

Performance- Based Pay in the Federal Government

Steve Nelson

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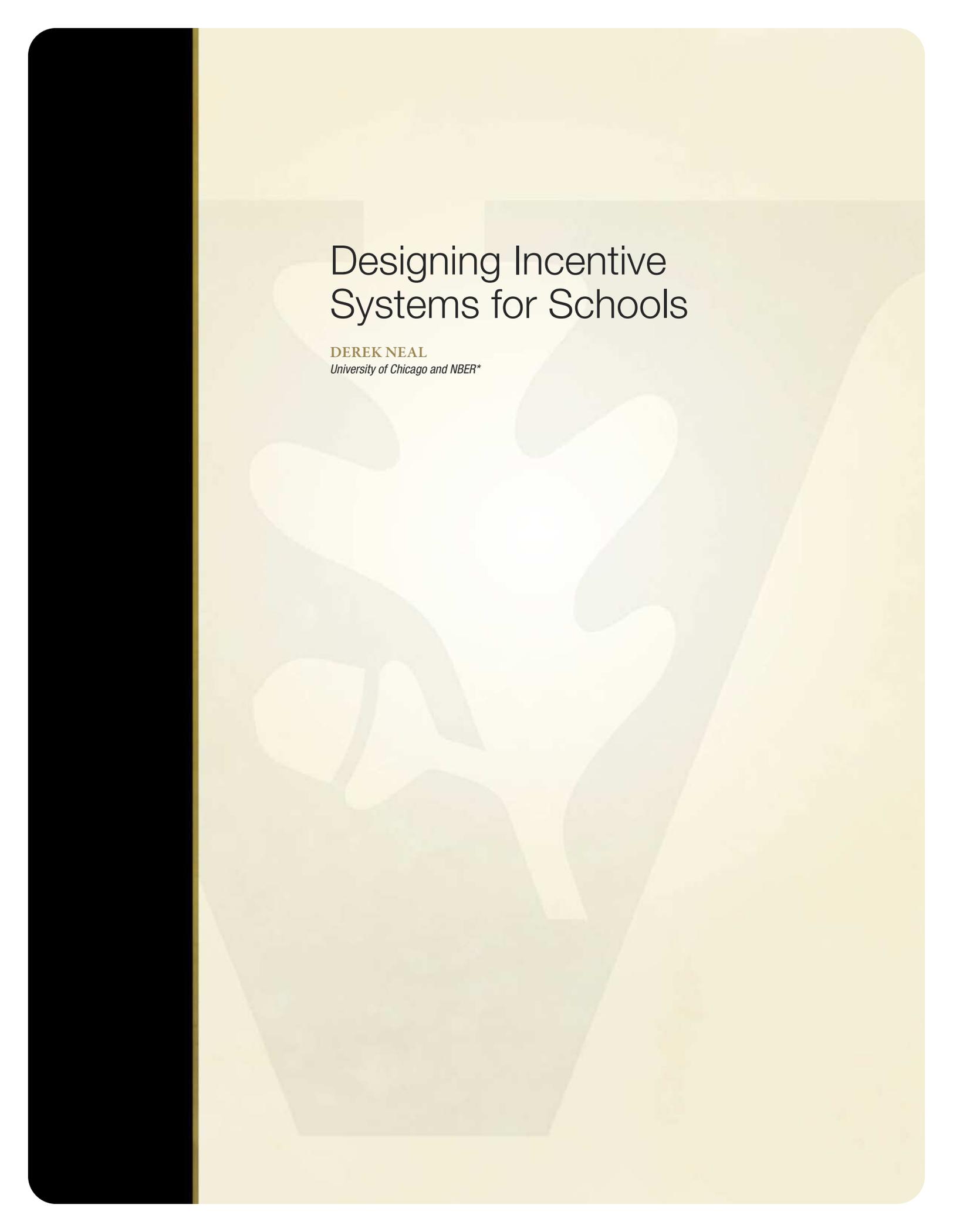
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Designing Incentive Systems for Schools

DEREK NEAL

*University of Chicago and NBER**

Performance-Based Pay in the Federal Government

1. History of Performance Based Pay in the Federal Government

In 1949, the Federal Civil Service implemented the General Schedule and codified it into Title 5 of the United States Code governing the Federal civil service.¹ This method of setting pay for all of the Federal civil servants was based on several concepts. The first of these was the Federal classification system determined the level of work done by an employee and the classification system was based primarily on the complexity of the job that the person performed. The intent was that all persons performing work of similar complexity would be paid within a similar range of pay. This was a particularly important element in determining a person's pay in that it tried to ensure a certain amount of internal equity in the pay of Federal employees. Employees who were determined to be doing similar levels of work would receive similar levels of pay. It is also important to note that Federal employees were not allowed to engage in collective bargaining over pay, so pay was supposed to be set at levels that compensated employees fairly and allowed the Government to compete with the private sector for the talent that it needed.

Initially, the classification system divided employees into one of 18 different pay grades. Subsequently, the top three grades levels were separated from the first 15 levels when the Senior Executive Service was created by the Civil Service Reform Act of 1978 under President Carter.² In general, progression among the various grade levels was accomplished by a merit promotion process that evaluated all the persons that wanted to be considered for the higher level position. If the employee was determined to be the person most qualified for advancement then he/she would be promoted to a higher grade level. Each of the 18 grade levels was in fact a range of possible pay. Each of these ranges was divided into ten equal levels called "steps" at which a person could be paid.

