

# COMPENSATION

## Vital, Visible, and Vicious

After studying this chapter, you should be able to:

**I may be unappreciated, but at least I'm overworked and underpaid.**

**—A bureaucrat's lament**

- Understand why conventional wisdom about pay is often wrong;
- Recognize that there is no absolute standard used to determine pay—that is, organizations do not pay people exactly what they are worth because they do not know what their employees are worth;
- Explain why compensation is a key human resource function but pay programs, paradoxically, are not a management system;
- Comprehend that a compensation system is the result of law and policy, labor markets, job evaluation, and personal contribution;
- Acknowledge that fair, threshold pay takes the issue of money off the table so that employees can focus on the work itself;
- Articulate why it is difficult to resolve the perennial pay debate;

If position classification and motivation define the individual-organization relationship (Chapters 5 and 6), then compensation quite literally quantifies it. Earnings affect a person—not only economically but also socially and psychologically—because they are a concrete indicator of employee value to the institution, purchasing power, social prestige, and, sadly, perhaps even self-worth. Payroll expenses, likewise, represent a substantial investment on the part of the organization; they often constitute the majority of its budget. In the U.S. Department of Defense and the U.S. Postal Service, for example—and in most other agencies irrespective of jurisdiction—labor costs often amount to more than 80 percent of outlays.

Accordingly, a compensation system should aim to align individual and organizational objectives, an ideal that may be difficult to achieve when many elected officials—with backgrounds in insurance agencies, real estate offices, law firms, and other small businesses—have little experience in large public organizations.<sup>1</sup> Nevertheless, dilemmas in managing compensation are of paramount importance. Trends in performance accountability and staff reduction suggest that supervisors and employees will determine resolution of these issues, with human resource management experts serving as consultants, not controllers. It will no longer do to blame controversial decisions on the personnel office.

Organizations have a right to expect staff to be as productive as possible, and individuals have the right to be fairly compensated. Thus, a value-added remuneration system should optimize the balance between institutional constraints and personal expectations by creating value for both the organization and its members. Program goals include attracting new workers, rewarding and retaining existing ones, providing equity, controlling budgets, and supporting the culture that the agency seeks to cultivate. Compensation is the juice of HRM as it communicates institutional philosophy, values, and

- Critique the claim that pay for performance is a panacea for compensation fairness;
- Describe key compensation tools—cost-of-living adjustments, longevity pay, merit pay, skill-based pay, bonuses, and pay differentials—and their often paradoxical nature;
- Design and calculate the essential elements of a salary survey; and
- Assess and critique criteria for an ideal compensation system in the context of future trends.

practices. The design and maintenance of a compensation system constitute a complex and prominent function in an organization; other human resource functions are important to some employees, but money is crucial to virtually everyone.

How a jurisdiction handles salaries and benefits, then, is vital (for individual sustenance and organizational credibility) and visible (personnel salaries and agency payrolls are a matter of public record), as well as vicious (actual or imagined inequities among workers breed considerable friction in organizations). Competence and performance may be hard to judge (Chapter 10), but pay and benefits are known. For instance, federal bankruptcy judges excluded from dining and transportation privileges enjoyed by other judges may well feel like second-class citizens.

Despite—or perhaps because of—its importance, the compensation function of human resource management is the one that produces the most displeasure among public, nonprofit, and private sector employees alike. Money may be a good servant, but it is a bad master. There are at least three reasons for discontent. One is that people compare themselves with others: with those doing the same job in the same office, with those performing different jobs in the agency, and with those holding equivalent positions in other departments. It is not unusual that perceived discrepancies and real discontent emerge as a result of those comparisons.

A second explanation is that remuneration is often driven more by political considerations than by economic ones. “It is completely fallacious,” Risher and Fay (1997), in an observation that remains true today, “to argue that government pay programs represent a management system” (p. 14). Elected officials typically focus on personnel costs, and compensation policies become pawns in a quest for political advantage. Raising taxes, cutting services, or reallocating budget monies to fund pay increases is not politically popular. Thus, over time, salaries may be affected more by political opportunism than by objective merit—something not likely to engender confidence in compensation policies.

A final, related reason for concern over pay is that many citizens believe civil servants are overpaid and underworked—despite arguably noncompetitive salaries and increased workloads resulting from downsizing. As Risher and Fay (1997) observe, “Some people will always think that public pay levels are too high; but it is safe to say that their views have a life of their own independent of the facts” (p. 323). Stated differently, the effectiveness of compensation reforms is certain to be constrained by the culture in which they are created. These three factors—personal comparisons, political expediency, and public beliefs—tend to reinforce one another in a manner that further exacerbates dissatisfaction. At the root of these explanations is the fact that most organizations want the most work for the least money, whereas many employees want the most money for the least work. Compensation, in short, is considered crucial by employees, decision makers, and taxpayers alike.

