

NEW PAY-FOR-PERFORMANCE SYSTEMS STRUGGLE WITH THE ADMINISTRATION'S PROVIDING NO NEW REGULAR FUNDING, SYSTEMIC DISCRIMINATION RISKS, AND (UNDERSTANDABLE) LACK OF ACCEPTANCE BY CIVIL SERVANTS

- I. Executive Summary
- II. Overview of Costs and Impacts From: No New Funding, Systemic Discrimination Risks, and Lack of Acceptance
- III. NSPS at DoD
- IV. HCOP at DHS
- V. IRS, IC, TSA and Other Agencies

I. Executive Summary

Thank you for the opportunity to testify on the subject of the new pay-for-performance, personnel systems at the Departments of Defense (DoD), Homeland Security (DHS), and elsewhere.

In the past year, these pay-for-performance systems had serious costs and impacts. First, they have systemic discrimination risks because evaluative ratings, unlike objective government-wide pay increases, are vulnerable to supervisors' stereotyping, attitudes, and communications issues. On September 4, a ruling in an agency-wide grievance arbitration found systemic age and race discrimination among thousands of SEC employees – from universal factors applicable to the other agencies. I recommend this Subcommittee commission a multiple agency study by GAO's Strategic Issues office on minority and age discrimination in several different pay-for-performance systems. Second, the Administration's "no new regular funding" basis, which depends upon diverting funds for government-wide pay increases, has diminished employee acceptance.

Looking at specific agencies, NSPS drew extensive criticism leading to Congress's reducing the diversion of funding to just 40% of the general pay increase. DoD used, for its January raises, a set of distortedly "spun" figures. It inflated these by lumping in non-pay bonuses; translating identical ratings into different raises by nontransparent and somewhat arbitrary methods; and, apparently by tapping irregular fund sources.

MaxHR/HCOP effectively stopped. The IRS IG reviewed the rollout for managers and found, scathingly, "the IRS risks reducing the ability to provide quality service to taxpayers." And, the Intelligence Community's nascent program elicited a skeptical and critical Congressional oversight provision. An OPM December 2007 study conveniently pretended not to notice all the criticism.

The conclusion recommends a GAO study of minority (including age) statistics, making aggregate figures available, and a freeze on further rollout for further evaluation.

Introduction

Thank you for the opportunity to testify on the subject of the new personnel systems, principally pay-for-performance, at the Departments of Defense (DoD), Homeland Security (DHS), and elsewhere. The past year has witnessed the juggernaut of the rollout of these systems lurching on, lacking the resources, transparency, and employee acceptability to avoid large-scale failure. There is no more vital and controversial subject in federal human resources management. Only this Subcommittee can tackle the issue, as it needs to be tackled – government-wide, across the board, taking a broad view of the developments, costs and impacts, and serving particularly as an early warning system for the alarming risks of systemic discrimination in federal pay.

I am Professor of Law at the University of Baltimore Law School since 1995, and the author of a number of pertinent law review and journal studies, and book sections, on federal personnel and related procurement policy, besides testifying in 2003 (Senate) and 2006-2007 (House) about prior stages of these personnel systems.¹

II. Overview of Costs and Impacts From: No New Funding, Systemic Discrimination Risks, and Lack of Acceptance

For this testimony, I have reviewed a number of scholarly and survey studies, and journalistic accounts of new personnel systems. Some of the most relevant ones are cited in footnotes below, including some notably high-quality journalistic reports.

A. Discrimination

Background

Let me briefly summarize the recent history of discrimination risks in general as to federal personnel, before turning to the new pay-for-performance systems in particular. On the one hand, the record of federal personnel policy includes some positives, particularly race-neutral or diversity initiatives.² In general, some personnel policies of the Civil Service, like the GS step-scale for pay raises, functioned either automatically, or otherwise without excess vulnerability to supervisors' subjective stereotyping and attitudes. These policies sometimes furnished minorities with more of a chance of fair

¹ These include sections about personnel in CHARLES TIEFER & WILLIAM A. SHOOK, *GOVERNMENT CONTRACT LAW: CASES AND MATERIALS* (Carolina Academic Press 2d edition 2004 & Supp. 2006). In 1984-1995 I was Solicitor and General Counsel (Acting) of the U.S. House of Representatives, and participated in numerous oversight investigations of federal personnel and procurement policy. I testified on such issues in 2003 before a Senate Government Operations subcommittee, in 2006 before a House Homeland Security subcommittee, and in 2007 before this Subcommittee. I wish to thank Michelle Reichlin, a second-year student of the University of Baltimore Law School, for her major research contributions.