¹ Classification Act of 1949, Public Law 81-429

² Pub. L. 95-454, October 13, 1978

As originally conceived, a new employee would begin by being paid at the first or lowest step and progression through these steps was supposed to be based on both performance and longevity. If a person performed his/her job adequately they would be advanced to the next step based upon how long they had been working at a given grade level. During their first three years in a given grade level, if they performed adequately, employees would advance to the next step after one year of service. After their third year of service in a particular grade, employees would be advanced to the next three grade levels (steps 4-7) only after two years of adequate performance. Similarly progression to steps 8-10 occurred only after three years of adequate performance. This model, both in private sector pay and in civil service pay, presupposes some inherent market economies. A very senior person at step 9 or 10 would earn an annual salary at the high end of the worth of the position, making it difficult for an individual to leave and find an employer who will pay them the same or greater salary. Conversely, at the lower end, the less senior worker is not yet at the industry average for the position and receives more frequent increases; otherwise, they may leave their employer to take a job at the middle or higher end of the industry average. Managers gained ability to use pay as a motivating tool in 1955 with the implementation of the Incentive Awards Act that allowed cash awards for superior performance.³ President John F. Kennedy signed Executive Order 11073 on January 2, 1963, making it possible to advance an employees base pay faster by granting them what was referred to as a “quality step increase” if their performance was deemed exceptional.⁴ In this way the General Schedule pay system attempted to incorporate elements of a sort of pay for performance system while at the same time not allowing managers to have too much discretion when it came to determining the salary of the employees that they managed. A critical component of the pay system was to ensure that employees were not compensated or rewarded based upon such things as their political affiliation. For the greater good of the American public, the Federal service was designed to be a system based upon merit. It was never intended to be an “at will” employment situation and the Supreme Court has held that under article

³ Government Employees Incentive Award Act, Pub. L. 83-763. November 30, 1954

⁴ Executive Order 11073, implementing the Federal Salary Reform Act of 1962, Pub. L. 87-793

14 of the Constitution, a Federal employee may not be denied the “property rights” of their employment without due process. This pay system which is primarily longevity based, is rooted on the principal of fairness and equity for positions of similar levels of responsibility or scope. The unions endorsed the General Schedule with the periodic increases based on longevity and it continued to thrive until the composition of the Federal workforce began to shift from a largely clerical workforce to one requiring more skilled workers and more knowledge workers. This change in the workforce helped drive the need for the Civil Service Reform Act (CSRA) of 1978 under President Carter, which came into effect in January 1979.⁵ This was a significant reform effort and it codified into law the merit principle of, “Equal Pay for Work of Equal Value”. The CSRA also abolished the Civil Service Commission and created the Office of Personnel Management (OPM) to help align Federal personnel management policies with the Administration and to make the Federal personnel policy office more responsive to the President. The job protection aspects of the Civil Service Commission were carried on by its successor, a newly created, independent agency called the Merit Systems Protection Board (MSPB). The Act also contained several initiatives that helped foster further moves toward performance based pay. One of these was creating the Senior Executive Service to replace the top three grades of the General Schedule. This separate system for the highest level political appointees and career executives provided the best opportunity for developing a different system and today is the most tightly aligned Federal system linking pay for performance with organizational goals and objectives. This will be discussed later in the paper. The broader pay for performance system enabled by the CSRA was the “merit pay” system for the next lower level of managers, i.e. GS-13 through GS-15, where portions of their base pay increase were “at risk” and dependent upon the performance levels they achieved. The formula called for half of their annual increase to be put in a merit pay pool along with monies for within grade step increases, i.e., longevity increases, and monies for any quality step increases for this group of managers. This system was unfortunately not sufficiently well thought out and it struggled through numerous problems including caps on managerial pay, last minute

⁵ Pub. L. 95-454, October 13, 1978

changes to the formula, and a perception by managers that the new objectives-based performance appraisal system did not effectively rate performance.⁶ In 1984 it was modified by legislation to become the Performance Management Review System (PMRS) but many problems remained. It was finally ended in 1993 in spite of the fact that a tremendous amount of effort went into training the affected workforce on a new performance appraisal system that took many agencies from a three level system (pass, fail, and marginal) to five rating levels with at least two levels above satisfactory. Insufficient funding seriously undermined this performance based pay system.⁷ The 1.5% of pay that constituted the merit pay pool was insufficient to significantly differentiate among levels of performance achieved and resulted in a peanut butter spread of the pay pool which obviated the premise that if individuals were to expect rewards for higher levels of performance they would strive to achieve that higher level under Vroom's expectancy theory of 1964.

Another of the initiatives under the CSRA was a new legislative authority allowing demonstration projects. Agencies were increasingly having difficulty placing new positions into the existing classification system, and in paying a market or industry rate for the more frequent knowledge jobs appearing in the workforce as well as for jobs in certain high cost areas. Numerous agencies began using the demonstration project authority for a variety of initiatives. Soon, other agencies realized that they too could devise a method to change the compensation system away from the General Schedule using this authority. The CSRA modified the basic provisions of Title 5, United States Code and defined in law a demonstration project as "a project, conducted by OPM, or under its supervision, to determine whether a specified change in personnel management policies or procedures would result in improved Federal personnel management."⁸

⁶ *Federal Merit Pay: A Longitudinal Analysis*, Jone L. Pearce, James L. Perry, *Public Administration Review*, Vol. 43, No. 4 (Jul. - Aug., 1983), pp. 315-325

⁷ National Research Council, "Pay for Performance: Evaluating Performance Appraisal and Merit Pay," National Academy Press, 1991, Washington, D.C., p. 27.

⁸ Title 5, United States Code, ch.47, sec. 4701

The Department of Defense (DoD) is a large Federal Department with numerous subordinate agencies and organizations. It is a sophisticated employer and it was one of the first to start dealing systemically with pay systems to address the changing civil service workforce and evolving market conditions. In 1980, the Department of the Navy in China Lake, California, created a demonstration program implementing a locally developed pay system that based pay increases on individual and organizational performance. It was extended indefinitely by legislation in 1994 and is still in effect today.⁹ This initiative caused other agencies to follow. The Department of Commerce implemented a similar program for their National Institute of Standards and Technology (NIST) organization neighboring the Navy China Lake program. They mirrored the Navy's actions including gaining approval to permanently institutionalize the program via legislation two years after the Navy gained their legislation.¹⁰ These demonstration programs were some of the first designed to utilize pay as a management tool.

