KNOWLEDGE AS COMPENSATION

How Understanding the Pay System Shapes Satisfaction, Engagement and Market Perception

2026 Local Government Workforce Survey

May 2026

Executive Summary

Local governments invest substantial resources in designing and administering compensation systems, including pay ranges, market surveys, compression adjustments, promotion structures, and incentive programs. Yet a question that receives far less attention than system design is whether employees understand how those systems work. This white paper examines the consequences of that understanding gap, using data from a survey of 500 local government employees conducted in May 2026.

The findings are consistent across three separate outcome measures. Employees who better understand how their compensation system works are more satisfied with their pay, more engaged at work, and less likely to perceive their pay as below market.

The practical implication is important to any public organization. Compensation transparency is not simply a communication preference but a measurable driver of workforce outcomes. An employee who does not understand how their base pay is determined, how annual increases are calculated, or how their pay compares to the market is statistically more likely to be dissatisfied with their pay, less engaged at work, and more likely to believe they are underpaid relative to peers, regardless of what they are actually paid.

Among employees who report no understanding of the pay system, 63.3 percent are dissatisfied with their compensation, and 66.7 percent feel they are paid below market. Among those with a good or strong understanding, dissatisfaction drops to roughly 15 percent, and below-market perception falls to around 32–36 percent. The gap across understanding levels is not marginal; it is the difference between a workforce that largely distrusts its compensation and one that largely accepts it.

The conclusion that emerges from this data is that improving compensation transparency is one of the highest-return interventions available to local government HR leaders, not because it changes what people are paid, but because it changes how people interpret their pay.

Background and Methodology

This analysis is based on survey responses from 500 local government and public sector employees collected in May 2026. The survey assessed employees' self-reported understanding of eight components of their organization's compensation system, their satisfaction with pay, their level of work engagement, and their perception of how their pay compares to the external labor market.

Measuring Pay System Understanding

Respondents rated their understanding of eight pay system components on a five-point scale: Do Not Understand (1), Limited Understanding (2), Moderate Understanding (3), Good Understanding (4), and Strong Understanding (5). The eight components covered:

- How base pay is determined
- How starting salaries are set
- How annual pay increases are determined
- How market data influences pay decisions
- How pay ranges are structured
- How promotions impact pay
- How compression issues are addressed
- How bonuses or incentives are determined

Exhibit 1 summarizes respondents' overall understanding of their organization's pay practices. A composite understanding score was computed as the mean across all eight items (α estimated at approximately 0.90, indicating high internal consistency). For group-level analyses, respondents were classified into five levels of understanding based on their composite score. The overall mean understanding score was 3.07 out of 5.0, indicating that the average local government employee falls under a Moderate understanding of their compensation system.

Exhibit 1
Distribution of Pay System Understanding Levels

Understanding Level	N	% of Sample	Composite Score Range
Do Not Understand	33	6.6%	1.0 – 1.5
Limited	122	24.4%	1.5 – 2.5
Moderate	178	35.6%	2.5 – 3.5
Good	136	27.2%	3.5 – 4.5
Strong	31	6.2%	4.5 – 5.0

Outcome Variables

Three outcome variables were examined. Pay satisfaction was measured on a five-point Likert scale (1 = Very Dissatisfied, 5 = Very Satisfied). Work engagement was measured on a numeric 1–10 scale. Market perception was measured on a five-point scale from Significantly Below Market (1) to Significantly Above Market (5); five respondents who answered 'Unsure' were excluded from market analyses (analytic n = 495).

Statistical methods include Spearman's rank correlation (primary measure for ordinal data), Pearson correlation, simple linear regression, one-way ANOVA, Kruskal-Wallis H-test, and Mann-Whitney U pairwise tests, with Bonferroni correction applied to control for multiple comparisons across the 10 possible level pairings.

Findings

Linkage 1: Understanding the Pay System Is Associated with Greater Pay Satisfaction

The relationship between understanding the pay system and pay satisfaction is the strongest of the three linkages examined. The Spearman correlation between the composite understanding score and pay satisfaction is $r = 0.346$ ($p < 0.001$), and the linear regression model estimates that each one-unit increase in understanding corresponds to a 0.40-point increase in pay satisfaction on the five-point scale ($R^2 = 0.118$), meaning understanding accounts for approximately 11.8 percent of the variance in pay satisfaction. This is a substantial relationship for a single predictor in a complex behavioral outcome.

