PARTNERSHIP FOR PUBLIC SERVICE

Testimony of

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on
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Thank you, Chairwoman Davis and Members of the Subcommittee, for the invitation to testify before you today on an issue that represents perhaps the greatest remaining challenge facing the federal civil service today: reform of an inflexible and outdated federal compensation system. As President and CEO of the Partnership for Public Service, my objective and that of the Partnership itself is to help the federal government recruit and retain the highly qualified, motivated, and effective workforce that the government and the nation so very much needs. An effective compensation system is one component of a performance management strategy necessary to achieve that goal. As the Subcommittee's hearing today would indicate, the current federal compensation system does not contribute to the federal government's ability to attract and retain the best and brightest.

The Partnership suggests that the Subcommittee undertake its review of compensation reform in the context of a larger discussion about how best to give managers more flexibility to properly reward and incentivize superior performance and to effectively deal with inferior performance. As the administration has already recognized, agencies should demonstrate that they have implemented or are ready to implement improved performance management systems before additional resources are dedicated to bolstering federal compensation.

It is vitally important that government workplaces are places where initiative, superlative effort and tangible results are rewarded. The dynamics of workforce culture are, in truth, the key drivers of our government's effectiveness and productivity. At the same time, the next generation of talent that the government needs to recruit is not attracted to government jobs in part because of a serious perception problem that such jobs do not reward initiative. These perceptions pose substantial recruitment challenges that can only be overcome by sustained attention to the hard work of making sure that effort leading to results and workplace rewards (including non-monetary rewards) are closely tied.

In pursuing these goals of increased organizational effectiveness and improved recruiting competitiveness, we would urge the Subcommittee to be mindful of two essential elements of successful performance management systems. The first is an acceptance of responsibility by agency leaders, managers and supervisors for the successful implementation and administration of effective performance management systems. These issues cannot be left to HR administrators. The second key element for success is the ongoing solicitation of employee input. The failure to engage employees in the design of a performance management system is one of the critical fault lines that lead to failure. Employee input and ongoing feedback is necessary to increase "buy-in" and ensure a shared understanding between employees and managers of goals and performance measures.

We already know that most federal employees view the promotion decisions of their supervisors with great skepticism. Only 45 percent of federal employees responding to a recent Merit Systems Protection Board (MSPB) survey reported that their supervisors promote the best qualified person, and 75 percent of employees said they were not promoted because the supervisor had someone else in mind before announcing the job was open to competition. Likewise, a significant portion of federal supervisors did not think that their organization's merit promotion process allowed them to select the best-qualified applicant. When you think about the fact that promotions are already a "pay for performance" system that is deeply imbedded throughout the government workplace, then you begin to see why improving the credibility of managerial decision-making in administering reward systems within the workplace is a key challenge and opportunity facing both agency leaders and policymakers. In many ways, the system is broken. The question, therefore, is not whether it is advisable to attempt compensation reform, but how best to undertake a project of such compelling importance to the health of our government workplaces.

Almost a year ago, the U.S. Office of Personnel Management issued its white paper, "A Fresh Start for Federal Pay: The Case for Modernization," which does an excellent job of laying out the problems inherent in a pay and classification system originally developed in 1949 and which has changed little even as the federal work environment and workforce needs have changed dramatically. As OPM concludes in their white paper:

> The divergence between the Federal pay system and the broader world of work where the war for talent must be fought has led observers to call for reform of the Federal system. To support achievement of the Government's strategic goals, a new, more flexible system may be called for, one that better supports the strategic management of human capital and allows agencies to tailor their pay practices to recruit, manage, and retain the talent to accomplish their mission.

