Testimony of
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Committee on Government reform
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Chairman Davis and members of the Subcommittee, thank you for the opportunity to testify today on the matter of compensation reform for federal employees. My name is George Nesterczuk and I am President of Nesterczuk and Associates, a management consulting firm located in Vienna, VA.

It is my understanding that the Subcommittee is giving serious consideration to proposing changes this session in the way federal employees are compensated. This is a rather broad topic and it contains a number of complex facets. I will limit my testimony to the pay component of compensation and more specifically to the white-collar pay systems captured by the General Schedule and the Senior Executive Service.

Let me begin with a fairly safe statement – dissatisfaction with federal pay has been a long standing irritant at all levels of the federal workforce. Federal pay is tied to a highly structured position classification system that is deemed by many critics to be too rigid and that attempts to be all things to all people, i.e. a “one size fits all” system. The combination of this classification system together with pay tables structured for longevity results in a pay system viewed as not sufficiently competitive at entry and that quickly stagnates at mid career. Presumably, despite the criticism, federal compensation (pay plus benefits) meets some employee expectations or else agencies would face periodic depopulation of their workforces.

Brief Historical Perspective

The pay system of today has its roots back in the 1940s and 1950s. The workforce in those years was much more clerical and administrative with a contingent of technicians and far fewer professionals than today. There was also a large contingent of blue-collar workers. Employees came in at entry level and could count on lifetime employment with careers spanning 30 to 40 years. The 10 steps of each of the 15 grades of the General Schedule were well suited to the career progressions of the dominant occupations of those earlier periods. Similarly the comparable grade and step structure of the Wage Grade Schedule fit the blue-collar workforce as well.

The missions and workloads of federal agencies today have evolved dramatically from those earlier days, as have the means by which work is accomplished. Automation and information technology have revolutionized the work place. They have also permitted enterprises to focus on core competencies and outsource supporting activities. Today’s labor force is more mobile and career progression in many fields is characterized by frequent job changes. Lifetime employment with one employer is no longer the norm and mid career changes are more common than rare.

During this period of radical change in the labor force and in the workplace many government management systems have lagged significantly behind. Counted among the laggards is the federal pay system.

Differentiation of Pay Systems Already Exists

Some differentiation of pay systems does already exist. The Executive Schedule attempts to deal with pay at the highest management levels of federal agencies and Cabinet departments. Congressional pay is linked to Level II of this pay schedule. Judicial pay was also linked to the Executive Schedule until it was severed during the 1980s. Legislative branch and judicial branch employees have their own separate pay schedules. Separate schedules have been established for the Foreign Service and the Public Health Service.

Early on, the General Schedule was extended beyond grade 15 to include "super grades" GS 16 to GS 18 as a recognition of the growing complexity of jobs in the federal sector. These were later converted to the Senior Executive Service (SES) with the passage of the Civil Service Reform Act of 1978. The SES pay system consists of 6 levels, the first being 120% of GS 15 step 1 and the highest pegged to Level IV of the Executive Schedule (EX IV). In recent years locality pay has been extended to apply to the SES and locality adjusted SES pay is now capped at EX III.

To this day the General Schedule still accounts for the largest share of the government's nearly $120 billion annual payroll and covers nearly 1.8 million part time and full time employees spread across more than 400 different occupations.

Recent Trends

Contemporary criticism of the General Schedule ranges from the dubious 30% underpayment "compared to" private sector salaries to the uncompetitive pay set at entry levels. Criticisms of the system include that it is too inflexible to reward or motivate outstanding performers, that it does not allow for accelerated career paths for some high tech or high demand occupations, that pay at the managerial levels is too low, and that pay compression at the top is created by the higher SES and EX pay levels. Some of the criticism is well founded though many problems could be mitigated using flexibilities allowed under existing civil service rules.

Nevertheless many agencies have turned to their authorizing committees over the past twenty years to seek relief from perceived pay constraints. In 1986 the financial regulatory agencies were given authority to establish separate pay systems outside of Title 5 USC in order to remain competitive with the institutions they were regulating. Soon the top pay scales in these agencies exceeded their counterparts in the civil service by 30% to 50%. Recently, the Securities and Exchange Commission used similar arguments concerning its inability to hire and retain lawyers, accountants, and securities specialists to gain its own authority to establish an independent pay system.

In 1996 the FAA was removed from coverage under Title 5 USC and within two years air traffic controllers negotiated a three-year contract providing for salary increases of up to 30%. The IRS followed in 1998 with a reform bill that allowed the agency to establish a banded pay system and permitted the creation of up to ten highly paid positions supplemented by a performance bonus of up to 50% of salary. The Transportation Safety Administration was next in 2001 with full authority to establish an independent pay system, followed most recently by the creation of the Department of Homeland Security holding similar pay authority. Other examples exist and additional agencies are even now submitting requests for legislative exemptions to the current pay system.

