schedule by 3.5 Percent for Each Year of the 1998-1999 Biennium

We recommend that the Legislature adjust the Classification Salary Schedule by 3.5 percent for each year of the 1998-1999 biennium. We believe that the increases are needed because:

- The average classified employee has experienced a cumulative loss in real earnings, or purchasing power, of $1,057 since 1992.
- Adjustments to the Classification Salary Schedule have not kept pace with national and local salary structure trends for three of the last five years and will lag behind again in fiscal year 1997.
- Benefits for new state employees now lag behind national averages. As a result, the competitiveness of state salaries takes on added importance in state agencies' ability to attract qualified employees.

If our recommendation is adopted, classified employees would receive an average salary increase of $70 per month, based on the average classified employee salary as of February 29, 1996.

As part of a sound compensation program, the State's Classification Salary Schedule should be adjusted periodically to ensure that classified salaries remain competitive with relevant labor markets. Salary structure adjustments deal with economic factors that affect all employees and reflect the need to have employees' salaries keep pace with the pay of peers in the marketplace. Unless classified salaries are competitive with the market, the State's ability to attract and retain the number and quality of people necessary to conduct the State's business may be adversely affected.

The salary structure adjustments would cost approximately $110 million in fiscal year 1998 and $114 million in fiscal year 1999.

Section 1-A:

### State Classified Employees Have Experienced a Cumulative Loss in Real Earnings Since 1992

The average classified employee has experienced a cumulative loss in real earnings, or purchasing power, of $1,057 since 1992. Inflation, as measured by the Consumer Price Index (CPI), has grown by 11.80 percent since 1992, while average classified employees' salaries have increased by only 7.47 percent over the same period. (See Figure 1 for detailed information on inflation's effect on classified employee earnings.)

Figure 1

**Effect of Inflation on Classified Employee Earnings for Fiscal Years 1992-1996**

| Fiscal Year | February Average Classified Salary | Cumulative Percentage Increase in Classified Salary | CPI Index | Cumulative Percentage Increase in CPI | Salary Needed to Maintain 1992 Real Earnings | Gain/(Loss) In Real Monthly Earnings |
|---|---|---|---|---|---|---|
| 1992 | $1872.01 | | 100.0 | | | |
| 1993 | $1965.97 | 5.02 | 103.2 | 3.20 | $1931.91 | $34.06 |
| 1994 | $1977.01 | 5.58 | 105.8 | 5.80 | $1980.58 | ($ 3.57) |
| 1995 | $1998.40 | 6.66 | 108.9 | 8.90 | $2038.61 | ($40.21) |
| 1996 | $2014.58 | 7.47 | 111.8 | 11.80 | $2092.91 | ($78.33) |

Sources: U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index; State of Texas, Human Resource Information System, Classification Analysis for the Quarter Ending February 29, 1996.

The average loss in real earnings calculation takes into consideration salary increases provided to classified employees for outstanding performance, for increased skill levels, or for moving into positions of greater responsibility (such as individual employee promotions, merit increases, or bonuses). However, salary administration activities that are not in the form of a salary structure increase are designed to reward performance, not to protect employees from the loss of real earnings to inflation.

The CPI is generally the best measure for determining the amount of a salary structure adjustment when the intent is to allow employees to purchase, at today's prices, the same market basket of consumer goods and services that they could purchase in an earlier reference period.

Section 1-B:

### The State Has Not Kept Pace with National and Local Salary Structure Trends for Three of the Last Five Years and Will Lag Behind Again in Fiscal Year 1997

Adjustments to the Classification Salary Schedule have not kept pace with national and local salary structure increase trends for three of the last five years. During the past three years, state classified employees have received no salary structure adjustments, and are not scheduled to receive an increase in fiscal year 1997. Nationally, salary structure adjustments ranged from 2.3 percent to 2.7 percent for each year since 1994. Moreover, other employers in the Central Texas area have increased their salary structures from 2.5 percent to 4.3 percent for each year since

1994. In fiscal years 1992 and 1993, salary structure adjustments for state classified employees fell within the range of increases at the national level, but did not match trends in the Central Texas area. (See Figure 2 for detailed information on salary structure increase trends.)