The following pages examine factors that affect the determination of pay: law and policy, external competitiveness as it relates to labor markets, and internal consistency as a function of job evaluation and various

systems of pay progression, as well as individual considerations. The analysis is framed by equity and expectancy theory and illustrated with controversial issues including pay banding and comparable worth, as well as discussion of cost-of-living adjustments; pay based on longevity, merit, and skill; bonus programs; and differential pay. Having diagnosed challenges for compensation programs, the chapter closes with a prescription for an *ideal* program and projections of future trends. Paradoxically, the chapter is about more than pay. It is about how public service is valued and whether citizens will support strategies to ensure that they are served by a well-qualified workforce.

## EQUITY AND EXPECTANCY THEORY

Equity theory explains that an individual's satisfaction with his or her job is largely (but not wholly) determined by the person's perception of the fairness of the balance between contributions made by the individual and the rewards received from the organization. Unfortunately, it is often the case that neither "the people who manage the (federal) systems, the managers who use them, [nor] the employees themselves" (Wamsley, 1998, p. 30) hold compensation programs in high regard. To appreciate the significance of equity theory, the weighing of contributions and rewards, consider the foundations and nature of this balance. Its basis is the presumed link between performance and pay, and its dynamic is how (or whether) this linkage operates.

While equity theory examines the effect of perceived fairness on satisfaction, expectancy theory (Vroom, 1964; see Chapter 6, this volume) examines the role of individual perceptions in determining behavior and offers insights into the choices that people make. In terms of inducing behavior, it includes what is offered, what is likely to be provided, and what is valued by recipients. Its tenets are a three-link causal chain:

1. The value (valence) the employee attaches to a desired result (e.g., higher pay)
2. The worker's belief that rewards will actually be provided as a consequence of high performance (instrumentality)
3. The employee's understanding (expectancy) is that he or she can successfully accomplish the task that will lead to reward.

Stated differently, the theory assumes that people take action based on their perception of the possible success of that action (expectancy) and the likelihood of their achieving outcomes (instrumentality) that they value (valence).

If any of the three links in this chain is weak, then the success of the pay program is reduced. Contemplate, for instance, that the parole supervisor in a state department of corrections demonstration project: He has authority to provide productivity bonuses to caseworkers who increase the number of interviews they conduct with their parolees. These officers want the bonus (valence) and understand that it will be awarded if they achieve the improvement objective (instrumentality). They are concerned (expectancy), however, that simply adding to the contacts they have with their charges, without a reduction in overall caseload, will result in superficial interviews. They are not convinced that the program is desirable (because it minimizes chances of in-depth information gathering) or feasible (overtime work is not available). Accordingly, public safety would be put at risk, and employee burnout is likely. In one such actual case, few sought the payouts, and the initiative was discontinued.

Consider a more common scenario. Although most people value money (valence), there are often significant constraints on their obtaining more of it. When local, state, or national legislative bodies regularly limit pay raises to inconsequential amounts, for example, the importance attached to those amounts is devalued (repeated raises that are below the rate of inflation in effect constitute pay cuts). Suppose instead that substantial monies are provided. Employees must then have confidence that the performance evaluation system (instrumentality) distributes rewards fairly and accurately. For reasons examined in Chapter 10, confidence is often uncertain at best. Finally, although many Americans believe that hard work makes a difference (expectancy), working smarter also counts. Thus, if training, acceptable working conditions, and up-to-date equipment are not provided, then working harder may make little difference. As these cases demonstrate, expectancy theory can be an effective diagnostic tool to ensure that the human resource management system is administered in a manner that coherently establishes linkages among valence, instrumentality, and expectancy.

- Do employees value available rewards?
- Do workers see a link between the rewards and their performance?
- Are they confident, given their background and organizational climate, that they can complete their assigned tasks?

Equity and expectancy theories mandate, in other words, that policy makers be concerned about more than the absolute amount of money required to fund public service. They must also focus on comparative levels of pay and how these monies are distributed. Reward systems unconnected to productivity indicators motivate poor workers to stay and high performers to become discouraged and leave. The irony of such a situation is that overall compensation costs rise because more employees are needed to complete tasks that fewer conscientious ones could readily accomplish.

