PARTNERSHIP FOR PUBLIC SERVICE

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"Robbing Mary to Pay Peter and Paul: The Administration's Pay for Performance System"

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Chairman Davis, Representative Marchant, Members of the Subcommittee, thank you very much for the opportunity to appear before you today. I am Max Stier, President and CEO of the Partnership for Public Service, a nonpartisan, nonprofit organization dedicated to revitalizing the federal civil service by inspiring a new generation to serve and transforming the way the federal government works. We appreciate your invitation to discuss pay for performance in the federal government.

The Partnership has two principal areas of focus. First, we work to inspire new talent to join federal service. Second, we work with government leaders to help transform government so that the best and brightest will enter, stay and succeed in meeting the challenges of our nation. That includes all aspects of how the federal government manages people, from attracting them to government, leading them, supporting their development and managing performance; in short, all the essential ingredients for forming and keeping a world-class workforce.

The question that frames our discussion today is, "How can we create a higher performing work environment in federal agencies?" Pay is one way to motivate federal employees to perform at their best. It is not the only or most important way – indeed, the Partnership's *Best Places to Work in the Federal Government* rankings demonstrate that compensation is not the most important driver of employee engagement – but pay can be a valuable tool in recruiting, retaining and motivating talent and improving individual and organizational performance.

The merit system principles in Title 5 recognize that incentives and recognition for excellence in performance are appropriate. But the current 1949-era General Schedule system does not reward high performers. It rewards, above all else, longevity. The length of time that someone spends in their job should not be the primary consideration in compensation decisions. To compete for the talent that government needs today and for the foreseeable future, the federal government must move toward a more performance-sensitive compensation system.

As this Subcommittee has learned through your oversight efforts and past hearings, the record of alternative personnel systems with a performance-based pay component is mixed. We know from the 2007 analysis completed by the Office of Personnel Management[1] that many agencies consider their efforts to be a success. However, various media reports and testimony before this Subcommittee tell a cautionary tale about the ease with which such efforts can and do go awry. The challenge for the federal government, Congress and stakeholders is to learn from these experiences – both the good and the bad – and apply those lessons going forward.

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[1] Office of Personnel Management, *Alternative Personnel Systems in the Federal Government*, 33-38, (December 2007).

Performance-Based Pay: A View from the Chief Human Capital Officers

In our July 2007 report[2] on the views of federal agency Chief Human Capital Officers (CHCOs), the Partnership found that while a consensus has yet to form on what a new government-wide pay and performance system should look like, the clear majority of the 55 CHCOs and senior HR professional interviewed think the General Schedule pay system is no longer adequate. More than half of the respondents agreed that a more performance-sensitive pay system should be a long-term goal. Several interviewees praised the results of pay for performance demonstration projects as examples of responsible ways to further strengthen the link between performance and compensation. One-third of those interviewed said we should scrap the GS system immediately. Most cautioned that the process to design and implement a new pay system should be slow and deliberate and that credible performance management systems and appraisals must come first. A number want to wait and see how ongoing transitions to pay for performance play out elsewhere in government before moving forward with any major changes for their agencies. Most of the concerns expressed about performance-based pay stem less from the policy itself and more from the fact that attempts to implement reforms at DOD, DHS and with Senior Executive Service (SES) pay have been controversial.

Our report found mixed reviews for the performance-based pay system established by Congress in 2003 for the SES. Respondents suggested that the timelines were too aggressive, and CHCOs said they did not receive clear or consistent guidance from OPM. Several complained that they still did not know exactly how to get their SES performance-based pay system certified by OPM.

Still, the overwhelming sense of government's senior HR leaders can be summed up by the comments of one CHCO: "Congress needs to understand the General Schedule is not working. Maybe we need to take baby steps – but we can't just go backwards."

A Way Forward

Colleen Kelley had it right when she was quoted as saying that performance-based compensation systems succeed only when they rest on a "trilogy of ideas" – fairness, credibility and transparency. We could not agree more. Indeed, Congress recognized that a fair, credible and transparent employee appraisal system is a necessary precondition to a pay for performance demonstration project. The only way to achieve credibility – the necessary "buy-in" from agency employees – is for federal agencies to work with employees and employee representatives to design, implement and assess the impact of performance-based compensation.

[2] Partnership for Public Service, *Federal Human Capital: The Perfect Storm, A Survey of Chief Human Capital Officers,* July 2007.

It is hard work but we know that it is possible to build consensus around the mechanics of a performance-oriented pay system. For instance, the National Treasury Employees Union (NTEU) reached agreement with the National Credit Union Administration (NCUA) last year on a compensation system that will reward employees commensurate with their performance. Previously, NTEU also reached a collective bargaining agreement with the Securities and Exchange Commission (SEC) and the Federal Deposit Insurance Corporation (FDIC) on their performance-based pay systems. In the latter two cases, however, there have been disagreements regarding the implementation of those systems. The point remains, however, that consensus is possible regarding how such a system should work. Of course, federal agencies still need to ensure that such systems actually operate as intended and they need to take corrective actions when they do not.

We know that performance-oriented pay systems falter when there is inadequate attention to the vital ingredients of employee involvement and communication. Simply put, a pay for performance system is doomed to fail if the affected employees do not perceive the system as fair for all, regardless of gender, race, religion, political affiliation, marital status, age, veteran status or disability. Employees must be confident that personal favoritism will not advantage or disadvantage any employee. And the best way to ensure the fairness, credibility and transparency of a pay for performance system is to measure its impact on affected employees. This is one of the reasons that the Partnership for Public Service tracks employee perceptions of performance-based rewards and advancement in its *Best Places to Work in the Federal Government* rankings.