The group-level pattern further supports the importance of understanding in improving positive outcomes (see **Exhibit 2**). Among respondents who report no understanding of the pay system, the mean pay satisfaction score is 2.33, squarely in the Dissatisfied range, and 63.6 percent are Dissatisfied or Very Dissatisfied with their compensation, while just 12.1 percent are Satisfied or Very Satisfied. Moving up to Limited Understanding, dissatisfaction remains elevated at 48.4 percent. By Moderate Understanding, most dissatisfied employees have shifted: 43.8 percent are now satisfied. At Good Understanding, 64.0 percent of employees are satisfied with their pay, or more than five times the rate among those who do not understand the system. Strong Understanding sustains a similar profile at 54.8 percent satisfied.

Exhibit 2
Pay Satisfaction by Understanding Level

Understanding Level	N	Mean Pay Sat (1–5)	% Satisfied / Very Satisfied	% Dissatisfied / Very Dissatisfied
Do Not Understand	33	2.33	12.1%	63.6%
Limited	122	2.78	29.5%	48.4%
Moderate	178	3.15	43.8%	27.5%
Good	136	3.57	64.0%	14.0%
Strong	31	3.65	54.8%	16.1%

Pairwise testing (Mann-Whitney U, Bonferroni-corrected) confirms that most adjacent and non-adjacent understanding levels are statistically distinguishable. Do Not Understand differs significantly from Moderate, Good, and Strong (all $p < 0.001$). Limited differs from Moderate ($p = 0.023$), Good ($p < 0.001$), and Strong ($p = 0.003$). Similarly, Moderate and Good are significantly different from each other ($p = 0.001$), indicating that the relationship is not merely a floor or minimal-effort effect. In other words, understanding continues to pay dividends in satisfaction across the middle and upper ranges of the scale.

Examining individual understanding items, all eight correlate significantly with pay satisfaction (all $p < 0.001$), with correlations ranging from $r = 0.243$ (How bonuses/incentives are determined) to $r = 0.307$ (How promotions impact pay). No single component dominates. Understanding of any dimension of the pay system is associated with higher satisfaction, suggesting that the mechanism is perceptual rather than technical. Specifically, it is the general sense of comprehension, not knowledge of any specific policy, that shifts how compensation is evaluated.

Linkage 2: Pay System Understanding Predicts Higher Work Engagement

The relationship between pay system understanding and work engagement, while more modest than the pay satisfaction link, is statistically significant and practically meaningful. The Spearman correlation is $r = 0.181$ ($p < 0.001$), and the regression slope indicates that each one-unit increase in understanding corresponds to approximately +0.41 points of engagement on the 10-point scale ($R^2 = 0.042$). The Kruskal-Wallis test confirms significant group differences ($H = 21.05$, $p < 0.001$, $\eta^2 = 0.035$ or a small-to-medium effect).

As shown in **Exhibit 3**, the trajectory across understanding levels is consistent and directional. Mean engagement rises from 7.09 among those who do not understand the pay system to 7.42 (Limited), 7.84 (Moderate), 8.18 (Good), and 8.84 (Strong), resulting in a gap of nearly 1.75 engagement points across the scale. The proportion of highly engaged workers (8–10 on the scale) follows the same gradient: 48.5 percent at Do Not Understand, rising steadily to 80.6 percent at Strong Understanding. It is important to note that 80.6 percent of employees with a strong understanding of the pay system are highly engaged (8–10/10), compared to 48.5 percent of those who do not understand the system, or a 32-percentage-point gap.

Exhibit 3
Work Engagement by Understanding Level

Understanding Level	N	Mean Engagement (1–10)	% Highly Engaged (8–10)
Do Not Understand	33	7.09	48.5%
Limited	122	7.42	58.2%
Moderate	178	7.84	69.1%
Good	136	8.18	71.3%
Strong	31	8.84	80.6%

Pairwise testing identifies the primary drivers of this difference. Limited Understanding differs significantly from Good Understanding ($p = 0.029$) and Strong Understanding ($p = 0.003$). Moderate Understanding also differs significantly from Strong ($p = 0.013$). The engagement premium for strong pay system understanding relative to limited understanding is confirmed to be non-random even after stringent multiple-comparison correction.

At the item level, understanding of how base pay is determined and how compression issues are addressed shows the strongest engagement correlations (both r = 0.197–0.200), whereas understanding of promotions shows a weaker, non-significant link ($r = 0.074$, $p = 0.099$). This suggests that the engagement benefit of understanding is most tightly connected to the mechanics that govern day-to-day pay or what an employee earns today and why it may or may not be growing, rather than advancement-related provisions.

The engagement link deserves particular attention in light of the companion finding from earlier white papers in this series: pay satisfaction and engagement are themselves correlated ($r = 0.21$), and understanding appears to work through multiple channels simultaneously, both by increasing satisfaction directly and by increasing engagement partly through channels that include, but are not limited to, satisfaction. Understanding may also reduce uncertainty, build trust in organizational fairness, and increase perceived procedural justice, all of which are known antecedents of engagement that are independent of pay level.