## **PAY DETERMINATION**

---

With these theoretical—and quite real—considerations noted, this section turns to an exploration of factors affecting pay determination. Money matters, but it is often unclear how or why. Perhaps the most significant goal of any remuneration system is fairness. An organization confronts two types of decisions in the management of compensation to achieve this goal: pay level and pay adjustments. Compensation in any jurisdiction is a product of the following elements:

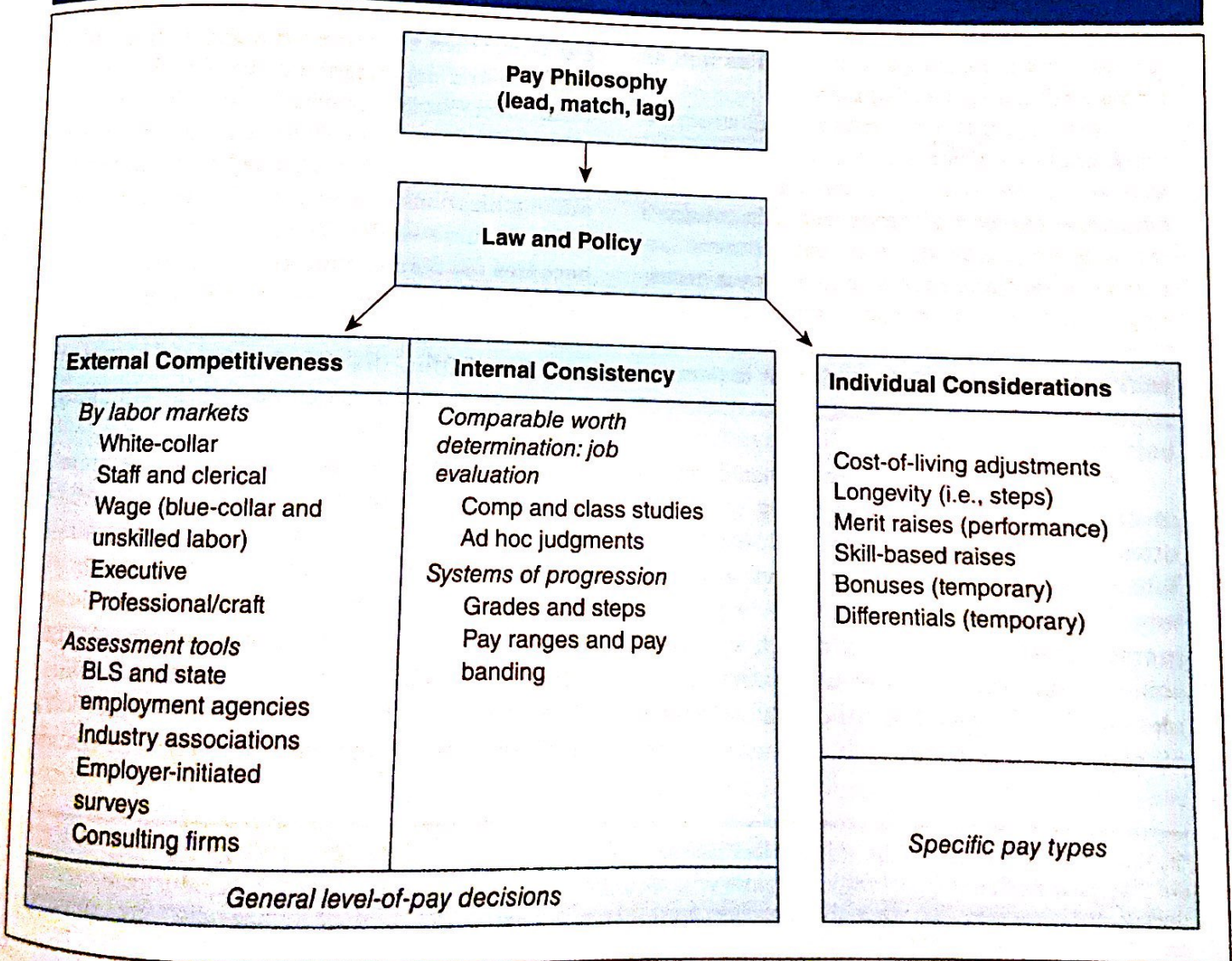
- Pay philosophy, as informed by law and policy
- Labor market forces (external competitiveness), as reflected by manipulation of supply and demand
- Internal consistency based on job evaluation, as tracked by different systems of pay progression
- Individual considerations, as manifested in various types of pay (see Exhibit 7.1)

Decisions about levels of pay are largely consequences of philosophy, market, and job evaluation, whereas decisions about pay adjustments emphasize employees' specific

placement in the salary structure. Taken together, these judgments should represent the greater good by aligning the interests of the public and its servants.