Failure…or Success?

Why do some pay for performance systems succeed while others fail? If the objectives of pay for performance systems are to attract, motivate and retain talent and to create higher performing organizations, experience suggests that current and recent efforts to implement performance-based pay have had mixed results. Problems in unsuccessful systems can often be traced to lack of communication with employees, overly ambitious timelines, ambiguous goals, inadequate guidance and poor assessment.

To ensure that future efforts have a high likelihood of realizing objectives, the Partnership offers the following recommendations:

1) *Create and employ meaningful measures to identify the positive and negative impacts of pay for performance systems and to ascertain the impact of such systems on various demographic groups.*

Performance-based compensation for federal employees must not advantage certain demographic groups over others. The Government Accountability Office took the bold step of publicizing the agency's promotions and performance ratings by race, gender, age, disability, veteran status, location and payband. The data revealed a gap between performance appraisals for African-Americans and whites, a disparity that the agency is now able to address. Measures are an absolutely critical ingredient in determining whether pay for performance rewards employees fairly and whether changes in the system are needed.

Based on the Partnership's research, we recommend that the Subcommittee work with agencies pursuing pay for performance systems to create, collect and analyze **measures in seven areas**: *recruitment, retention, skills gaps, performance distinctions, performance culture*, *leadership* and *implementation*. We also recommend the creation and collection of this data by **specific demographic group** – e.g., minority employees or a particular age group – as compared to the workforce as a whole. The data should be collected and analyzed with the objective of determining the impact of performance-based compensation in each of these important areas.

As previously mentioned, the Partnership's *Best Places to Work* rankings include a dimension on performance-based rewards and advancement. Agency scores on this dimension are driven by employee responses to a variety of statements, including:

- Promotions in my work unit are based on merit
- Employees are rewarded for providing high quality products and services to customers
- Creativity and innovation are rewarded
- My performance appraisal is a fair reflection of my performance
- Satisfaction with recognition received for doing a good job
- Satisfaction with opportunity to get a better job in organization

2) *Engage federal employees and their representatives in the design, implementation and assessment of the pay for performance system.*

A performance-based pay system that is imposed upon, rather than established with, agency employees will not further the goals of better employee and organizational performance; indeed, it may have the opposite effect. For example, the Treasury Inspector General for Tax Administration said in a 2007 report that the IRS pay for performance system may not support initiatives to recruit, retain and motivate future leaders in part because the IRS did not sufficiently communicate the details of the new pay system or attempt to seek support from the affected managers. Congress should insist on demonstrable, meaningful agency engagement with employees and their representatives at all points in the process.

3) *Ensure that any pay for performance system is based on a sound performance management system.*

Employees and their managers need a common understanding of how performance is measured, how performance will be evaluated and how pay decisions are made. Congress should require that an agency's alternative pay system meet certain requirements, and be certified by OPM, GAO, or another entity specified by Congress, <u>before</u> it is implemented. The requirements for certification should include (a) a fair, credible and transparent performance appraisal system, (b) a means of ensuring employee involvement and ongoing feedback, (c) a mechanism for ensuring the system is

adequately resourced, and (d) meaningful measures to quickly identify positive and negative impacts and ascertain the system's impact on various demographic groups.
4) *Managers must be trained and held accountable for unbiased and transparent decisions regarding performance assessment and pay decisions.*

As agencies have abandoned pass/fail employee appraisal systems in favor of multi-tiered systems that recognize meaningful distinctions in performance, it has reinforced the need to ensure that federal managers are well-trained to implement these new systems. In the Partnership's 2007 report on the views of Chief Human Capital Officers, many CHCOs stressed the importance of sensitivity to employee needs and effective communication by federal managers. As one CHCO said, "Writing an effective performance review is not intuitive." These skills must be taught, and trained managers must be held accountable for implementing the system fairly. Indeed, the performance appraisal and compensation of managers should be linked directly to how successfully they are managing and communicating about performance with their subordinates.

5) *Allow performance-based pay systems time to mature before making a final evaluation.*

A January 2004 GAO report (GAO-04-83) based on an examination of pay for performance approaches at six established demonstration projects found that the pay-banded, pay for performance demonstration project started in 1980 at the Department of the Navy's China Lake Naval Weapons Center, for example, was initially favored by only 29 percent of employees. By 1998 that number had grown to 71 percent. It's clear that the process of making major changes in federal human resources systems, especially in pay and performance management, involves culture change as well as system change. Such change is inevitably slow and iterative. Attempts to implement performance-based pay in the federal government have a mixed track record, to be sure, especially in terms of employee acceptance. We note, however, that a number of the federal agencies that have been allowed to operate under alternative personnel systems have consistently been rated by their employees as among the top ranked "*Best Places to Work*."

6) *Congress must allocate resources to enable the success of pay for performance in federal agencies.*

Congress should closely monitor agencies' investments in training, development and employee compensation. Too often, training and development accounts are among the first to be cut when the fact is we need to be investing more in training and development, particularly when we are demanding more of managers and implementing a new system. It is also essential to ensure that adequate resources are in place to enable each federal agency to compensate its employees in accordance with the agency's pay for performance system.

Conclusion

In summary, we believe that movement back to the 1949-era General Schedule or a rollback of existing authorities supporting performance-based compensation would likely have greater costs than benefits. None of the alternative personnel systems have been "magic bullets," but over time most have been improvements over what existed previously and the affected organizations would be loathe to return to the previous state. The challenge, therefore, is to effectively move forward from here and ensure that pay for performance systems meet the objectives of helping to recruit, retain and motivate talent and improving employee and organizational performance.