Similarly, the January 2003 report of the National Commission on the Public Service, "Urgent Business for America: Revitalizing the Federal Government for the 21st Century," took a comprehensive approach in identifying the very significant challenges facing the federal government as it struggles to keep pace with the growing demands of the modern and increasingly complex world. While the Commission made a number of sweeping recommendations dealing with the organization and leadership of government, it was quite targeted when it came to the federal government's pay and classification:

> We recommend that the General Schedule classification system be abolished….As a default system, we recommend a "broadband" system under which the 15 pay grades and salary ranges would be consolidated into six to eight broad bands with relatively wide salary ranges. Managers would be able to determine individual pay based on competence and performance. Other agencies might adopt systems with an entirely different form….we envision the development of modern personnel management approaches that afford agencies far more flexibility and responsiveness in packaging attractive job offers at the entry level, while fitting talent to task across the full spectrum of federal activity….

The General Accounting Office, in its January 2003 report, "High-Risk Series: Strategic Human Capital Management," pays particular attention to the need for effective performance management systems in the federal government, and also notes that:

> Ultimately, an effective performance management system must link pay and incentive programs to individual knowledge, skills, and contributions

> to achieve organizational results. However, this link will never be achieved without modern and effective performance management strategies. In that regard, leading organizations understand the importance of creating effective incentives and rewards for high-performing employees that place a greater emphasis on knowledge, skills, and contributions to achieving organizational results…rather than the passage of time, the rate of inflation, or geographic location, as so often is the case today.

Finally, we also find ourselves in agreement with the National President of AFGE, Mr. Bobby Harnage, when he noted in testimony on July 17, 2001, before the House Subcommittee on Oversight of Government Management, Restructuring and the District of Columbia that:

> No one engaged in the discussion over how to solve the federal government's human capital crisis disputes the fact that the pay and benefits package provided by the federal government needs improvement.

The issue then, is not whether the current method of compensating federal employees is broken, but rather what needs to be done to fix it and to ensure it supports an effective performance management system. On that point, there are considerable differences of opinion. For its part, the Partnership for Public Service is persuaded that movement towards a more performance and market-sensitive pay system is the right course of action and long overdue. I would also note that the recent release by the Office of Personnel Management of the results from their 2002 Federal Human Capital Survey also made it clear that federal employees themselves seem to agree with this assessment. For example:

- Only 39 percent of federal employees think that their work units are able to recruit people with the right skills.
- Fewer than half of all federal employees are satisfied with the recognition they receive for doing a good job.

- Similarly, fewer than half of the federal workforce believes there is any connection between job rewards and how well they do their job.

Designing a 21st Century Compensation Strategy for the Federal Government

Having established that the federal government's current compensation and classification system is in need of a major overhaul that will enable it to become more market-sensitive as well as performance-sensitive, the next logical step is development of a design strategy to achieve that goal. Fortunately, the federal government need not start from scratch in this regard. For more than 20 years, the government has been developing information about what does and doesn't work within a federal work environment through "demonstration projects" authorized by the Civil Service Reform Act of 1978 (starting with the Naval Weapons Center at China Lake) and from the experiences of federal organizations that were given special statutory flexibilities in this regard (for example, the Federal Aviation Administration, Patent and Trademark Office, and the Internal Revenue Service). There is also a large body of research from the private sector that can be adapted for the public sector.

Some clear conclusions emerge from the body of evidence that has been gathered over the last couple of decades. One is that a performance-based pay system can work in the federal government but it cannot simply be dropped into place and expected to achieve the intended results. As with any worthwhile and effective human resources management policy, program, or practice, an employee classification and compensation system that is successfully performance and market-sensitive will require concentrated effort, resources, and a long-term commitment to making it work. In addition to providing some lessons about what can work via the demonstration project authority, the Civil Service Reform Act of 1978 (CSRA) also provided an early lesson with regard to what does <u>not</u> work. This lesson was the experiment with "merit pay" that started with federal supervisors and managers at the GS-13 through 15 grade levels and which was to be gradually extended to the rest of the federal workforce.