Pay systems, then, reflect not only law and policy but also comparisons of similar jobs in different organizations through salary surveys (external competition), comparisons of content among jobs within an agency through job evaluation techniques (internal consistency), and comparisons among employees in the same job category in the same organization through measures of seniority, merit, skill, or temporary pay (individual considerations). As each of these equity dimensions is explored below, it is important to keep in mind that "there are no absolute measures of job value. For things like temperature and weight, instruments are both reliable and valid. Job value is at best a relative or comparative measure" (Risher & Wise, 1997, p. 99). Instead, what exists in many organizations are inconsistent mixes of fair-pay criteria. A common denominator and underlying assumption shared by all forms of equity, however, is that they implicitly hold a time clock model of work (Kelly & Moen, 2007). That is, as examined in Exhibit 7.2, labor is commoditized, to be bought and sold in easily measured time units (hours, days, weeks, months, years). Time is money—or is it?

**Exhibit 7.1 Determinants of Compensation**



Time isn't money; money is money.

—Anonymous

In an attempt to curb exploitative work schedules and thereby create jobs during the Great Depression, the 1938 Fair Labor Standards Act (FLSA) instituted the five-day, 40-hour workweek—a compromise measure agreed to after the Senate passed a 30-hour workweek bill. Since that time, dramatic changes have occurred in the economy (from industrial to service), the workforce (from predominantly white and male to increasingly diverse and female), and lifestyles (from a family model consisting of a husband with a stay-at-home wife with children to singles, single parents, and married as well as unmarried dual-career families).

Most organizations, however, still structure work hours as if nothing has happened in the intervening decades, a posture that has exacerbated the paradox of needs (see this volume's introduction). Indeed, under employment law any workplace rule that is not a business necessity cannot disproportionately affect one group. This can be interpreted to mean that inflexible work schedules are illegal unless it is demonstrated that they are essential to the conduct of business (Fairchild, 2014).

This is not to say that there has been no reaction to these changes.\* Many organizations have experimented with alternative work schedules—the *joy of flex*—in the past half century. Variations are nearly infinite (e.g., compressed workweeks). In the oldest and most common approach, however, alternative schedules consist of a specified bandwidth when the office will be open (e.g., 6:00 a.m. to 8:00 p.m.

Monday through Friday) and a set of core hours (perhaps 10:00 a.m. to 2:00 p.m.) around which people can arrange their eight-hour workdays (usually on a set schedule rather than with daily flexibility). Thus, early risers can come in early and leave at 3:00 p.m., and late risers can come in at 9:00 a.m. and leave late. Typically, everyone completes time sheets. Agencies may also benefit from such schedules by having offices staffed during a longer workday and by having reduced tardiness and absences.

Advantages should be evident: Employees work when they want to work, with all the personal and organizational benefits that may result from that fact. Drawbacks are of two types: inherent and practical. There is some work that is structured so that it cannot be flexed, and there are organizations that cannot effectively implement flextime—either because record keeping becomes too burdensome or because managers lose a sense of control over subordinates. When available, flextime is often seen as an individual accommodation that deviates from standard policy instead of a recognition of the changing workforce.

As a matter of fact, many private companies and government agencies indicate that they have flexible hours and telecommuting, but this does not mean that large numbers of eligible employees actually participate in these programs on a daily basis (see Chapter 8). Just 2.3 percent of the American workforce consider home as their primary workplace (Heathfield, 2011). As one scholar has observed, “The reality

\*By most accounts, the numbers of employers offering flexible work hours have steadily increased. Although employers may provide these opportunities in parts of their organizations, many employees do not participate because they do not know they can; when they do know, most take advantage of them (see the Families and Work Institute's website at [www.familiesandwork.org](http://www.familiesandwork.org)).

is that the full potentials of flexible work remain largely untested and unverified" (quoted in Bernard, 2014). Thus, while the 2010 Telework Enhancement Act requires federal agencies to establish a policy, few eligible employees telework, and those that do work at the office most of the time.

Generally, results are varied, but often flextime improves the quality of work life for employees more than it enhances the productivity of the organization. Herzberg's theory of motivation helps explain this finding (Herzberg, Mausner, & Snyderman, 1959). Flextime is a job context factor (these extrinsic factors focus on policies, supervision, and working conditions) that, if absent, can create job dissatisfaction. When these factors are available in desired forms, however, they normally are taken for granted. Consider university parking: If convenient, it is unlikely that it would create job satisfaction; if it is a continuous hassle, however, it can create substantial on-the-job morale problems. What really matters in explaining productivity, however, are *job content* factors (intrinsic elements that emphasize challenging work, responsibility, achievement, and the like). Flextime has nothing to do with the substance of work.