The trend seems rather clear. In the absence of government wide pay reform agencies will continue to address this problem on a piecemeal basis.

What About Performance?

But what of performance, as in “pay for performance”? In the federal workplace pay and performance are addressed as two completely divorced concepts. Annual pay increases based on ECI are provided as automatic adjustments to the pay scales. Additional longevity pay increases of one pay step (approximately 3% of pay) are awarded annually, bi-annually, or every three years depending on how far along in grade the employee has progressed. Denial of a longevity increase is subject to appeal and thus they are considered automatic and very rarely denied.

With up to two increases per year, pay is viewed as an entitlement independent of an individual’s performance. Performance is associated with behavior that may be rewarded with additional pay if the boss likes you. That kind of cynical view among federal employees has grown over time in the absence of any credible performance management or performance measuring system. With inflated performance reviews resulting in 80% to 90% of employees being rated as performing above average, it is not surprising that fellow employees wonder what criteria were used to determine who among them is to receive performance awards. The lack of transparency seriously undermines the credibility of current performance recognition procedures.

Furthermore, if an employee can receive a 6% to 7% pay increase annually (3% annual inflation adjustment plus 3.3% step increase plus 0.5% to 1.5% locality increase) without putting out special effort then a 1% or 2% performance bonus will not seem terribly significant. Performance bonuses must be comparable to or greater than annual pay adjustments if they are to be meaningful.

In spite of the cynicism, a large number of performance recognition programs and activities are in place across the federal government. The largest and most visible are the annual SES bonuses, ranging from 5% to 20% of salary, and the Presidential Rank awards to Senior Executives (35% of salary for Distinguished Executives and 20% of salary for Meritorious.) For employees below the SES agencies use incentive awards, and special act cash awards to recognize individual accomplishments. These awards typically range from a few hundred dollars to a few thousand. Agency heads can authorize up to ten thousand dollars for an individual award while the Director of OPM can approve awards of up to $25,000. Awards in excess of $10,000 are very rarely proposed. In addition to cash awards agency performance recognition programs utilize large numbers of non-cash awards. All of these focus on special accomplishments rather than sustained performance and do not affect base pay determinations nor benefits based on base pay.

Performance -- Recent History

After a significant effort to strengthen performance management and link pay and performance in the 1980s, the last ten years witnessed a significant erosion and decline. The merit pay system that had been established following passage of the Civil Service Reform Act was allowed to languish until finally repealed in 1993. The GM system was a pay for performance system for GS 13-15 managers and employees. Steps in those grades were abolished to permit more rapid movement at grade based on individual performance. A pool consisting of a fixed percentage of GM payrolls was used to pay performance bonuses as well. The system operated like a pay banded system though the bands were very narrow (1 grade bands).

The GM system covered over 130,000 employees. Those that advanced quickly through their grade were pleased with the system. Those that did not constantly compared their progress with the step they would have achieved had they remained in a GS system. Over time the grumbles of the lesser performers exceeded the cheers of the high performers and the system was abolished. There are important lessons to be learned in the demise of the GM system about managing expectations in any pay for performance system.

By 1998 performance management in federal agencies was in full retreat. OPM regulated performance expectations downward by permitting agencies to place their employees into two level performance evaluation systems, i.e. pass-fail systems. By the year 2000 hundreds of thousands of federal employees had been moved from multilevel rating systems to the greatly simplified pass-fail ratings. Notable among federal agencies to move to “pass-fail” were the Social Security Administration and the Department of the Navy. While administration of “pass-fail” systems is indisputably easier than multi-level rating systems one must wonder how management at these agencies could undertake the task of making meaningful distinctions among employees for purposes of making awards or establishing pay. Unless of course the distinctions are based on non-performance factors such as say height, weight, color of hair, age, or the old standbys of seniority and personality.

What are the Options for Pay Reform?

A necessary condition for pay for performance is the existence of a robust performance management and recognition system. In the absence of meaningful distinctions in performance among employees a perception is created that decisions are based on cronyism. Employees need to have confidence that performance evaluation systems will be transparent and administered fairly. Managers must be held accountable for making performance management systems work and not be rewarded for making them fail.