The CSRA merit pay approach was designed as a government-wide system driven by a five-level performance appraisal process designed around a set of "elements and standards" developed for each position. Every supervisor and manager attended required training on how the system was to operate and their responsibilities for making it work. A key aspect of this merit pay system was the abolishment of "within grade increases," in favor of annual pay adjustments driven by each supervisor's and manager's annual performance appraisal The early experience with this merit pay was unsatisfactory due to funding limitations that greatly restricted the monetary differences that could be made among employees with different performance ratings and the fact that some supervisors and managers received smaller pay increases than they would have received with the same performance rating under the old system. Adjustments were made in this early attempt at a government-wide performance-sensitive pay system and it was reconfigured as the Performance Management and Recognition System (PMRS). After several years experience under the PMRS, however, the hoped for benefits still did not materialize to a sufficient degree and Congress allowed the PMRS to sunset and the covered employees were converted back to the "old" general schedule system.

What was learned from the general failure of the PMRS and the success of some "pay for performance" systems tailored for specific federal organizations under demonstration projects or via special legislation, is that a performance-sensitive pay system can work in the federal government, but that there are a number of conditions that must be present and some general principles that should be applied. In designing a 21st Century compensation strategy for the federal government, therefore, we recommend that Congress and the Administration pay particular attention to incorporation of the following principles or "success factors:"

1. Recognition that "one size does not fit all," particularly with regard to performance-sensitive pay systems. Even organizations within the same large federal department or agency can have very different cultures, missions, workforce demographics, and work or outcome measures. It's possible, perhaps even likely, that what might make sense for high level scientists and engineers in the collaborative environment of a

research laboratory is very different from the system that would be successful in a production-oriented environment such as an IRS Service Center or an SSA or VA claims processing center where there are clear quantity and quality standards in place that can be used to determine an employee's individual contribution to the mission of the organization. Any changes in the statutory framework regarding federal compensation should provide considerable flexibility that allows federal organizations to develop a customized approach tailored to the unique needs and work environment of the organization while remaining within the broad framework of the law. Evaluation of the relative success of an organization's program would be based on results achieved (e.g., productivity improvements, employee and "customer" feedback, and other outcome measures) rather than simple adherence to the mechanics of a system.

2. Federal pay should be market-sensitive. Again, this is not a one size fits all proposition. Pay must be different for different talent pools, geographies, etc. Agencies should be allowed to target critical talent and take into account what the OPM white paper calls "strategic rewards" in referring to the combination of compensation, benefits, opportunities for learning and development, and the work-environment. We are not arguing that the federal government needs to be the market leader in terms of base pay, particularly when it offers some very competitive intrinsic rewards, but neither should it be at the back of the pack. In this regard, we also note that even with the advent of some sensitivity to geographic differences via the locality wage adjustments that can be made under the Federal Employees Pay Comparability Act (FEPCA), different occupations at the same grade in the same region are paid the same regardless of local labor market conditions that may vary widely by occupation. This does not make sense.

3. Developing sufficient pay flexibility to allow the federal government to become truly an employer of choice for its fair share of the "best and brightest" in the talent pool will require flexible position classification strategies that allow federal departments and agencies the options of using more relevant systems, such as a competency-based

or “pay banding” approach to pay setting. While such systems are not “magic bullets” in the war for talent and require considerable skill and preparation on the part of an agency, such approaches have been demonstrated to be effective in attracting and retaining employees in hard to fill or “shortage category” occupations.
This will also help improve the competitiveness of pay across pay levels. It has been noted, for example, that the median salaries paid by the federal government for some hard to fill occupations, such as engineers and scientists, appear to already be competitive with the private sector. What this masks, however, is that entry-level salaries offered to new college graduates in these occupations are often significantly below those offered by the private sector. The difference is that the federal sector salary increases in the first several years of employment are often more rapid than in the private sector as employees move via career ladder promotions geared to the two-grade interval federal position classification system. Some of the most highly qualified new college graduates, however, are more likely to be enticed by starting salary than the promise of future promotion possibilities. A more flexible classification system could allow the federal government to be more competitive when it matters the most.