² During the era of Jim Crow, some agencies of the federal government, including the postal service, functioned in some parts of the country as the one substantial employer giving even a semblance of fair employment to minorities. President Truman's Executive Order 9981 in 1948 to desegregate the Armed Forces stands as one of the great historic landmarks in equal opportunity. But the full background has more negatives than positives. See Desmond King, *Separate and Unequal, Black Americans and the US Federal Government* (1995).

treatment in some government departments than in backward parts of the private sector.³ For example, as to simple numbers of hiring (apart from job level), Professor Naff's leading work on the subject noted, "with the exception of Latinos, people of color held proportionately more jobs in the federal civil service than they do in the civilian labor force."⁴

On the other hand, the recent record of federal personnel policy includes disappointing negatives. These center upon aspects with vulnerabilities to supervisors' subjective stereotyping and attitudes. Promotion, which depends upon supervisors' subjective evaluations, is a particular sore point. Minorities "remain underrepresented in the upper grades. . . . although 1.2 percent of Euro-Americans can be found in senior pay jobs, only about one-half of 1 percent of African Americans . . . [and other minorities] can be found at that level."⁵ Numerous studies, including Congressional hearings, found a "glass ceiling" for women and minorities in the government. The explanation: "stereotyping can have a powerful, if surreptitious, impact, including their prospects for advancement."⁶ The same negatives are found in discipline, including discharge, compounded by problems of inadequate communication particularly across racial lines.

As I will note below, the Subcommittee on the Federal Workforce has been commendably developing a record on this subject. Working with GAO's Strategic Issues office, it has gathered government-wide statistics on federal minority employment. This is real progress. This kind of analysis should be extended to pay-for-performance.

The Ruling on Discrimination in SEC Pay-for-Performance, and Its Implications

With that background, we see the systemic discrimination risks in the Administration's pay-for-performance systems. The existing Civil Service GS system distributes the main components of raises neutrally by objective measures, such as by government-wide pay comparability percentage raises. In contrast, under the new pay-for-performance systems, women and minorities lose these objective measures. They receive their pay raises in the same ways as they receive personnel actions, like promotion and discipline, known to have statistical patterns reflecting systemic discrimination risks. That is, minorities receive pay-for-performance evaluative ratings and raises based on their superiors' subjective evaluations. Moreover, those ratings often suffer from inadequate communication, particularly found across racial lines.

Unfortunately, this past year showed the strength of these reasons for concern about systemic discrimination risks in pay-for-performance. A very dramatic ruling occurred in the past year as to the impacts of pay-for-performance: the ruling on September 4 in an agency-wide grievance arbitration that the Securities and Exchange Commission (SEC) discriminated in pay-for-performance merit pay. That SEC ruling found systemic age and race discrimination among the thousands of SEC employees in the proceeding. That was not just a systemic risk of discrimination; **that ruling found**

³ For an overview, see *Equal Employment Opportunity: The Policy Framework in the Federal Workplace and the Roles of EEOC and OPM*, GAO-05-195 (April 2005).

⁴ Katherine C. Naff, *To Look Like America: Dismantling Barriers for Women and Minorities in Government* (2001), at 84-85. Professor Naff teaches in the department of public administration at San Francisco State University.

⁵ *Id.* at 85.

⁶ *Id.* at 971

actual, agency-wide discrimination against thousands of employees in pay-for-performance.