Pay Banding -- The preferred pay reform now appears to be pay banding. Pay banding was recently recommended by the National Commission on Public Service in its final report as the means to reforming the federal pay system. It offers the benefit of simplifying the classification requirements attendant to pay setting and in it's simplest form reduces the fifteen grades and ten steps of the General Schedule to four or five overlapping bands providing a continuum of salary options. It also provides the added benefit of resolving the entry level pay problems facing recruiters, it allows fast tracking for high performing employees, and it eliminates the mid career plateau by permitting a continuum of pay increases throughout each band.

Care must be taken however to manage the overall payroll since experience has shown that pay banded populations tend to drift to the top of the band over time producing payroll inflation. Early demonstrations resulted in 20% payroll inflation of banded systems after just four years of implementation. Furthermore, for pay-banded systems to be fully effective, the setting of pay at the bottoms and tops of each band must reflect labor market realities. Currently pay bands are tied to specific GS grade levels. These in turn are set by employment surveys without regard to turnover statistics (accessions, separations) or recruitment experience (applicant to vacancy ratios, qualified applicants to hires ratios) among federal agencies. Thus all of the shortcomings of "pay comparability" surveys are mapped into the pay bands from the outset.

SES Pay Band – The Administration in its 2004 Budget Proposal included a provision to consolidate the current 6 pay levels of the SES into one band. The lower level would be set at 120% of GS 15 step 1 and the top would be rise to EX II (currently $154,700). The proposed increase in top pay for senior executives will alleviate some of the compression sustained by 60% of today's senior executives at the current top of the pay scale (EX III). This recurrent problem of SES pay compression will persist as long as Congressional pay is tied to the Executive Schedule. Pay compression at the top ultimately radiates down to affect the top of the General Schedule. Eventually it creates a crisis in retention among the most senior employees. A periodic resetting of the top of the SES band as proposed by the Administration is a reasonable short-term fix to this problem.

Human Capital Performance Fund – The Administration has also proposed a hybrid pay for performance system for General Schedule employees. The Administration proposes to set aside $500 million dollars (about 0.5% of payroll) to be made available as additional pay for high performing individuals. The award would be based on an employees actual performance and the amount added to base pay as a performance based pay increase. The amount would be treated as basic pay for purpose of retirement and benefit calculations. The fund would be administered by OPM but would be available to agencies that establish performance management systems that permit meaningful distinctions in relative performance among employees. Since the fund is administered by OPM, agency employees will know that the funding will be there and will not be cut to accommodate other agency needs.

Although modest in size, the Fund should serve as an excellent inducement to reverse the trend back to meaningful performance management at federal agencies. Performance systems that make meaningful distinctions among relative performance are a necessary precursor to participation in the OPM administered program. Based on subsequent experience the scope of the Performance Fund can be expanded.

"Superior Pay" – A number of agencies in recent years have been granted special authority to create positions compensated at $150,000 or higher, what I have called "superior pay". In effect the pay was set higher than Congressional pay but lower than the cabinet Secretary level. The number of such positions has been restricted to 10 or 20 in any given agency. This practice should be continued, keeping controls on the overall number of such positions, as a means of relieving the serious pay compression that periodically sets in at the senior levels of government as the result of linkages to Congressional pay. By creating these pressure valves throughout government Congress establishes needed precedents to lay a foundation to subsequently raise pay ceilings. One alternative to consider is to grant OPM statutory authority to establish these positions on an as needed basis. OPM could manage a government wide pool of perhaps 250 to 300 such positions and move them around agencies based on agency justifications.

Conclusion

Let me conclude by summarizing some key points. First, it is clear from the trend of the past fifteen years that federal agencies are seeking ways around Title 5 USC pay constraints. The pay system needs to be reformed either centrally or reforms will be achieved piecemeal. Based on past experience the top of the pay scale is likely to rise and individual pay levels will rise with it thereby inflating the overall payroll.

It will therefore be important to channel growth in pay in directions that produce the most return to the government and taxpayers. The growth should be channeled in the direction of performing employees. Federal agencies seeking authority to reform pay should therefore be required to institute robust performance management systems that produce meaningful distinctions in relative performance among employees.

Pay banding has proven to be a well received alternative to the current General Schedule but it must be carefully administered to avoid unnecessary payroll inflation. Rather than move to a sweeping government wide reform, agencies should be provided authority through OPM to implement pay banded reforms on their own timetables and suited to their specific workforce and mix of occupations.

Pay compression at senior levels is a recurring problem that is largely created by linkages of pay to the Executive Schedule. It is aggravated during periods when Congress is reluctant to vote itself a pay raise. The Administration proposal to move the SES into a single banded system capped at EXII of the Executive Schedule is a sound proposal.

Consideration should also be given to establishing a small pool of highly compensated positions to be managed by OPM to relieve pay pressures at the top of the pay scale.

That concludes my remarks and I would be happy to respond to any questions that you might have.