The DoD also used this new special demonstration authority in the CSRA to start the Pacer Share demonstration program and the Project Expo or Experimental Personnel Office demonstration program. These large DoD demonstration programs included numerous organizations across the Department implementing various initiatives including several on pay for performance. From the inception of the CSRA through today there have been 18 different demonstration programs covering about 42,600 employees approved by OPM. Ten of these are still running with three others now permanently in place.¹¹ It is noted that DoD continued to seek more independent control and in 2000 obtained authority to self manage their eight Science and Technology Labs rather than functioning as OPM controlled demonstration programs.

⁹ Public Law (P.L.) 103-337, Section 342.

¹⁰ Public Law (P.L.) 104-113, Section 10

¹¹ *Alternative Personnel Systems in the Federal Government: A Status Report on Demo Projects and other Performance Based Pay Systems*, Office of Personnel Management, December 2007

This left OPM with only two non DoD demonstration programs.¹² Subsequently, OPM has solicited more demonstration projects and has two additional programs in the early stages of development.

While numerous agencies were collaborating with OPM to initiate demonstration projects in the 1980's, many more were going direct to Congress and obtaining specific legislation that would enable them to establish their own pay systems. The movement was starting from the organization and agency level upward to obtain a compensation system that was more flexible and capable to help achieve mission goals as recruitment and retention problems continued to drive the need to reform the General Schedule. During the 1980's a variety of Federal agencies began obtaining special legislation to permit independent pay systems directly and not go under the auspices of the OPM demonstration program. They obtained the legislation by convincing Congress that without special pay authorities (usually involving greater salaries) they would not be competitive in employing the type of knowledge workers they needed. Among the first groups of these were the Financial Regulatory agencies which included among others, the Comptroller of the Currency that created an independent pay system in 1981. Finally in 1989, the Financial Institutions Reform Recovery and Enforcement Act (FIRREA) was passed, providing eight of the financial regulatory agencies with broad pay reform authority in order to keep them competitive with the institutions they were regulating.¹³ This legislation for the FIRREA agencies was part of a major push to move away from the constraints of the General Schedule.

About this same time, the National Commission on Public Service, headed by the former Chair of the Federal Reserve, Paul A. Volcker, was addressing "the quiet crisis" of the government falling behind the private sector in obtaining talent. The National Commission's recommendations in 1989 helped convince congress to pass the Federal

¹² National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398) Section 1114.

¹³ Public Law (P.L.) 101-73, August 9, 1989

Employees Pay and Comparability Act of 1990 or FEPCA.¹⁴ This act, now codified into Title 5 US Code, was intended to address the need for pay reform in the Executive branch that became apparent in the 1980's as Federal civil service salaries fell behind those in the private sector. FEPCA addressed both pay comparability and flexibility issues to support recruitment and retention issues. FEPCA provided guidelines to achieve pay comparability between Federal and non-Federal jobs by providing for a two-part annual pay adjustment for General Schedule workers. First with an across-the-board pay adjustment and secondly with a locality pay adjustment that varied by pay locality. The President has authority under FEPCA to submit an "alternative" pay plan with a lower raise than that called for by the FEPCA formula (or none at all) "if because of national emergency or serious economic conditions affecting the general welfare".¹⁵ Although FEPCA provides for an automatic formula to determine the annual pay raise, this formula was and continues to be ignored due to the cost of implementation. In reality, the final pay raise has been decided by Congress, which has historically authorized higher increases than those originally requested by the President in his annual budget submissions. FEPCA also provided greater flexibilities to agencies to help them become more competitive, externally, with the private sector. FEPCA allowed agencies to pay bonuses for recruitment, retention, and relocation. It also provided expansion of special salary rates for certain positions up to 60% above the General Schedule.

2. Performance Based Pay Research and Policy Work

A large amount of research has been done and many new policies have occurred over the last 30 years on performance based pay in the Federal government by individuals, academics, agencies, and associations. This paper highlights some of the more prolific and influential work in context with the attempts and rationale to move away from the General Schedule pay system; to provide more delegated authorities to individual

¹⁴ Public Law (P.L.) 101-509, Nov. 5, 1990

¹⁵ 5 U.S.C. Section 5303(b)(1)

organizations or agencies; and to install a performance based pay system into the Federal civil service.

Recruitment, retention and pay comparability issues were examined by numerous groups, one being the National Academy for Public Administration (NAPA) starting in 1991. NAPA is an independent, non profit organization chartered by the Congress to study and improve governance at the federal, state, and local level. NAPA has done considerable work and published numerous reports in the area of broad banding and performance based pay in the Federal sector. Individually and collectively their reports have influenced policy makers. NAPA issued its first seminal work in this area in 1991 describing the concept of pay banding to allow 10 job families and 3 band levels.¹⁶ NAPA made a recommendation in their 1991 broad banding study to allow agencies to use “pay banding” which would band together several grade levels of jobs for the purpose of addressing salary shortfalls and an inability to attract candidates. One band would consist of entry level through developmental to full performance. Another band would encompass senior journey level and first level supervision, i.e., GS 12-13 and another band would cover managers at the GS-13 through GS-15 levels. In February 1992, all agency personnel directors were convened in Charlottesville, Virginia, by the OPM Director, Connie Newman, to consider the NAPA recommendations for pay banding and the need for such a step with the new promise of FEPCA. The NAPA recommendations were not endorsed by the group as it was felt that the new FEPCA authorities would address salary and recruitment concerns.¹⁷

It became apparent that FEPCA alone would not solve these problems and subsequently, in 1995, NAPA published a document describing how several alternatives using pay banding could be operational.¹⁸ These operational models included pay for performance as well as other alternatives for advancement in the pay banding system. In July of 2002, NAPA published a summary of their Human Resources Management Research for the

¹⁶ *Modernizing Federal Classification: An Opportunity for Excellence*, NAPA. July 1991

¹⁷ Notes of the author as an attendee

¹⁸ *Modernizing Federal Classification: Operational Broad Banding Systems Alternatives*, NAPA August 1995

second National Commission on the Public Service, headed again by the former Federal Reserve Chairman, Paul Volcker. In this report, NAPA summarized what had often been felt to be one of the main complaints about the current system when it stated that, “Rewards and incentives for high performers are considered inadequate.”¹⁹ Furthermore, their recommendations to the National Commission on Public Service stated that it was especially important to abolish the General Schedule and incorporate broad banding where feasible and to provide for performance with variable pay as a greater proportion of the overall compensation.²⁰ These conclusions helped shape the advice and opinion of the National Commission on Public Service and subsequently some members of Congress, some in the Administration, and numerous agency policy officials. However, these recommendations did not convince everyone of the need to move quickly to that model.