4. Clearly, most well-designed pay or performance management systems can be thwarted by ineffective or poorly prepared managers and supervisors. Therefore, any effective fixes to the current compensation and classification system will be largely dependent upon senior leadership and management support and “ownership.” Once given more effective tools, and training and support in using these tools, managers must be held accountable for achieving cost-effective results, i.e., they should be able to demonstrate their ability to recruit and retain motivated and productive employees who contribute to the agency’s mission.

5. An effective performance-sensitive pay system must also gain the confidence of the employees that they will be treated fairly and that their relative performance and contributions to their agency’s mission accomplishment is linked in a meaningful way to their job rewards. Federal employees and/or their representatives should be

involved in the early planning stages of any new system and throughout its implementation. Thereafter, employees should have the opportunity to provide meaningful feedback on how well the system is operating and that feedback should help drive any mid-course corrections or adjustments that are needed.

6. A performance-sensitive pay system must also clearly be driven by a performance management system that establishes credible and transparent measures of the work done or contributions made by individuals or employee teams. In any credible performance management system –
   - agency strategy must be clearly articulated;
   - leaders and managers must work with employees to identify the right individual or team goals that link their efforts to mission;
   - managers must devote appropriate time and attention to ongoing counsel and feedback and employee development;
   - managers must conduct meaningful year-end sessions with employees, including constructive feedback about their accomplishments and career-development goals; and,
   - employee feedback should be sought and used to improve the system.

7. Finally, movement to the type of performance-sensitive and market-sensitive classification and compensation system described above represents a major culture shift for most federal departments and agencies. To successfully make this leap into the 21st Century will require a long-term commitment by the government and by political and career managers. Fortunately, we already have more than 30 different federal agencies or organizations that have already experimented with various performance management approaches that seek to create a stronger link between pay and performance (see the attached chart). Two of those organizations are highlighted in the following text. There are some useful lessons to be learned from these attempts, including the fact that there are indeed viable alternatives to the unsatisfactory status quo that still exists in most federal agencies.

Two Case Studies: Bonneville Power Administration and GAO

As we have already noted, there is no "one-size-fits-all" performance management system that is appropriate for all government agencies. Each agency must have the flexibility to craft appropriate performance measures and to choose how to link organizational goals to individual job responsibilities. Within this context, there are terrific examples of agencies that have successfully implemented performance management systems that have resulted in better results for the agency mission, increased employee satisfaction and increased employee commitment.

Bonneville Power Administration

This agency within the Department of Energy markets wholesale power to 11 million customers in the Pacific Northwest. Operating much like a business, they have been self-financing since 1998 and reinvest the revenue from their power sales ($4.5 billion in 2001) in fish, wildlife and energy conservation programs. Their customer satisfaction surveys repeatedly show that they do a terrific job at delivering valuable services and stewarding a vast network of natural resources. In short, BPA is the kind of high-performing organization that government should strive to emulate.

How does such an organization manage its workforce? One of the keys to BPA's organizational success is ensuring that managers really own their responsibilities to manage effectively, including the obligation to recognize and reward performance. BPA managers sign performance management contracts that link 50 percent of leader's financial rewards to their people management skills, including communicating with employees, empowering employees, creating a community among diverse people, collaborating effectively and building workforce excellence. These contracts promote an ongoing dialogue between supervisors and employees about performance and goal achievement. BPA has worked hard to communicate with its employees about the new performance plans by holding accountability training and sessions on the plans. At the beginning of each Fiscal Year, employees meet with supervisors to negotiate what they will be responsible for producing over the course of the year. Employee performance is rated according to a "balanced scorecard," which includes measures of employee contributions to company-wide objectives. Employee responsibilities are broken down into four key categories: stakeholder, financial, internal and learning and growth.