Figure 2
**Salary Structure* Increase Trends**

| **National Salary Structure Trends** | **1996 (Projected)** | **1995** | **1994** | **1993** | **1992** |
|---|---|---|---|---|---|
| FLSA** Exempt Employees | 2.7% | 2.4% | 2.5% | 2.8% | 3.2% |
| FLSA Non-Exempt Employees | 2.6% | 2.3% | 2.4% | 2.7% | 3.0% |
| **Central Texas Salary Structure Trends** | **1996 (Projected)** | **1995** | **1994** | **1993** | **1992** |
| FLSA Exempt Employees | 3.7% | 4.3% | 2.8% | 3.3% | 3.6% |
| FLSA Non-Exempt Employees | 3.6% | 3.9% | 2.5% | 3.2% | 3.6% |
| **State of Texas Classification Salary Schedule Adjustments** | **FY 1996** | **FY 1995** | **FY 1994** | **FY 1993** | **FY 1992** |
| Classified Employees (both FLSA exempt and non-exempt | 0.0% | 0.0% | 0.0% | 3.0% | 3.0% |

Sources: American Compensation Association Salary Budget Survey and Austin Area Compensation and Benefits Directory, 1992-1996

* *Salary structure* refers to the structure of job grades and pay ranges in an organization. The current salary structure for Texas' classified employees is the Classification Salary Schedule in Article IX of the General Appropriations Act.

** Fair Labor Standards Act (FLSA exempt employees are not subject to the overtime provisions of the Act.)

The 3.5 percent increases we are recommending for each year of the 1998-1999 biennium would maintain, but not improve, the State's relative position in the labor market. The proposed increases fall within the range of salary structure increases *projected* by national and local employers of between 2.6 percent and 3.7 percent for 1996. Although higher than national averages, 3.5 percent is consistent with 1996 trends projected in the Central Texas area, the primary labor market in which the State competes for its classified work force.

With Austin's economy expected to continue its growth through the 1998/1999 biennium, we believe Central Texas will continue its pattern of granting salary structure increases that exceed national averages. Our recommendation for increases of 3.5 percent are based on this premise, although projected salary increases for 1998 and 1999 are not yet available.

Section 1-C:

### Benefits for New State Employees Now Lag Behind National Averages. As a Result, the Competitiveness of State Salaries Takes on Added Importance in State Agencies' Ability to Attract Qualified Employees

The State should not rely on its employees' benefits package as the means to narrow any historical gaps between state employee salaries and those paid by the private sector for comparable jobs, especially for new state employees. State employees hired September 1, 1995, and later, are not eligible for benefit replacement pay of up to $965.00 each calendar year. (Benefit replacement pay replaced the state-paid portion of employees' social security contributions.) The benefits for state employees eligible for benefit replacement pay equal 45.5 percent of payroll, while the benefits for ineligible state employees drop to 33.8 percent of payroll. The benefits package for the latter group of state employees is significantly below the national average of 40.7 percent, according to the U.S. Chamber of Commerce's 1994 survey of 929 public and private sector employers.

Section 1-D:

### Overall, the State Has Not Experienced Unusual Retention Difficulties

Overall, the State has not experienced significant recruitment and retention difficulties for its full-time classified work force during the past two years. The turnover rates of 13.26 percent and 13.51 percent for fiscal years 1994 and 1995, respectively, for full-time classified employees were in-line with local, state, and national turnover averages. The Bureau of National Affairs reported that nationwide, turnover rates averaged 10.8 percent in 1994 and 12 percent in 1995.

Classified employees resigning their employment because of inadequate salary was 8.54 percent of total terminations (1,682 classified employees) in fiscal year 1995, an increase from 7.89 percent in fiscal year 1994. Inadequate salary was the third most commonly stated turnover reason in 1995, excluding interagency transfers.