The private sector was also moving toward broad-banding at this time. Evaluative data developed by the Hewitt Associates for the American Compensation Association indicates that 27 of the Fortune 500 companies used broad-banding in 1992, 58 in 1993, and 200 in 1994. That is an increase from five percent to forty percent in two years. In another study of the time, the William M. Mercer Corporation reported that about one-third of 2,700 U.S. companies surveyed were using broad-banding or considering its use.²¹ It would take more than a decade and several Congressional approvals of individual agency authorities for new pay systems before the Federal service in total began to consider adopting pay for performance to achieve necessary business objectives of addressing recruitment and retention problems.

The Government Accountability Office (GAO) is a major research arm of Congress. The GAO responds to Congressional requests to study a variety of topics in the area of

¹⁹ Summary of Human Resource Management Research by NAPA for the National Commission on Public Service, July 2002, p.7

²⁰ Summary of Human Resource Management Research by NAPA for the National Commission on Public Service, July 2002, p.12

²¹ *Modernizing Federal Classification: Operational Broad-banding Systems Alternatives*, NAPA, August 1995, p5

improved government operations which incorporates federal personnel policies and practices including initiatives in pay banding and performance based pay. In the early years after the passage of the CSRA, the GAO was called the General Accounting Office. There were relatively few Congressional requests to look into Federal personnel practices and almost no specific activity around moving from the General Schedule or moving the government to pay for performance. GAO began looking into this issue as the concept heated up under the transformational leadership of David M. Walker, the current Comptroller General of the United States. Mr. Walker took office on November 9, 1998 and he has a 15 year appointment. This fact alone insures the impact of his tenure and his continuity in being a champion of human capital management reform both inside his agency and across the government.

Within the GAO it is notable that Comptroller General Walker obtained legislation to allow his agency to practice what he was preaching and for his agency to be a model in the government. The GAO Personnel Flexibilities Act of 2000²² and the GAO Human Capital Reform Act of 2004²³ were enabling pieces of legislation to help bring about the large scale transformational changes that the Comptroller General wanted to see at GAO and across the Federal government. It is noted that most of the pay for performance changes within GAO were in the 2004 Act.

The legislation in 2000 also changed the name of GAO to the Government Accountability Office and Comptroller General Walker quickly began incorporating accountability into the Human Capital Management arena by publishing a series of reports on Human Capital. One of the first such reports in January of 2000, stated that if agencies were to have effective implementation of performance based management as envisioned by the Government Performance and Results Act of 1993,²⁴ then they needed to strategically manage their most important asset, Human Capital.²⁵ This theme was

²² GAO Personnel Flexibilities Act, Pub. L 106-303, enacted October 13, 2000

²³ GAO Human Capital Reform Act of 2004, Pub. L. 108-271, enacted July 7, 2004

²⁴ *Government Performance and Results Act of 1993*. Pub. L. 103-62, August 3, 1993

²⁵ *Key Principles from Nine Private Sector Organizations*. GAO-GGD-00-28, Jan 31, 2000

reinforced by providing the Congress with a list of questions to ask potential political appointees including how they would strategically manage their human capital program responsibilities.²⁶ The Comptroller General also placed Strategic Human Capital Management on the “high risk list” government-wide²⁷ and followed up in 2002 by providing a model of Strategic Human Capital Management.²⁸ The GAO also studied, at the request of Congress, pay for performance initiatives of the agencies with demonstration projects. The GAO reported that they strongly supported the concept, but stated that the demonstration projects ability to show an understanding of how to better link pay to performance is very much a work in progress at the federal level.²⁹

The OPM has played both a policy role and a research role in compensation or pay banding, in that they report to Congress on the status of demonstration projects and evaluate the results of those projects in preparing guidance and government-wide policy. They also gain information through agency inspections and program reviews to insure compliance with the civil service laws and OPM regulations. One of the central purposes of the 1978 CSRA in disbanding the Civil Service Commission and creating OPM was to make the civil service personnel system more responsive to the needs of the Administration. This included a political appointee as the OPM Director who served as the Presidents’ agent. While this, on occasion, creates an uncertainty of bias around the conclusions of their reports, the OPM has nevertheless developed and published a wealth of information on agency experiences in demonstration projects and on similar legislatively approved variances for pay systems. They also have extensive material available on their website regarding every aspect of performance management about which they have published information.³⁰ One of their more seminal works was initiated under a “Strategic Compensation Initiative” which was begun under the Clinton administration and completed under the current Bush administration. This “white

²⁶ *Potential Questions to Elicit Nominees’ Views for Management Challenges*, GAO-01-332R. Jan 18, 2001

²⁷ *Major Management Challenges and Program Risks: A Government-wide Perspective*, GAO -01-241, January 2001

²⁸ *A Model of Strategic Human Capital Management*, GAO-02-373SP. March 15, 2002

²⁹ *Implementing Pay for Performance at Selected Personnel Demonstrations Projects*, GAO-04-83. January 2004

³⁰ See <http://www.opm.gov/perform/sitemap.asp>

paper” on compensation outlined the problems with the General Schedule and was intended to provoke discussions on how to move beyond it to a more modern system for compensation.³¹ Through multiple administrations, OPM has been a continuous supporter of good management practices, solid foundations of communication, and linking agency strategic goals to individual performance goals. They continue to do this even while helping champion a larger scale movement towards pay for performance across large agencies like the Department of Homeland Security (DHS) and DoD. However, OPM does not blindly support pay for performance as they recently noted, “As generally accepted by researchers, a well-planned pay-for-performance system *can* work in an organization with the appropriate appraisal program and performance culture.”³² (emphasis added)