The SEC had implemented the pay-for-performance system in 2002-2003, the NTEU filed a grievance, and the arbitrator made findings about the extensive statistical evidence. As Stephen Barr of the Washington Post reported, the Arbitrator's ruling "found the SEC pay system led to discrimination against 324 black employees and 1,109 employees who were 40 or older."⁷ GovExec summed up the ruling's findings about race and age bias:⁸

A statistical analysis performed for the union showed that only 16 percent of African-American SEC employees received raises of three steps, while 30 percent of white employees received those maximum raises. Ten percent of African-American employees received no merit-based pay increase, compared to only 6 percent of white employees.

That analysis also revealed that while half of SEC employees were 40 or older, 67 percent of the employees who received no merit-based pay increase fell into that age range, and those older employees received only 45 percent of the three step increases.

Other agencies, from DoD to DHS, will try to duck the distressing implications of the SEC discrimination ruling, namely, that the Administration's pay-for-performance systems are at high risk for systemic discrimination just like what that ruling found agency-wide at the SEC. Let me note something here that I will mention several times. In December 2007, the Office of Personnel Management (OPM) released a so-called "status report" on pay-for-performance.⁹ Some snippets of useful inside information came out, which will be noted where germane. However, the OPM Status Report's nonstop happy-talk rather conveniently omits to mention all the other studies that disconfirm OPM's self-congratulation about pay-for-performance. The SEC is a striking example. The arbitrator's agency-wide ruling about systemic discrimination received major play in the Washington Post, GovExec, BNA, and almost everywhere else covering the personnel world – except in the OPM report's section on the SEC, which does not have a word of discussion (p.29). Discussing the SEC without mentioning the discrimination ruling is like discussing the cruise of the *Titanic* without mentioning the iceberg.

I closely reviewed the arbitrator's extensive ruling, and am struck by how universally the underlying factors apply generally to the Administration's pay for performance proposals. For example, other agencies from DoD to DHS will want to contend that they set up a "neutral" system, that their officers would have the opposite of intent to discriminate, and that there is no evidence they will intend to discriminate. But, the ruling found this, too, at the SEC, and yet the ruling's statistics showed rampant age and race discrimination. The SEC, too, set up a "neutral" system; at the SEC, too, there was no evidence presented that their officers had conscious intent to discriminate; at the

⁷ Stephen Barr, *Bias Found in SEC Pay System*, Wash. Post, Sept. 6, 2007.

⁸ Alyssa Rosenberg, *Arbitrator Rules Against SEC Pay for Performance System*, GovExec, Sept. 7, 2007.

⁹ Office of Personnel Management, *Alternative Personnel Systems in the Federal Government: A Status Report on Demonstration Projects and Other Performance-Based Pay Systems* (Dec. 2007).

SEC, too, the agency maintained that the combination of lack of managerial intent to discriminate, plus a “neutral” rating system, prevented systemic discrimination.

However, the hard statistical agency-wide evidence as to the SEC showed, as similar evidence is only too likely to show, about the IRS, NSPS and so on – and possibly even about the SES, the apex of the personnel system -- that in practice the awarding of pay-for-performance raises discriminated along age and race lines. At the SEC, as similarly would be seen about other government agencies, it “was implemented without providing adequate guidelines to employees and supervisors, and was executed in a haphazard and inconsistent fashion across the agency.” At the SEC, as similarly would be seen about NSPS and so on, the criteria for pay-for-performance left room for loose subjective evaluation (e.g., whether employees “collaborate with others”), a wide opening for discriminatory stereotyping, diversity-disparaging, and similar patterns of discriminatory evaluation. And, at the SEC, as in the NSPS and so on, the pay-for-performance system’s “encouragement” of disregarding seniority – and experience – in evaluations can readily morph into a not-too-subtle way of withholding raises from older employees, tantamount to illegal age discrimination.

The problems analyzed by Professor Naff with both stereotyping and inadequate communication throughout the federal government as the source of discrimination apply with great force to pay for performance. Counterbalance was not built in at the SEC, and similarly not built in at the other agencies from DHS to NSPS. That is, there was no positively accounting for the value of experience and diversity to counterbalance age and race stereotyping. Above all, NSPS and similar systems lack the kind of transparency and accountability that would check the all-too-easy lapses into discriminatory patterns, and facilitate corrective action when they occur.