This speaks to the fundamental flaw of all forms of flextime—even if perfectly implemented. It assumes, applying the concept of functional rationality, that work must be a function of time instead of a function of the actual task to be performed. Indeed, exempt from the FLSA, most professionals of yesteryear<sup>†</sup> and today (managers, surgeons, members of the clergy, military officers) work until the work is done. They are not paid by the clock but rather for their overall contribution to the organization.

In like manner, Best Buy's Results-Only Work Environment (ROWE) was an unparalleled and viable non-time management program intended to redefine work from a place to go to something

people do. Performance, not presence, was what counted at the 4,000-employee corporate headquarters. ROWE's transformational strategy completely altered the way employees worked: Because no two lives are the same, individual employees decided how, when, and where they would do their assigned tasks; they were required to put in only as much time as they needed to do the job. The program took flexibility—and accountability—to the maximum. With employees so empowered, surveys revealed, the approach:

- Increased productivity,
- Saved significant amounts of money,
- Produced higher customer satisfaction,
- Resulted in enhanced recruitment and retention,
- Improved morale and loyalty,
- Enhanced family/work balance, and
- Encouraged employees to be more focused and energized about their work as teamwork improved and the numbers of meetings declined (Kiger, 2007).

These results encouraged the U.S. Office of Personnel Management to launch a ROWE-like pilot program, which it later terminated because of insufficient managerial support.

At Best Buy, the pioneering strategy, which has been successfully adopted by at least 40 companies, lasted in its original form for nearly 10 years. In 2013, the company's new chief executive officer found the work-at-anytime-and-place innovation to be too radical, arguing that its extreme delegation of responsibility to employees was inappropriate. He instituted an *all-hands-on-deck* approach, and he now emphasizes top-down accountability and believes that

<sup>†</sup> Samurai warriors, who refused to touch money, simply could not understand how it could be used as a substitute for expertise, discipline, and loyalty. The legacy of that feudal tradition remains, as the contemporary Japanese *salaryman* typically has his wife handle family finances.

(Continued)

(Continued)

"you need to feel dispensable, not indispensable" (quoted in Peterson, 2013).

Results-oriented programs, overall, appear to resolve the paradox of needs. When implemented effectively by leaders who focus on the long term, such methods not only promote work-life balance for individuals but also maximize the value of human capital for the organization. To the extent that New Millennials, or members of Generation Y, reject traditional workplace routines, the program acknowledges, indeed celebrates, the need for an individualized, accepting, productive workforce. As one employee said, Best Buy gave "you the opportunity to really be an adult" (quoted in Kelly & Moen, 2007, p. 497; also see Ressler & Thompson, 2013).

Further experimentation and research are needed to determine if the ROWE approach produces unintended consequences as people attempt to set boundaries on work and home commitments. Employee schedule control, for instance, could lead to employees taking on more work. In fact, employment laws are meant to protect personnel from abuses that

could occur in a clockless office. With Millennials often desiring a relationship between work and life that is different from that experienced by earlier generations, increasing numbers of women in the workforce, and large numbers of Baby Boomers retiring, attempts to improve work-life balance may—or may not—be the wave of the future. Concurrent with these developments, the behaviors of growing numbers of employees are being monitored anytime, anyplace by biometric identification devices, raising questions of personal autonomy (West & Bowman, 2016).

It is not necessarily maintained that all organizations and jobs could—or should—be reconceptualized in a manner consistent with substantive rationality. It is suggested, however, that agencies seek a blend of functional and substantive approaches instead of an unquestioning focus on quantity time. A catalytic strategy to accomplish this is an annual hours program whereby the number of hours needed during a given year is agreed on and a scheduling format is then designed.

## PHILOSOPHY

---

### Lead, Match, or Lag

Organizations can lead, match, or lag behind what other employers offer employees. In sharp contrast to the strategies of governments in some other advanced democracies, the approach in U.S. governments has generally been to limit pools of job candidates to those prepared to accept that salaries in the public sector are frequently not competitive. Compensation is *not* seen as a strategic tool to achieve organizational objectives, but rather as a cost to be managed and contained (with the controversial exception of performance pay programs, discussed below). At least since the passage of the 1883 Pendleton Act (Chapter 1), public servants have been expected to forgo opportunities for wealth in exchange for opportunities to serve the citizenry, often in challenging and unique ways (e.g., environmental protection, criminal justice, teaching, foreign relations, tax collection). Self-enrichment after all, was and is not the purpose of service. The idea, unlike that underlying the spoils

system, was to create a corps of career professionals insulated from political intrigue by providing job security, career progression, and reasonable benefits and working conditions. Also important was the fact that they represented but a tiny proportion of the workforce (less than 1 percent in 1900); they held little political power or ability to organize themselves into unions, and none at all to strike (Chapter 11).