The Merit Systems Protection Board (MSPB) is an independent agency with statutory responsibility to conduct studies of the Federal civil service and other merit systems in the executive branch. MSPB conducts objective, non-partisan studies that assess and evaluate Federal merit systems’ policies, operations and practices. The studies typically take a government-wide view with a long-term perspective on merit and effective human capital management. They also conduct a review of significant actions of OPM and have the authority to set aside any OPM regulation or policy that on its face or in practice would constitute a prohibited personnel practice.³³ The MSPB has a reflective look on how policy has been implemented including best practices rather than a prospective one to formulate policy. MSPB has looked at the initial CSRA inspired merit pay program initiated for managers³⁴ and has twice looked at the Senior Executive Service in 1989,³⁵ and in 1990.³⁶ The evolving movement toward pay for performance in DHS and DoD combined with the legislation proposed by the Administration in 2006 to

³¹ *A Fresh Start for Federal Pay: The Case for Modernization*, Kay Coles James, Director, OPM April 2002

³² *Pay for Performance: Your Performance Management Program Is the Foundation*, OPM, April 2007

³³ 5 USC Section 1204 (f) (2) (A) and (B)

³⁴ *Status Report on Performance Appraisal and Merit Pay Among Mid-Level Employees*, MSPB, June 1981

³⁵ *Senior Executive Service: Views of Former Federal Employees*, MSPB, October 1, 1989

³⁶ *SES Pay Setting and Reassignments: Expectations vs Reality*, MSPB, October 1, 1990

permit all agencies to move to a performance based system³⁷ caused MSPB to study the issue from their longer term view. Their report highlights some of the benefits and risks associated with pay for performance and addresses decision points in the design of a pay for performance system.³⁸ Their study delves deeper into each feature necessary for a successful pay for performance system in order to help raise agency awareness of the hurdles they face in implementing a pay for performance system.

Private sector research has also frequently looked at how to achieve greater performance. The Corporate Executive Board (CEB) is a leading provider of best practice research and analysis focusing on corporate strategy, operations, and general management issues. The CEB provides its integrated set of services currently to more than 2,800 of the world's largest and most prestigious corporations, including over 80 percent of Fortune 500 companies. Their Corporate Leadership Council provides Human Resources best practices research, executive education, and decision-support services to a large global network of HR executives. The Council focuses on topics that are most critical for senior HR executives: employee engagement, performance management, leadership development and succession management, diversity, HR service delivery, and executive compensation. Their findings indicate that employee engagement on both an emotional level and a rational level have the greatest impact on performance. The rational level includes systems like a pay for performance system. However, their research indicates that the emotional level of engagement is four times more powerful in driving employee effort than rational engagement.³⁹

Their findings suggest that if the objective is greater performance, then more management effort should be spent on achieving employee engagement through the emotional side. The rational side, which includes compensation and benefits, matter

³⁷ Working For America Act (draft proposal) as of February 2006

³⁸ *Designing an Effective Pay for Performance Compensation System*, MSPB, January 2006

³⁹ *Driving Performance and Retention Through Employee Engagement*, Corporate Leadership Council, Catalog no:CLC12MSALD, Washington DC, p. 4

more to retention than to employee effort. Having a pay for performance system (rational side) is not in their top 25 levers of engagement.

In a broader more independent review by a non government entity, the Commission on Behavioral and Social Sciences and Education found in 1991, that most of the research examining the relationship between pay for performance plans and increased performance focused on individual incentive plans such as piece rates. By design, these plans most closely approximate the ideal motivational conditions prescribed by expectancy and goal-setting theories, and the research indicates that they can motivate employees and improve individual-level performance. However, the contextual conditions under which these plans improve performance without negative, unintended consequences are restricted; these conditions include simple, structured jobs in which employees are autonomous, work settings in which employees trust management to set fair and accurate performance goals, and an economic environment in which employees feel that their jobs and basic wage levels are relatively secure. Because these conditions, especially the job conditions, are not found collectively in many organizations they do not apply to many jobs.⁴⁰ They went on to point out that merit pay plans have some design features, such as the addition of pay increases to base salary, and the use of individual performance measures, including both quantitative and qualitative objectives, that can help avoid some of the negative consequences of individual incentives plans. However, these characteristics may also dilute the plans' potential to motivate employees.

3. Current State of Performance Based Pay

As discussed previously, an agency that has transformed itself and adopted a performance based and market based pay system, is the General Accounting Office.

⁴⁰ *Pay for Performance: Evaluating Performance Appraisal and Merit Pay for Performance*. Commission on Behavioral and Social Sciences and Education, National Academies of Sciences, Washington DC, 1991. p 89

Their transformation started under the influential leadership of David M. Walker in November 1998, and included a subsequent name change to the Government Accountability Office. That transformation is significant in terms of change management as consistent leadership and recognition of a burning need for change are two hallmarks of a successful change effort.

Comptroller General Walker's 15 year term is now slightly less than two-thirds through. As is the case in many organizations, Comptroller General Walker felt the GAO had inflated performance appraisal ratings. When he arrived at GAO the performance appraisal ratings were on a 5 point scale and his organization had an average rating of 4.62. This made it very difficult to differentiate between middle and top performers and this was felt to be a major structural barrier to transforming the agency.⁴¹ He initially attempted disciplining the existing system to bring down the average performance rating and cause performance appraisals to more accurately reflect the differentiating levels of performance across the GAO workforce. This effort met with minimal success and the return of performance appraisal creep (4.16 and 4.18 and 4.26 respectively in the next three cycles).