Recommendation: GAO’s Strategic Issues Office Should Do a Follow Up Study on Minority Pay-for-Performance Statistics

In light of the ruling about agency-wide pay-for-performance age and race discrimination, there is a vitally necessary study for this Subcommittee to task the GAO to do. This Subcommittee should commission a multiple agency study on the cross-cutting human capital issue of minority and age discrimination statistics in several different pay-for-performance systems.

Let me note some background. This Subcommittee has already commissioned, and received, several excellent studies by the GAO Strategic Issues offices on minority statistics in different agencies. I have carefully reviewed two May 2007 GAO Strategic Issues office studies: *Data on Hispanic Representation in the Federal Workforce*;¹⁰ and, *Human Capital: Diversity in the Federal SES and the Senior Levels of the U.S. Postal Service*.¹¹

These GAO Strategic Issues office studies for this Subcommittee show the tremendous value of multiple agency studies on minority statistics. On the technical level, they utilize the invaluable resource of analysis of the Office of Personnel Management’s (OPM) Central Personnel Data File (CPDF). GAO has years of experience validating and utilizing the CPDF database. The value of CPDF statistical studies is beyond question. On the substantive level, these studies show the kind of

¹⁰ GAO-07-493R.

¹¹ GAO-07-838T.

unarguable statistical conclusions that put policy debates about minorities on a sound framework. For example, look what we see with one glance at the government-wide tables on SES women and minorities statistics, overall (Table 1), and then broken out by 24 agencies (Table 2):

Which (in Sept. 2006)	SES numbers	% Women	% Minorities
Government-wide	6,110	28.4	15.9
Dept' of Defense	1,133	21.0	8.0

In other words, DoD has only *half* the level of minorities in its SES than is found government-wide. Moreover, these particular government-wide numbers include DoD. So the situation, bluntly, is that it takes just about all the other government agencies put together, to have enough minorities in their total SES, to counter-balance the very low levels of minorities in DoD SES and produce the government-wide figure of 15.9%. Put another way, DoD alone sets back the entire government effort to have an SES like that civilian work force. This strongly suggests the need for other DoD personnel treatment, such as pay-for-performance, to receive similar statistical evaluation.

GAO may, or may not, have to analyze a great deal of data beyond the CPDF to study the pay-for-performance minority (including age) statistics, depending on what there is and what GAO does. But, even if it has to go beyond the CPDF, the task is feasible. In January 2004, the GAO Strategic Issues office did a multi-agency analysis of pay-for-performance. *Human Capital: Implementing Pay for Performance at Selected Personnel Demonstration Projects* (Jan. 2004).¹² The key data included “rating and payout data, cost data, [and] rating distribution data from OPM’s Central Personnel Data File (CPDF). . . .”¹³ Among the multiple systems to examine, one of the most important is the SES one, because it is at the apex of the federal personnel structure. For GAO Statistic Issues office, this study would utilize the analytic approach found in its SES minorities study and its pay-for-performance study. For other agencies, such as NSPS and the systems for IRS managers or DHS or both, it would utilize similar data.

One of the most important questions for the GAO to analyze is the minority (including age) statistics on which employees receive the largest raises – the limited number of employees receiving a top evaluation. Recall that the SEC ruling made the key finding that whites were receiving those top evaluations and top raises disproportionately often compared to minorities. Since the bulk of NSPS employees (as discussed below) receive the mid-level “3” rating, the key question is whether some groups are disfavored in receiving the high ratings. That would raise the question of whether there is a prima facie case of discrimination along the lines found in the SEC ruling.

B. Employee Non-Acceptance, Driven By “No New Funding”

As I have testified before, a pay-for-performance system has little chance for success in the face of intense employee non-acceptance. New studies this past year

¹² GAO-04-83. One of the two co-requestors was the chair of the Subcommittee on Civil Service and Agency Organization (Rep. Jo Ann Davis). The other was the Senate counterpart.

¹³ *Id.* at 41.

confirmed this. The IBM Center's report, written by Professor James R. Thompson,¹⁴ noted the following:

Gain and Ensure Employee Acceptance

. . . . Employees inevitably compare features of the new system to the old. In the federal context, the "old" is represented by the GS. . . .