By the 1960s, however, public employees were far more numerous, had fallen substantially behind in compensation, and had won the right to organize. Beginning with the 1962 Federal Salary Reform Act, attempts were made to establish the principle that federal pay would match that found in the private sector. Codified in the Federal Pay Comparability Act of 1970, the law established a mechanism to provide annual comparability adjustments unless the president directed otherwise—which whoever was in that position did virtually every year for two decades.

In 1989, the first National Commission on the Public Service (the Volcker Commission) called for significant salary increases at the federal level; the passage of the **Federal Employees Pay Comparability Act of 1990** mandated that the 30 percent public-private sector pay gap be closed gradually by the end of the century.<sup>2</sup> According to the findings of the 2003 Volcker Commission II, the gap was wider than ever because successive administrations repeatedly cited *severe economic conditions*, irrespective of the state of the economy, as a reason to deny employees full pay raises. If the raises promised under the law had been enacted in 2008, according to the Congressional Research Service, they would have been nearly 20 percent (Davidson, 2008). Although the situation is more varied elsewhere (and some critics disagree with these assessments, as examined below), the difficulties experienced by the national government are manifested in many states and localities. Such conditions lend credence to the idea that employees should seek a **pay restoration**, not merely a pay raise. It should be noted that the principle of comparable pay has long been practiced for federal blue-collar hourly workers. Thus, in different statutes, it is required that wage grade as well as Postal Service workers receive compensation comparable to that received by workers doing similar jobs in the private sphere.

The paradox of needs (discussed in this book's introduction) indicates that organizational and individual objectives may not coincide. Ideally, business strategy, human resource philosophy, and compensation goals should be aligned in a manner suited to meeting the needs of both employer and employee.

A wage-lead approach may reflect a belief that by *working smarter*, a high-quality, satisfied workforce constitutes a cost-effective, money-saving strategy. That is, total labor costs are not the same as labor rates. It is possible to achieve high productivity from a relatively small workforce if the cost per unit of output is less with a highly efficient, though well-paid, staff. Known as **efficiency wages** ("you get what you pay for"), paying above-market increases effort, loyalty, and retention. This practice, however, may be seen by elected officials as counterintuitive, and difficult for many cash-strapped public and nonprofit organizations to adopt in the short run.

A wage-competitive policy in effect neutralizes compensation as a factor in human resource management. It does this by paying consistently at market rates and accentuating nonmonetary amenities affecting the overall ability to attract and retain employees. These include such time-honored (and timeworn) techniques as *selling scenery* (or the area's weather), contending that the community is *family-friendly*, and claiming that the organization is at the seat of power in a political capital (*Potomac fever* and its subnational

### Lead

*Labor is prior to, and independent of, capital. Capital is only the fruit of labor, and could never have existed if labor had not first existed. Labor is the superior of capital, and deserves much the higher consideration.*

—Abraham Lincoln

### Match

*Under the influence either of poverty or of wealth, workmen and their work are equally liable to deteriorate.*

—Plato

### Lag

*Bad jobs at bad wages are better than no jobs at all.*

—Paul Krugman

The selection of an appropriate pay policy involves a complex set of factors, including the types of skills required, job market characteristics, ability to pay, desired institutional image, assumptions about employee work attitudes, and employer ideologies. The strategy chosen likely will position the organization within or across sectors of the economy. Thus, in the public arena, some cities and counties, for instance, use a wage-lead approach at least when compared with state employment. The federal government's pay policies, however, are generally superior to those of many subnational governments—but inferior to those utilized by major corporations. It should also be noted that different policies might exist within one organization. The compensation package available to public service clerical personnel, for instance, may be better than that found in many small businesses. This lead approach is reversed, however, for most public and non-profit executives

within the same agency, whose remuneration is the result of a wage-lag strategy.

The paradox of needs may be resolved in good measure through employee self-selection, provided that basic economic and noneconomic needs are met. Equity theory suggests, however, that if people do not perceive that a balance exists between their contributions and the rewards they receive, then they will try to relieve the tension by reducing productivity, misusing organizational resources, or seeking higher rewards either within the department or outside it.

These trends can be expected to continue as agencies: seek pay policies designed to reduce the size of the workforce, evidence less concern with competitive compensation and more with what can be afforded, and attempt incentive programs to make payroll costs more variable than fixed expense. Organizations, in the end, usually get what they are willing to pay for.

equivalents). Many of these tactics, however, are available to organizations using above- and below-market pay policies. Still, a match policy does not necessarily place the organization at a disadvantage in the marketplace. Indeed, the virtue of reasonable pay is that "it takes the issue of compensation off the table" (Pink, 2009, p. 79).