Consequently, in 2002 he led GAO in a vast reform to change the performance management system as well as move to pay bands and pay for performance. This resulted in a drop in the average performance ratings to 2.19 and 2.30 and 2.34 in the following three cycles. It also led to some consternation within the organization as people accepted or did not accept this cultural change. However, Comptroller General Walker felt this systemic change to the performance management system was necessary to drive the type of change, to both the performance culture and to the organizational direction, he wanted to achieve at GAO. His continued personal presence, personality and persistence provide the highest probability for a successful cultural change in any Federal agency. Change in the Federal government is often difficult for a variety of reasons. The length of service for the average political appointee is about 18 months,

⁴¹ Presentation by the Honorable David M. Walker, to Merit Systems Protection Board, April 20, 2006

making their ability to persevere through significant change such as establishing a performance based culture in an organization, nearly impossible.⁴² Most researchers in change management conclude that cultural change takes 4-7 years to accomplish and the rapid turnover of the chief executive in an organization and his or her top team, rarely allow a continuous transition to their replacements.

In 2005, new legislation created the Department of Homeland Security⁴³ and provided it with numerous special authorities for human capital management as well as additional legislation providing similar new authorities to the Department of Defense, creating the National Security Personnel System (NSPS)⁴⁴. These two large agencies comprise more than half of the Civil Service and their authorities are matched with President George W. Bush's efforts to make government more accountable and more results oriented. Accordingly, a greater emphasis has been placed on performance based pay in the Federal Government since 2001. Within each of these two large Departments somewhat minimal progress has occurred. In both Departments dramatic changes to the labor management relationship were defined by the new legislation and perceived by the unions as setting them back many years to a less respectful relationship. The lack of union involvement in crafting these two pieces of legislation and their subsequent concerns with the legislation fueled union opposition to many of the changes the new legislation allowed. This included any endorsement of a pay for performance proposal until the unions' central issue of their standing was agreed. Lawsuits were filed by the unions and initial court decisions were favorable to them. Even after considerable labor management meetings on a new performance management system, the DHS has not been able to implement a pay for performance system.

⁴² Carolyn Ban and Patricia W. Ingraham, *Political Appointee Mobility and its Impact on Political-Career Relations in the Reagan Administration*. Administration & Society, Vol. 22, No. 1, 106-124 (1990)

⁴³ Homeland Security Act of 2003, Pub. L. 107-296, sec. 1322

⁴⁴ National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398) Section 1114

At the Defense Department there was considerable initial discussion about the new NSPS. Just as at DHS no agreement was reached with the unions. However, DoD made a unilateral decision to roll out the system as last discussed with the unions to only non bargaining units. DoD spent considerable effort training supervisors and employees on the new system as they spiraled it out to ever growing numbers of non bargaining unit organizations. They accomplished a dry run of the new performance management system to show how payouts would link with the ratings in the initial cycle and then began phasing in actual payouts in the next cycle. Accordingly, about 15% of the DoD civilian workforce is covered under the initial spirals of implementation. In the 2006 rating year about 11,000 workers received actual payouts and in 2007, a larger spiral totaling 110,000 employees received actual adjustments under the new system. The average raise for the General Schedule was 4.49%. However, the DoD group in this same geographic pay area averaged a 5.9% base pay increase plus a 1.7% bonus.⁴⁵ Only 5,425 employees out of the 110,000 received an amount less than their General Schedule counterparts, indicating that the new system has notably raised the payroll costs in the pay for performance group. NSPS had numerous internal disagreements early on with the demonstration labs wanting to continue their own successful pay for performance systems. They were being forced to adopt the new NSPS until legislative protections were inserted by Senator Voinovich. They continue to remain outside the NSPS until at least October of 2011 because of language in the 2008 Defense Authorization Act as do all Wage Grade or blue-collar jobs. This latest law also reaffirms full collective bargaining rights for unions.⁴⁶ This implies that extending the pay for performance system to bargaining unit employees will likely be slowed or perhaps will never occur. The Congressional interest in oversight of how NSPS is implemented is further demonstrated by the fact that the 2008 law also requires an annual review of DoD by the GAO, to determine both internal employee satisfaction with the system and whether or not accountability mechanisms are in place. DoD is also limited to expanding NSPS coverage by no more than 100,000 employees per year.

⁴⁵ Stephen Barr, "For Many Defense Workers, a Day With Some Merit", Federal Diary column, The Washington Post, January 25, 2008

⁴⁶ National Defense Authorization Act for Fiscal Year 2008 (P.L. 110-181) Section 1106

Other Federal agencies such as the FIRREA agencies continue to tweak their own systems which vary greatly. For example, the Federal Deposit Insurance Company (FDIC) adopted a pass fail performance appraisal system with pay raises based on comparative contributions for those who pass. Their HR Director cited lessons learned to insure that the system allows for significantly different awards and stated that more graduated levels of awards were preferable to fewer levels of awards.⁴⁷ Other individual agencies with varying systems permitted either by FIRREA or by their own legislation are relatively small and have limited influence to include those with demonstration project authority. Individually they are too small and collectively they are too diverse, to convince Congress that pay for performance should or should not be adopted government-wide.

4. Legal and Political Dynamics of Performance Based Pay in the Federal workforce

The movement toward performance based pay has grown out of agency desires for greater flexibility than what is available in the General Schedule. The nature of the Federal sector requires a solution that is acceptable to a myriad of stakeholders in this issue. As previously discussed, there has been considerable legislation passed to help address the identified issues including the Civil Service Reform Act of 1978 that allowed demonstration projects to vary from the General Schedule. There were also numerous pieces of specific legislation enabling individual organizations to make their demonstration projects permanent and many more pieces of legislation that specifically enabled organizations to establish their own system separate from the General Schedule without a demonstration project or OPM guidance or approval.