Section 2:

## Flat-Dollar Increase

A flat-dollar increase of $70.00 per month for each year of the biennium is approximately equal to the cost of providing a 3.5 percent increase. However, a percentage rate increase is preferable to a flat-dollar increase for the following reasons:

- A flat-dollar increase would have the largest impact on jobs where the private-public sector pay gap is small, but would have the smallest impact on jobs where the private-public sector pay gap is large. The differences in pay between the two sectors are most pronounced in the higher paid professional and administrative jobs.

- The necessary salary differentials between higher and lower paying jobs would be gradually reduced if flat-dollar increases were consistently granted. It is important to maintain fair differentials between supervisors and the employees whom they supervise. Salary compression can occur if highly-paid non-supervisory employees earn as much or more than their immediate supervisors, thereby reducing the incentive to occupy supervisory positions.

Section 3:

## Cost Estimates

Figure 3 shows the estimated annual costs to implement the percentage or flat-dollar rate increases. The estimates are based on 130,493 classified employees as of February 29, 1996. They do *not* include the cost of additional state-paid retirement contributions or benefit replacement pay for eligible employees.

The estimates also do *not* include the cost of providing increases to employees exempt from the Classification Plan or employees in institutions of higher education. Since we did not review the salaries of employees exempt from the Classification Plan or employees in institutions of higher education, we cannot report on the competitiveness of these employees' salaries in relation to the labor market. We do note that, in most cases, positions exempt from the Classification Plan have had their not-to-exceed salary rates increased, and employees in higher education institutions have received general wage increases since fiscal year 1993, the last year in which the Classification Salary Schedule was increased.

Figure 3
**Estimated Annual Cost of Increases**

| | Fiscal Year 1998 | | Fiscal Year 1999 | |
|---|---|---|---|---|
| | 3.5% | $70/Month | 3.5% | $70/Month |
| Classified Employees Only | $110,436,226 | $109,614,120 | $114,301,494 | $109,614,120 |

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# Objective, Scope, and Methodology

The State Classification Office (Office) in the State Auditor's Office conducts periodic studies of salary rates and trends in industry and other governmental units for work similar to that performed in state government. The Office is required to report these findings and make recommendations for the adjustment of the Classification Salary Schedule. This report examines general salary trends, discusses other factors which influence salaries, and provides recommendations for the adjustment of the State of Texas' Classification Salary Schedule.

In developing our recommendations for the adjustment to the Classification Salary Schedule, the State Classification Office analyzed:

- national and regional salary structure trends for both the private and public sector
- the State's total compensation package for classified employees
- inflation rates
- classified employee recruitment and retention trends

The salary structure trends in Section 1-B were based on data from the *ACA Salary Budget Survey* and *Austin Area Compensation and Benefits Directory*.

The *ACA Salary Budget Survey* contains data from over 3,300 U.S. firms, representing a broad cross-section of industries, including public administration, financial, insurance, real estate, communications, service, utilities, transportation, manufacturing, and wholesale and retail trade industries.

The *Austin Area Compensation and Benefits Directory* represents data from government, finance and insurance, manufacturing, health care, wholesale and retail trade, and service industries.

The employee benefit calculations in Section 1-D include vacation leave, sick leave, holidays, Worker's Compensation, insurance, benefit replacement pay, retirement, and unemployment compensation.

For analysis purposes in this report, we used 1994 data on the State's benefits package in order to match the latest available benefits data from the U.S. Chamber of Commerce. In 1995, however, the State's benefits package for employees eligible for Benefit Replacement Pay dropped to 44.9 percent from 45.5 percent of payroll in 1994, primarily as a result of a .45 percent decrease in the State's contribution for retirement.

If state employees' benefits remain unchanged, an increase in the average classified salary as a result of the recommended 3.5 percent increases would cause a slight reduction in the percent that benefits represent compared to overall payroll.