Last, wage-follower plans may be indicative of unique characteristics of the occupation (military service, State Department diplomacy), a philosophy that dictates service is not about making money (Salvation Army), high unemployment in the area, short time horizons, or simply a *lean and mean* approach to human resources that involves *working harder* to get the most from as few poorly paid workers as possible. Such a strategy, to the degree that it is conscious and not a product of economic malaise, must work to mitigate low morale, higher turnover, and increased training costs. A below-market approach would clearly be a *penny-wise and pound-foolish* strategy for professionally staffed organizations. For example, the federal agency with the lowest-paid workforce (despite well-paid medical staff), the Department of Veterans Affairs, has chronic problems related to poor management due to systemic underfunding (Oppel, 2014). Everyone, in any case, seems to have an opinion about what constitutes an appropriate pay policy (see Exhibit 7.3).

## THE PERENNIAL PAY DEBATE

Public employee compensation—both salaries and benefits—has long been a prominent political issue. In recent years, stagnating pay and budget deficits have fueled controversy. One survey found that 75 percent of citizens think that federal employees “get better pay and benefits than people doing similar work outside of government” (Risher, 2010). For these reasons, civil servants have become a symbol of government excess, and legislators have instituted limits on hiring, pay freezes, furloughs, salary reductions, pension benefit cutbacks, and outsourcing. Working for government had provided a middle class life for generations of public employees, but in recent decades the number of civil servants has remained the same even as the populations they serve have grown.

Not surprisingly, this *war on public salaries* has become highly politicized; for every claim that government pays too much, another is made that it pays too little with the nonpartisan U.S. Governmental Accountability Office concluding there is no clear way to make the determination. For example, news stories and reports from *USA Today*, the *Wall Street Journal*, the Congressional Budget Office, the President’s Pay Agent (the directors of the Office of Management and Budget and the OPM as well as the secretary of labor), the Cato Institute, the Heritage Foundation, and the American Enterprise Institute assume that the typical private sector wage package is the right one, and the country’s economic problems are tied to public service pay. They charge that governmental employees are paid more than business workers (at least 20 percent better when benefits are included) (U.S. Government Accountability Office [U.S. GAO], 2012).

In contrast, the U.S. Office of Personnel Management, the Federal Salary Council, and employee unions counter that the public workforce is not only older but also more educated, unionized, and white-collar than business employees. The pay of an average private sector worker, because it masks such important factors, cannot be fairly used as the standard for public service pay. As organizational size significantly affects earnings, they also point out that an *apple-to-apple* comparison should compare large corporations with the civil service. Indeed, even with these differences, federal employees, according to official reports, are consistently underpaid by at least 26 percent (Losey, 2011b; on states and localities, see Bender & Heywood, 2010; Keefe, 2010). At the federal level (which is much less personnel-intensive than state and local governments), the nation’s economic woes have little to do with allegedly overpaid government employees; even cutting the

payroll in half would reduce spending by less than 3 percent (Krugman, 2010). Declaring that a huge and complex workforce is *overpaid* or *underpaid* may be good politics, but is not very useful in making rational policy. The pay gap is likely to grow as public service salary freezes become a popular tactic among lawmakers.

Both sides of this fierce, complicated controversy believe that the other mischaracterizes the research findings, and neither has had its data independently verified. In a full-throated critique of current methods used in analyzing the pay gap, Risher (2018d, 2015) maintains that the only alternative to is to use salary surveys to compile market pay data, a practice that has long been utilized not only by business, but also by the government's Federal Wage System that covers federal blue collar workers. While surveys are not problem-free, they are easy to understand and are not *a statistical black box*. It should be noted, though, that OPM has stated that performance appraisal policy should be addressed before compensation issues; without a clear connection between an individual's evaluation and compensation, pay reform is problematic.

In the meantime, critics assert that public employers should be no different from profitable private employers who have curtailed salaries, hired low-paid temporary workers, and downsized their workforces. Defenders counter that those actions are attributable to reduced demand for products and services—which is not the case in government. If services are to be reduced no matter what, then the use of well-paid contractors should be cut back and/or positions should be insourced to save money. They also point out that the focus on public salaries deflects attention from lucrative corporate compensation policies that continue to reward the kind of high-risk behavior and criminal perfidy that contributed to the 2008 economic debacle. Unions point out that they fight for workers' pensions and paychecks the same way CEOs fight for theirs. What is evident in this brouhaha is that arguing about salaries is easier than tackling the biggest sources of governmental financial problems: military expenditures, special interest tax subsidies, and entitlement programs. There is a lot less political risk in attacking bureaucrats than in reducing popular programs, although the two are hardly unrelated.