The political minds have also continued to address this issue. The report of the National Performance Review (NPR) under Vice President Gore was adopted by

⁴⁷ Miguel Torrado, *Symposium on Market Based and Performance-oriented Pay Systems*, Sponsored by MSPB, GAO, OPM, NAPA and Partnership for Public Service, March 9, 2005

President Clinton in his administration's plan for *Creating a Government that Works Better and Costs Less*. One of the major recommendations was to reform the General Schedule Classification and Pay System. This included a requirement for the OPM Director to submit proposed legislation to remove all grade-level classification criteria from the law which would further the concept of broad-banding and broad pay system flexibilities.⁴⁸ The follow-up report to assess implementation of NPR recommendations was done in 1994 by the National Partnership Council (NPC) whose composition included national level unions. The NPC reiterated the need for legislation to require OPM to broaden government-wide classification criteria for agency broad-banding systems. The NPC also waffled by saying that any changes to the basic pay system should be done after more experience was gained with the pay flexibilities provided under FEPCA or the use of alternative personnel system authority.⁴⁹ These mixed messages of support by the varied stakeholders in the NPC left OPM reticent to move quickly.

When President George W. Bush came to office, he stated that if reform is to help the Federal Government adapt to a rapidly changing world, its primary objectives must be to a government that is Citizen Centered, Results Oriented, and Market Based.⁵⁰ His administration went on to develop the Presidents Management Agenda (PMA) which became the scorecard of five critical areas (one of which is Human Capital) by which the performance of his cabinet would be judged. OPM and the Office of Management and Budget (OMB) in the Executive Office of The President collaborate to give the ratings to cabinet level Departments and many agencies in the Human Capital Management area. They also collaborate to give advice and guidance to agencies on how to achieve a higher rating on the elements. OMB also measures progress on the related initiative in the PMA of "competitive sourcing". This is one of the five PMA

⁴⁸ National Performance Review, *Creating a Government That Works Better and Costs Less: Reinventing Human Resource Management*, Government Printing Office: Washington, D.C., September 1993, 163.

⁴⁹National Partnership Council, *Report to the President on Implementing Recommendations of the National Performance Review*, January 1994, p. 31.

⁵⁰ White House Press Release, July 11, 2001

objectives whereby agencies are to look at all jobs and determine if they are “inherently governmental” or if they could be done more effectively or efficiently by the private sector. Nearly 850,000 jobs were identified for consideration and the President’s initiative was to have half of them, or about 425,000 jobs, undergo competition to see if it was more efficient to keep them in the Federal sector or not. The net result over the reported years of this initiative covers 1243 competitions through fiscal year 2006 which have resulted in 83% of the jobs being retained in the Federal sector.⁵¹ This is notably at variance with the DoD reported history from 1978 onward when similar competitions were done under the A-76 guidelines and a result in the 50-60 percent range was achieved.⁵² Significant savings is reported on each initiative although the cost of holding a competition for a function and then not moving it is not stated in the total savings. OMB estimates are that a twenty percent savings is realized by the Federal organization creating the “most efficient organization” in preparation for the competition with the private sector.

The attack of September 11, 2001, helped create a need to reorganize the Federal government and this resulted in the creation of the DHS which aligned 22 different agencies from across the government under a single new Department and provided the Department and its approximately 198,000 civilian employees, considerable flexibility for personnel systems.⁵³ The initiative to reorganize various agencies also included shifting several agencies within DoD and providing DoD with needed personnel flexibilities to meet national security mandates. While the DHS personnel flexibilities were straightforwardly addressed through congressional committees the DoD authorities were not brought through congressional committees and sub-committees dealing with Civil Service Reform. Instead DoD obtained legislation via their annual Authorizations Act to allow similar authorities to the Department of Homeland Security.⁵⁴ This back door approach rather than addressing the need for civil service

⁵¹ http://www.whitehouse.gov/omb/procurement/comp_src/cs_report_fy2006.pdf p. 6

⁵² http://www.whitehouse.gov/omb/procurement/comp_src/cs_report_fy2006.pdf p. 13

⁵³ Homeland Security Act of 2003. Pub.L.107-296, Sec.1322

⁵⁴ National Defense Authorization Act for Fiscal Year 2004., Pub.L.108-136, Nov 24, 2003

reform through appropriate committees in Congress greatly vexed some Members although the measure still easily passed. It also provided a foothold for labor union arguments against the proposals being implemented. Considerable time and energy was spent with joint labor management committees and in Federal court. Both Departments combined have over 900,000 employees which are more than half of the total civil service. Therefore, these two agency “experiments” will have a large impact on the future of the Federal personnel management system.

In 2006, the Administration proposed legislation to permit all Federal agencies to move toward pay for performance with the Working for America Act. The unions actively opposed the concept and lobbied against it. Numerous concerned Senators including George Voinovich and Susan Collins and Members of Congress including Tom Davis, Joanne Davis, Danny Davis, and Steny Hoyer recommended a more wait and see attitude on how the DHS and DoD models worked. There was no sponsor of the legislation in either the House or Senate and the energy created around the proposed act dissipated although the need for such reform remains.

5. Conclusion

Pay for performance is not new in the Federal government. This paper helps to show why it has been implemented in fits and starts and why we are likely to see more of the same. There is still insufficient political capital around this issue to create legislation that would allow any Federal agency to move from the General Schedule and create a broad banding system let alone one that mandates progression via pay for performance. As more government agencies venture into pay for performance compensation systems and base a greater percentage of salary on individual and organizational accomplishments, there is greater concern about whether they will succeed in preserving other merit principles including “fair and equitable treatment” for all employees and protecting employees against “arbitrary action” and “personal

favoritism.”⁵⁵ A pay for performance system can provide more reward for the high performer and can help address the incorrigibly poor performer. However, focusing on the ends of the bell curve has its limits. If 15% of your staff are high performers and 5% are the incorrigibly poor performers, how does a pay for performance system impact the remaining majority? Can such a system make this eighty percent more engaged in their work or improve productivity? Is the underlying appraisal system sufficiently sophisticated and relevant that both employees and managers will be able to rate, see, and accept the differentiations in performance as they are translated to meaningful distinctions in pay? Is pay a major motivator of performance or employee engagement in an organization?