The pay-for-performance element of most payband systems is, at least on its face, disadvantageous to employees to the extent that pay increases that historically have been automatic now become contingent. Agencies moving to paybanding have often had to overcome resistance In attempting to gain employee acceptance, many agencies have incorporated features that emulate those of the GS. For example, GS employees generally receive a yearly general pay increase, called the "comparability increase" Most of the systems reviewed here continue to grant the general pay increase to the vast majority of their employees consistent with GS practice. [As for the] . . . general pay increase monies be[ing] included in the pay pool and distributed on the basis of performance [I]t would be harder to gain employee acceptance of such a practice given the inevitable comparison with GS employees.¹⁵

Although leaving the Congressionally-provided automatic comparability general pay increase alone, and obtaining new funding, is thus a common feature of even the half-successful federal pay-for-performance systems, and experts warned about it being "harder to gain employee acceptance" if tinkered with, that is precisely how the Administration funded NSPS.

To the extent that NSPS drew on funding other than diversion of the government-wide pay increases, it has spelled out nothing publicly. Moreover, to the extent it drew on such funding, it may have drawn on temporary irregular sources not dependable in future years (i.e., temporary slack in the system, such as pay for positions that remain vacant). That is a special "one-time introductory funding" finagle that sugar-coats the introduction of NSPS but insures a later let-down when the temporary irregular funding stops. Since, in terms of a stable basis for future operation, NSPS has not obtained expressly-dedicated, stable new funding, for pertinent purposes, this testimony speaks simply of a "no new funding" basis.

Predictably, nothing has so surely and intensely diminished employee acceptance of the Administration's pay-for-performance systems as the Administration's rollout of those systems without new funding for performance-rated raises. This requires an explanation, for which NSPS provides the biggest example.

DoD refused to make NSPS's rollout depend on new funding for performance-rated raises. Rather, the rollout occurs without new separate funding for performance-rated raises. Instead, DoD wrests away a portion of the Congressional appropriation provided to be distributed automatically government-wide by the even-handed, neutral formulas of the GS, and diverts that for NSPS-manipulated distribution as pay-for-performance raises. In other words, employees who would automatically get the

¹⁴ James R. Thompson, *Designing and Implementing Performance-Oriented Payband Systems* (IBM Center for the Business of Government 2007).

¹⁵ *Id.* at 16 (underlining added).

Congressional-formula pay raise, most of which simply keeps their pay from shrinking in real terms due to inflation, do not get the raise and see their real pay shrink. Employees who get NSPS-manipulated distribution may not get more than they would by automatic formulae. Such employees may do no more than break even and avoid an inflationary reduction in real pay.

This “no new funding” method is perhaps the single biggest downside of NSPS, for the reduction of pay, in real terms, to a large percentage of employees sharply depresses its already limited acceptability. In any event, in 2007 DoD kept insisting on a high percentage – 50% -- of the pertinent automatic government-wide pay raises would get diverted to NSPS. As described below, employee labor organization efforts and Congressional oversight got this changed to the compromise figure of 40% diversion to NSPS and 60% distributed by the automatic formulae. Were the Administration to have its way, it has said in the past it would like to go to 100% diversion for 2009. If Congress does nothing else this year, it should adopt provisions (in authorizations, appropriations, or both) precluding the threatened 100% diversion of the general pay increase.

III. NSPS at DoD

A. General Criticism of the NSPS Rollout

The relentless rollout of NSPS continued this past year and will continue in 2008, and the past year’s intense criticism of its patent shortcomings has only won limited amelioration and only postponed – until this year and next year – the confrontation with its alarming aspects.

At the start of this Congress, there were some reasons for hope in a slowing of the ill-conceived relentless rollout of NSPS. Originally, the NSPS’s statutory authorization occurred immediately after the 2002 election, at a time of public support for Rumsfeld’s direction.¹⁶ NSPS at DoD had been synonymous with Rumsfeld, whose true belief in his own top-down management has been criticized.¹⁷ The 2006 election, and Rumsfeld’s resignation immediately thereafter, showed that the winds of change were blowing Defense Department management in a less single-minded, more pragmatic direction.