Like the debate over pay, arguments over benefits—the cost of which comes out of wages—are driven at least as much by partisan ideology as they are by fiscal responsibility. Critics of civil service benefit programs describe them as *lavish*, *gold-plated*, and *out of line* (e.g., Montgomery, 2011), arguing for reduction in their scope and increases in cost sharing. If less secure and more expensive 401(k) defined-contribution pensions, for instance, are good enough for business employees, then they should be good enough for bureaucrats. Indeed, private citizens—whose companies have frozen, decreased, or defaulted on their obligations—may resent the more arguably secure pensions of public employees.

Advocates of the civil service point out that the benefits civil servants receive are comparable to those found in most major corporations. In the case of pensions, converting to defined-contribution plans (typical of small and medium-size businesses and the federal government since 1984)<sup>3</sup> does not address funding shortfalls. The principal reasons for unfunded pension liabilities today are investment losses during the Great Recession starting in 2008 and the refusal by officials to make legally required payments;<sup>4</sup> these liabilities have not been caused by governmental retirement benefits that are too generous. Such benefits average \$19,000 per year (Reich, 2011), representing outlays that are less than 4 percent of a typical state's budget (McEntee, 2011). To suggest that these costs are a primary cause of budget problems is disingenuous.

Arbitrarily cutting pensions—which are delayed salary payments promised to civil servants in exchange for lower pay—is a betrayal of those who chose public service over

higher business salaries. Difficult economic times demand shared sacrifice. Indeed, recent reforms have included raising the retirement age, increasing employee contributions to pensions, cutting benefits, and abolishing retiree cost-of-living adjustments. Yet making civil servants scapegoats for economic problems—while well-heeled politicians refuse to cut their own compensation, businesses prosper, and the wealthy get tax breaks—does little to address underlying issues. It is worth pointing out that budgetary problems are largely self-inflicted, resulting from unsustainably low taxes on the ultrawealthy and corporate tax loopholes.

It is important to recognize that there may be no lasting solution to pay and benefit issues because, as even some critics acknowledge (Biggs & Richwine, 2011), government is not, and cannot be, subject to market forces in the way that business is. Rather, at least for the federal government, the legislatively mandated standard (as noted above) is comparability of employee compensation with compensation in the private sector (Chassy, 2011). What is needed is a transparent way to determine the comparisons and to assess the potential effects of changes before reform is adopted. Finally, it should be remembered that public service pensions and benefits vary substantially; while there are certainly examples of excessive benefits being approved in the *good years* prior to the recession of 2008, this is a far cry from saying that all or even most are out of line with appropriate and sustainable levels (see Exhibit 7.4).

#### Exhibit 7.4 Tipping From Reasonable to Unsustainable Pension Benefits

Not all pension plans are created equal. Most California local governments had reasonable defined-benefits plans in the 1990s, with rank-and-file workers eligible for between 2 percent and 2.5 percent of their salary for each year of employment at age 60. Public safety employees were generally eligible for 2.5–2.7 percent per year at age 57. All local government retirement plans were paid-up-date plans. However, more than a few California cities and counties boosted their retirement plans in the late 1990s and early 2000s during the *long boom*, in many cases to unsustainable levels.

For example, Riverside County boosted public safety personnel to 3 percent at age 50 to be *competitive*. This gave police officers the chance to retire after many years of service and begin second careers. Someone who came out of the academy and served 25 years could retire at 50 with 75 percent of his or her peak salary, which that person would then collect for the next 30–35 years on average. In other words, because individuals would be drawing a large percentage of their top salary, in many cases they might get

more in retirement than they did while working. Pension benefits liabilities shot up when the economy faltered. Although California local governments were not alone in making pension boosts, fortunately they were not common across the country.

Recently, Riverside County dropped its pension formula for public safety back to 2.7 percent at age 57. So to get the same 75 percent, an employee would have to work 28 years and would expect to draw for 23–28 years. The difference is about 10 years (i.e., three additional working years and seven fewer retirement years), or the equivalent of \$750,000 to \$1 million per officer over time in reduced costs for the county.

It should be clear that the differences between small defined-benefit multipliers are huge for the jurisdictions paying for them, as are differences in the ages when people may start drawing benefits. Changes should be made with long-term sustainability in mind; when defined-benefits plans are reasonable, their costs can easily be absorbed as a part of *doing business*.