In the Federal sector the Defense Department and the Department of Homeland Security initiatives will have a tremendous impact on the rest of the government’s ability to move away from the General schedule. The statistical fairness of their pay for performance systems and their ability to shift organizational performance are far less important than how they are perceived by the stakeholders including employees, unions, and the Congress. In a system with nearly two million employees and many more stakeholders, varied perceptions remain around an issue upon which we should not expect prompt agreement. It is the nature of the beast regardless of the type of organization. Resistance and mistrust will be present unless a collaborative effort has been undertaken to establish a credible performance appraisal system prior to venturing into pay for performance. The larger the organization, the more difficult it is to build the trust and gain the consensus of the stakeholders. Allowing smaller organizational entities to establish their own pay for performance systems would increase chances for success whether it is an agency within a government department or a school within a district. Major changes such as replacing a pay system create a crucial opportunity for innovation. There are numerous key decision points to consider in determining

⁵⁵ Title 5, United States Code, ch. 23, sec.2301

whether an individual organization is ready to make such a transition.⁵⁶ Implementing such a system presents unique opportunities and challenges. If done correctly, it can help obtain the objective of increasing individual and organizational performance. It can also have a positive impact on a secondary objective of recruiting high performing individuals. However, if done improperly, it can have a substantial detrimental affect on recruitment, performance and retention.

There has been a lack of measures to evaluate whether or not such systems are successful. Measures must include more than achievement of objectives or increased outputs. Congress has included a two pronged measurement of NSPS success by tasking GAO to look at internal employee satisfaction and whether accountability mechanisms are in place. This seems in concert with the ongoing initiatives by OPM in their Federal Human Capital Survey and MSPB in their Merit Principles Survey to question employees government-wide on their views. It is crucial to take the pulse of the workforce on whether these systems are aiding retention and adding to the important levers in employee engagement. Successfully implementing such a change is much more than a process. It must make a real difference in employee's work lives. It must direct resources – that is people, money, and training – where they are most needed. To do otherwise is to gamble with the commitment and productivity of Federal employees. That is a gamble the Federal government and the American people can ill afford.

⁵⁶ See, *Designing an Effective Pay for Performance Compensation System*, Merit Systems Protection Board, Washington DC, January 2006

Appendix A

The 2008 General Schedule

Grade	Step 1	Step 2	Step 3	Step 4	Step 5	Step 6	Step 7	Step 8	Step 9	Step 10	WITHIN GRADE AMOUNTS
1	17046	17615	18182	18746	19313	19646	20206	20771	20793	21324	VARIES
2	19165	19621	20255	20793	21025	21643	22261	22879	23497	24115	VARIES
3	20911	21608	22305	23002	23699	24396	25093	25790	26487	27184	697
4	23475	24258	25041	25824	26607	27390	28173	28956	29739	30522	783
5	26264	27139	28014	28889	29764	30639	31514	32389	33264	34139	875
6	29276	30252	31228	32204	33180	34156	35132	36108	37084	38060	976
7	32534	33618	34702	35786	36870	37954	39038	40122	41206	42290	1084
8	36030	37231	38432	39633	40834	42035	43236	44437	45638	46839	1201
9	39795	41122	42449	43776	45103	46430	47757	49084	50411	51738	1327
10	43824	45285	46746	48207	49668	51129	52590	54051	55512	56973	1461
11	48148	49753	51358	52963	54568	56173	57778	59383	60988	62593	1605
12	57709	59633	61557	63481	65405	67329	69253	71177	73101	75025	1924
13	68625	70913	73201	75489	77777	80065	82353	84641	86929	89217	2288
14	81093	83796	86499	89202	91905	94608	97311	100014	102717	105420	2703
15	95390	98570	101750	104930	108110	111290	114470	117650	120830	124010	3180

Faculty and Research Affiliates

Matthew G. Springer

Director
National Center on Performance Incentives

Assistant Professor of Public Policy
and Education
Vanderbilt University's Peabody College

Dale Ballou

Associate Professor of Public Policy
and Education
Vanderbilt University's Peabody College

Leonard Bradley

Lecturer in Education
Vanderbilt University's Peabody College

Timothy C. Caboni

Associate Dean for Professional Education
and External Relations
Associate Professor of the Practice in
Public Policy and Higher Education
Vanderbilt University's Peabody College

Mark Ehlert

Research Assistant Professor
University of Missouri – Columbia

Bonnie Ghosh-Dastidar

Statistician
The RAND Corporation

Timothy J. Gronberg

Professor of Economics
Texas A&M University

James W. Guthrie

Senior Fellow
George W. Bush Institute

Professor
Southern Methodist University

Laura Hamilton

Senior Behavioral Scientist
RAND Corporation

Janet S. Hansen

Vice President and Director of
Education Studies
Committee for Economic Development

Chris Hulleman

Assistant Professor
James Madison University

Brian A. Jacob

Walter H. Annenberg Professor of
Education Policy
*Gerald R. Ford School of Public Policy
University of Michigan*

Dennis W. Jansen

Professor of Economics
Texas A&M University

Cory Koedel

Assistant Professor of Economics
University of Missouri-Columbia

Vi-Nhuan Le

Behavioral Scientist
RAND Corporation

Jessica L. Lewis

Research Associate
National Center on Performance Incentives

J.R. Lockwood

Senior Statistician
RAND Corporation

Daniel F. McCaffrey

Senior Statistician
PNC Chair in Policy Analysis
RAND Corporation

Patrick J. McEwan

Associate Professor of Economics
Whitehead Associate Professor
of Critical Thought
Wellesley College

Shawn Ni

Professor of Economics and Adjunct
Professor of Statistics
University of Missouri-Columbia

Michael J. Podgursky

Professor of Economics
University of Missouri-Columbia

Brian M. Stecher

Senior Social Scientist
RAND Corporation

Lori L. Taylor

Associate Professor
Texas A&M University

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Peabody #43
230 Appleton Place
Nashville, TN 37203

(615) 322-5538
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