To keep employees motivated and energized as they work toward the annual goals on their plans, BPA provides many opportunities for rewards and recognition. Although many rewards are non-monetary, BPA has made a real financial commitment to the success of its performance management system. In 1998, BPA tripled the money available for awards from 3 percent to 9 percent of base salary. While recent economic challenges have reduced the bonus pool funding, the intent of sharing rewards remains. The agency distributes awards on both an individual and a group basis, with team awards making up more than half the total amount of awards given. BPA also administers targeted development programs to give employees the skills they need to achieve their annual goals.

The results of these emphases on managerial accountability and effective employee communications have been dramatic. According to BPA's 2002 employee survey (modeled on Fortune Magazine's "Best Places to Work" survey), 72 percent of respondents agreed with the following statement: "Taking everything into account, I would say this is a great place to work." These results represented sharp increases over the 67 percent in 2001 and 57 percent in 2000 who felt BPA was a great place to work. In addition, the organization topped the list in 14 of 17 categories of OPM's organization effectiveness surveys in 2002. BPA's customers and constituents, whom the agency also surveys, have similarly registered a steady increase in customer satisfaction over this same time period. This correlation is not surprising. Committed employees produce organizational results.

General Accounting Office

The experience of the General Accounting Office under the leadership of Comptroller General David Walker provides another set of important lessons about the importance of employee engagement in developing an effective and comprehensive performance management system. In 1999, after Comptroller General Walker arrived at the GAO, he conducted GAO's first employee feedback survey, which revealed widespread dissatisfaction with GAO's performance management system and a desire for greater transparency and more consistency in the ratings process.

GAO's old performance management system was behaviorally based, meaning it focused more on activities rather than results. GAO, drawing from best practices in the private sector and Mr. Walker's own experience as a leading HR consultant, devised a new system which is competency based, flows from the agency's strategic plan and which was used to develop performance standards for employees. Significantly, focus groups of affected employees were used to determine the required competencies. This process helped achieve crucial employee buy-in for the new system, as there was 85 percent agreement among analysts on the selected competencies. As an added bonus, the new performance standards that emerged helped GAO to identify gaps in the organization's required knowledge, skills and abilities.

Successful implementation of the new system relied heavily on extensive employee communication and training. GAO developed a web-based training tool to teach employees how to use the new system. A tutorial video with simulation exercises is available twice a day on the intranet, and employees are encouraged to access the video from their desktops.

External consultants were tasked to develop a training course for managers called "Having constructive conversations about performance." The course is designed to ensure that dialogue and feedback about employee performance and business results are continuous. Most importantly, the agency has focused on educating managers about the difference between performance management and simply filling out a performance appraisal form.

GAO does not claim to have the perfect system yet, but as they continue to adjust and fine-tune based on experience, results and employee feedback, they are clearly moving in the right direction. These important steps augur well for GAO's prospects in transitioning to a performance management system that effectively links individual performance to organizational goals. Congress would be well-served by keeping the

Comptroller General's model in mind as it undertakes to craft a set of guidelines that will allow the rest of government to follow suit.

OPM's Proposed Human Capital Performance Fund and SES Pay for Performance

Having identified several "success factors" that will determine the degree to which federal compensation reform, and in particular pay-for-performance initiatives, will succeed, I will now turn to the two proposals recently put forth by the Administration: an SES Pay for Performance proposal and the establishment of a Human Capital Performance Fund. The former would significantly expand the pay range for federal senior executives and provide some much needed relief from the effects of pay compression. The SES proposal would also give federal agencies significantly more flexibility to set pay within the new and broader pay range and would seek to more closely link any annual adjustments within that range to the performance of each executive and the results they achieved. The proposed Human Capital Performance Fund would, for the first time, provide a relatively substantial amount of funding to be used to adjust the base pay of employees based solely on individual or group performance and contributions to the agency.