And, during 2007, criticism of the shortcomings of NSPS accumulated. A number of Congressional hearings, before this Subcommittee and elsewhere, exposed this. For example, on March 6, 2007, the newly established House Armed Services Subcommittee on Readiness held that committee’s first oversight hearing on NSPS. Bipartisan and expert criticism poured onto NSPS. Rep. Walter Jones, R-N.C., said: “The shadow of Donald Rumsfeld is still around,” and, “This system was his creation, and I feel like it is another failed policy.”¹⁸ Professor Marick Masters testified about NSPS “I am concerned that there may not be enough money in the pay pool to make the

¹⁶ From the National Defense Authorization Act for FY 2004, codified at 5 U.S.C. sec. 9902(a).

¹⁷ The subject is discussed in Charles Tiefer, *The Iraq Debacle: The Rise and Fall of Procurement-Aided Unilateralism as a Paradigm of Foreign War*, 29 U. Penn. J. Int’l L. (2007).

¹⁸ Quoted in Richard Brown, *Rumsfeld’s Gone, But His Failed Personnel Plan Lives On*, Commentary, Federal Times, March 27, 2007.

received salary increases and/or bonuses meaningful enough to be motivating [T]he process is based heavily on supervisory ratings, and is highly subjective”¹⁹

The GAO issued a report on July 16, 2007,²⁰ rejecting the Defense Department’s claim that implementing NSPS would only cost \$158 million. GAO denounced the artificially low costing of NSPS, finding DoD had deliberately low-balled the estimates by leaving out normally costed-in items like the full salaries for personnel charged with putting the system in place, the cost of general administrative services, research and technical support, rent, and so forth. As a professor of government procurement, I can assure you that when defense contractors bill the government under cost reimbursement contracts, the items the DoD left out to low-ball its NSPS cost estimate are not left out and substantially swell their cost figures.

GAO’s July 2007 report on that budgetary low-balling of NSPS has many worrisome implications that persist to today. NSPS imposes a much greater burden on DoD than acknowledged, and, to hide the higher cost, DoD is inadequately budgeting for it. Inadequate budgeting means diminished acceptance of the system, diminished checks on abuses like discrimination, and diminished benefits to go along with the worsened problems. DoD’s inadequate budgeting is a formula for failure. Moreover, DoD may well be using its costing methods for NSPS as a way to flout Congressional oversight.²¹

On the other hand, a significant legal development occurred. When I testified a year ago, I noted with concern that the District Court ruling against NSPS had been argued in December 2006 before a panel including Judge Brett M. Kavanaugh, who was a deputy for Ken Starr and then served as associate White House counsel in the Bush Administration. I warned that Judge Kavanaugh would give the Administration a victory, something that observers might not expect from the limited legal support for the Administration’s position. And, he did as expected. I take no pleasure in the prediction. The law was much more on the side of the different D.C. Circuit panel that had ruled unanimously, on a similar issue, against the same type of system (then MaxHR) for the Department of Homeland Security.

Still, the Kavanaugh ruling interpreted the NSPS statutory charter as authorizing its most extreme provisions: the labor relations provisions that deprive federal employee labor organizations of key bargaining rights, and the provisions depriving federal employees of key appeal rights for personnel matters. Federal employee labor organizations led by AFGE announced plans to petition the Supreme Court for certiorari as to the Kavanaugh ruling. Also in the wake of that ruling, in June and July, both the House and the Senate moved along provisions to repeal DoD’s authority to move forward

¹⁹ Testimony of Prof. Marick Masters, Subcomm. On Readiness of the House Comm. On Armed Services, March 6, 2007, at 2. Prof. Masters teaches at the Graduate School of Business of the University of Pittsburgh.