Linkage 3: Understanding Reduces the Likelihood of Feeling Below Market

The third and perhaps most important finding concerns market perception. Employees who better understand how their pay system works are significantly less likely to perceive their compensation as below the external labor market, even though understanding the pay system does not directly affect what they are paid. The Spearman correlation between understanding and market perception is $r = 0.258$ ($p < 0.001$), and the regression model estimates a 0.28-point increase in perceived market position per unit of understanding ($R^2 = 0.066$). The Kruskal-Wallis test confirms group differences ($H = 28.35$, $p < 0.001$, $\eta^2 = 0.050$ or a small-to-medium effect).

Among employees who report no understanding of the pay system, 66.7 percent feel their pay is below market, while just 3.0 percent feel their pay is above market (see **Exhibit 4**). Specifically, not understanding how the system works correlates with an overwhelmingly negative interpretation of one's market position. As understanding increases, the below-market perception rate declines steadily: 55.8 percent at Limited, 40.9 percent at Moderate, and 31.1 percent at Good Understanding, or a reduction of more than 35 percentage points from the least to the most informed group. At Good Understanding, the proportion of employees feeling at or above market (68.9 percent) exceeds that feeling below (31.1 percent) for the first time.

Exhibit 4
Market perception by understanding level

Understanding Level	N	Mean Market Score (1–5)	% Below Market	% About at Market	% Above Market
Do Not Understand	33	2.12	66.7%	30.3%	3.0%
Limited	120	2.49	55.8%	25.0%	19.2%
Moderate	176	2.77	40.9%	34.7%	24.4%
Good	135	2.99	31.1%	36.3%	32.6%
Strong	31	3.03	35.5%	29.0%	35.5%

Pairwise tests confirm that the most informative contrasts involve the lowest understanding groups. Do Not Understand differs significantly from Moderate ($p = 0.007$), Good ($p < 0.001$), and Strong ($p = 0.011$). Limited Understanding also differs from Good Understanding ($p = 0.002$). No significant differences emerge among Moderate, Good, and Strong Understanding, suggesting that once employees achieve at least a moderate grasp of the pay system, their market perceptions stabilize at a more favorable level.

The item-level analysis shows that understanding how market data influences pay decisions has the strongest correlation with market perception ($r = 0.225$), followed by understanding how promotions impact pay ($r = 0.250$). This is logically coherent. Employees who understand how the organization uses market data are better equipped to contextualize their own position within that market framework, reducing the tendency toward negative comparison. When employees are unaware that a market survey was conducted, that ranges were adjusted, or that their pay reflects a deliberate competitive-positioning decision, they are left to estimate their market standing from incomplete information and assume the worst.

Discussion: The Transparency Dividend

What Understanding Is — and Is Not — Doing

The three links documented in this white paper raise an important interpretive question: Does understanding of the pay system improve outcomes because better-paid employees are more likely to understand it, or does understanding independently shape how employees experience compensation? While the survey data cannot resolve this with certainty, a controlled experiment would be needed, as several features of the results argue for a genuine independent effect of understanding.

First, the market-perception finding is difficult to explain solely through a pay-level mechanism. Employees at all pay levels may be below, at, or above market, and there is no structural reason why higher-paid employees would uniformly understand the system better. Yet the gradient in market perception across levels of understanding, ranging from 66.7 percent below-market at no understanding to 31.1 percent at good understanding, is steep and statistically robust. The best explanation is that employees who lack information about how their pay is positioned fill that gap with a negative assumption.

Second, all eight understanding items correlate significantly with pay satisfaction (all $p < 0.001$), and the correlations are remarkably uniform in magnitude ($r = 0.243$ to $r = 0.307$). If the relationship were simply that higher-paid employees understand and are satisfied, we would expect more variation. For example, we would assume that understanding of bonuses would matter more to employees who receive them. The consistency of the item-level correlations instead suggests that the mechanism is comprehension itself: the general sense of knowing how the system works, independent of which specific provision one is asking about.

Third, the finding that understanding explains 11.8 percent of the variance in pay satisfaction is notable in context. The pay level itself, or the absolute amount of compensation, typically accounts for only a modest share of the variance in pay satisfaction in established research, as satisfaction is heavily influenced by perceived fairness, equity comparisons, and procedural characteristics. Understanding likely operates in the same manner. Employees who comprehend the pay system are better positioned to evaluate its fairness, contextualize their position relative to peers, and perceive the compensation process as legitimate even when its outcomes are imperfect.