We applaud the intent behind both proposals to provide additional pay-setting flexibility to federal agencies to develop a closer link than currently exists between base pay and the performance and contributions of the individual or executive. These are clearly steps in the right direction with regard to systems design. We also recognize, of course, that the details regarding how these legislative proposals—if passed—are implemented and funded will determine whether the hoped for benefits are realized and whether any unintended negative effects are avoided or minimized. In that regard, we offer a few more specific observations on each proposal as follows:

<u>SES Pay for Performance:</u>

If the federal government is going to take pay reform seriously and move to a more market and performance-sensitive compensation system, the Senior Executive Service is the right place to start. If we are going to attempt to do a better job of holding employees accountable for results that matter and recognizing those who do an especially good job of achieving those results, it sends the right message to the rest of the workforce to start at the top. Further, the federal government's ability to recruit and retain highly qualified senior executives in any number of critical jobs has clearly suffered as a result of pay compression and the inability within the existing system to adequately reward in any ongoing manner the truly stellar performers. Also, the fact that at least 7 out of every 10 senior executives will be eligible to retire within the next five years makes it even more imperative for the federal government to develop additional tools for agency leaders to use on a targeted basis to attract or retain critical talent in the SES. We think this proposal deserves serious consideration and implementation in at least some form.

Our endorsement is based on a deeply help belief that federal executives should be assessed and compensated based upon their success in meeting organizational and managerial objectives under the Government Performance and Results Act and the President's Management Agenda. We have an opportunity with this legislation to revise existing performance appraisal systems from the current process-oriented, subjective assessments that are still too common to an approach which articulates and measures objective benchmarks for the accomplishment of organizational and managerial goals.

A hallmark of a true pay for performance system for the SES, therefore, will be its ability to provide a transparent and credible means for making meaningful distinctions among executives regarding pay adjustments based on their accomplishments and contributions. Correspondingly, a challenge for that system will be its ability to make those distinctions without de-motivating executives who also had success in achieving their objectives but perhaps not as much success as some others experiencing a truly banner year. In this regard, we would recommend that the focus remain on measurable outcomes and achievements (and appropriate differential pay adjustments based on those outcomes) with less emphasis placed on the assignment of individuals to performance categories. To be sure, we expect federal senior executives, as a group, to be high performers and to regard themselves as members of a senior leadership team. While OPM will logically take the lead in the design and implementation of this system, they will also need to work closely with federal agencies and executives and the Senior Executive Association.

Human Capital Performance Fund:

As with the SES proposal, flexibility to recognize high performing federal employees is an essential component in the federal government's effort to recruit and retain quality staff. The administration's proposal can enable federal managers to differentiate and reward performance and make a significant dent in addressing the factual basis underlying current perceptions that pay and rewards are not linked to performance accomplishments. A significant challenge here will be to ensure that the human capital performance fund does not become a substitute for adequate funding of the federal compensation and performance management systems. To succeed and to have credibility among employees, the fund should be a method of making pay adjustments under a fully-funded and market-sensitive compensation system. The federal workforce is too important and the demands being made upon government are too great to do otherwise.

Finally, the legislation calls upon OPM to manage this fund and allocate monies to agencies based upon OPM's review and approval of a plan submitted by each agency outlining how they intend to use the share of the fund. While guidance and oversight by OPM each agency's plans for and use of the fund helps to provide some assurance that the funds will be used appropriately, serious consideration should be given in the out years to allowing an agency with an established track record of success in this regard to receive funding directly through the appropriation process rather than through OPM. OPM, however, should continue to have general oversight responsibility as it does now for other federal HR programs.

Madam Chairwoman and Members of the Subcommittee, I want to again thank you for allowing me to share with you the perspectives of the Partnership for Public Service on these issues that are so important to the future of the federal workforce. We would be happy to assist the Subcommittee in any way we can as you seek to ensure that the federal government has the world-class, highly motivated workforce that it needs for the challenges that lie ahead. I would be happy to answer any questions you may have.