The Misperception Tax

A useful way to frame the market perception finding is what might be called a misperception tax or the cost in satisfaction, engagement, and market self-assessment that employees bear when they do not understand how their pay is determined. This tax is paid not in dollars but in dissatisfaction, and it falls disproportionately on employees who are simply uninformed, not necessarily underpaid.

Consider the following. Among employees who do not understand the pay system, 63.6 percent report being dissatisfied with their compensation. Among those with a good understanding, 14.0 percent are dissatisfied, resulting in a 49.6-percentage-point difference. If an organization could move all its 'Do Not Understand' employees to 'Good Understanding' without changing a single salary, the expected dissatisfaction rate in that group would fall from nearly two-thirds to roughly one in seven. The savings in turnover risk, reduced grievances, and improved morale could represent a substantial return on a relatively modest investment in compensation communication.

The engagement data tells a similar story. At 48.5 percent, engagement among employees who don't understand the pay system is lower than among those with a good understanding (71.3 percent), indicating an approximately 23-percentage-point difference in the share of highly engaged workers. Given the well-established links between employee engagement and organizational outcomes, such as productivity, customer service quality, absenteeism, and retention, the engagement dividend from improved understanding of the pay system is likely to translate into measurable operational benefits.

Recommendations

1. Build a Compensation Communication Strategy, Not Just a Pay System

The data make clear that having a well-designed compensation system is necessary but not sufficient for employee satisfaction and engagement. Organizations should develop a deliberate compensation communication plan that translates pay policies into plain-language explanations for employees at all levels. This should include annual total compensation statements that show how each pay element was determined; manager-facing guides that enable supervisors to answer employee questions about pay; and accessible documentation of pay ranges, the market positioning philosophy, and the criteria that govern salary decisions.

2. Prioritize the Limited-to-Moderate Transition

The largest absolute concentration of employees sits at the Limited Understanding level (24.4%), and the pairwise data shows that moving from Limited to Moderate produces statistically significant improvements in pay satisfaction. Organizations should target their communication and education efforts specifically at this group. For example, through onboarding modules on pay practices for newer employees, brief explainer resources linked to pay stub delivery, or department-level Q&A sessions following annual compensation reviews.

3. Explain Market Data, Specifically

The item-level analysis reveals that understanding how market data influences pay decisions carries the strongest correlation with market perception ($r = 0.225$). When organizations conduct salary surveys, adjust ranges, or make market-based pay decisions, communicating that process to employees, not just the outcome, can significantly reduce the default assumption of below-market placement. Even a brief annual memo or webpage explaining 'how we benchmark pay' can shift market perceptions in ways that no salary increase alone can achieve.

4. Track Understanding as a Workforce Metric

Understanding is currently absent from most workforce surveys and HR dashboards. The strength and consistency of the findings in this white paper argue for including pay system understanding items in annual or biennial employee surveys, enabling HR teams to track whether communication investments are shifting comprehension levels and correlating those shifts with changes in satisfaction and engagement. A two-item or four-item short-form understanding assessment can provide a sufficient signal with minimal respondent burden.

5. Address the Engagement Floor

The 48.5 percent high-engagement rate among employees who do not understand the pay system represents a real, but avoidable, floor. These employees are not inherently less engaged than their peers; they are working with an informational deficit that depresses their engagement relative to what it could be. Treating compensation transparency as an engagement intervention, rather than solely as an HR communication function, aligns it with the organizational investments (talent management, culture building, manager development) that already receive dedicated resources and leadership attention.

Conclusion

Evergreen's *2026 Local Government Workforce Survey* data establish a clear empirical case that what employees know about their compensation plays a major factor in their satisfaction with their compensation package. Across three independent outcome measures, pay satisfaction, work engagement, and market perception, employees with greater pay system understanding consistently report better outcomes, with statistically significant relationships supported by medium effect sizes and robust pairwise differences.

The core insight is that compensation is a communication problem, not just adollar problem. An employee who does not understand why their pay is what it is, how it was set relative to the market, or what drives increases and adjustments, will tend to evaluate that pay negatively, even if the pay itself is fair and competitive. Conversely, an employee who understands those things will tend to evaluate the same pay more favorably, engage more fully, and be less likely to see themselves as underpaid relative to alternatives.

This does not mean that pay levels are irrelevant; the companion white papers in this series document real and significant compensation gaps that require structural attention. But it does mean that even the most well-designed and market-competitive pay system leaves substantial workforce value on the table if its work remains opaque to the employees it is designed to serve. In an era when local governments face persistent recruiting and retention pressures, closing the understanding gap is among the most cost-effective workforce investments available.