²⁰ GAO-07-851

²¹ For an illustration, at the Department of Homeland Security, Congressional oversight in 2006 tried to curb the rollout of MaxHR, but the Administration went ahead with expensive contracts to Northrop Grumman. The MaxHR rollout, and preparation for further rollout, continued on an excess scale because the department put normally costed-in items under other accounts – just as GAO was finding at DoD about NSPS.

on the labor relations portions of NSPS. By December, a version of these had gone into the DoD authorization conference report.²²

B. Congressional Provisions Curbing the NSPS Rollout

Congress moved along provisions to curb the highly counterproductive DoD plan for funding raises for NSPS. DoD had slyly provided extra funding for the token first increment of 11,000 employees who were first covered under NSPS starting in January 2007.²³ But thereafter, DoD refused to make NSPS's rollout depend on new funding for performance-rated raises. This Administration "no new regular funding" method is perhaps the single biggest downside of NSPS, for the limited increase in stable pay, in real terms, to a large percentage of employees sharply depresses its already limited acceptability.

In any event, in September 2007 DoD warned its employees – which shocked them – that NSPS would divert a high percentage –50% -- of the pertinent automatic pay raises.²⁴ The Washington Post reported many sources, including AFGE, responding that DoD employees would be shocked at such a high percentage of diversion.²⁵ In October, an influential bipartisan letter to Secretary Gates warned that DoD employees "were informed from the outset that for the first year in the NSPS they would at least receive their base pay increase. . . . It would be difficult if not impossible to recruit or retain employees if they knew they could not rely on their promised salaries."²⁶ Already, on July 31, this Subcommittee had held an important oversight hearing, with one of the year's leading factual critiques of pay-for-performance by AFGE Secretary-Treasurer J. David Cox.²⁷

Congress responded by provisions to reduce the diversion to just 40% to NSPS, letting 60% get distributed the across-the-board way, which by December had reached the defense authorization conference report.²⁸ In the face of the AFGE-led court challenge and the extensive critical Congressional oversight, DoD began in the last two months of 2007 to move toward a compromise on NSPS. The first week of January, DoD issued a new fact sheet outlining the compromise, which AFGE President John Gage responded was "acceptable." As FederalDaily said:²⁹

In December, in the face of continued court challenges over NSPS, DoD ditched its effort to curb employee collective bargaining rights. The Pentagon even compromised on pay in the DoD appropriations bill, proposing that all employees, regardless of rated performance, get at least 60 percent of the automatic government-wide pay increase scheduled under the GS system. Only

²² Stephen Losey, *Congress Protects NSPS Employees' Bargaining Rights, Sets Appeals Process*, Army Times, Dec. 10, 2007, at 4.

²³ *Id.*

²⁴ Tim Kauffman, *Pay Reform to Mean Smaller Raises at DoD*, Army Times, Sept. 17, 2007, at 1.

²⁵ Stephen Barr, *Defense Begins Transition to Merit-Based Pay*, Wash. Post, Sept. 17, 2007, at D1.

²⁶ Frank R. Wolf, James P. Moran, & Tom Davis, Letter to Secretary Robert M. Gates of Oct. 10, 2007.

²⁷ Laura D. Francis, *Lawmakers Told of Inequities in Federal Pay But Urged to Reject Alternative Pay Systems*, BNA Government Employee Relations Report, Aug 7, 2007.

²⁸ Stephen Losey, *Congress Protects NSPS Employees' Bargaining Rights, Sets Appeals Process*, Army Times, Dec. 10, 2007, at 4.

²⁹ *DoD Outlines Compromise on NSPS, Issues New Fact Sheet*, FederalDAILY, Jan. 7, 2008.

the remaining 40 percent of congressional allocations for pay increases would be divvied up as raise money under NSPS, reducing the impact of the new system. To date, more than 100,000 of the agency's 700,000 civilian employees have been transferred out of the GS and into NSPS, with more to come.

The DoD Fact Sheet explained this "60-40" split in detail.³⁰

Currently, the Administration still plans to move more than 75,000 DoD employees into NSPS in March, a move called "Spiral 2."

C. Dubious, Heavily "Spun" DoD Figures About the NSPS Pay Increase The Suspect DoD Figures

In January 2008, the Administration's announcement of the NSPS pay increases made a series of exaggerated claims that warrant scrutiny. These Administration claims foreshadow the problems likely to produce a backlash of employee non-acceptance and other problems.

The Administration's announcement consisted of a set of headline figures intensely spun, but without backup, and reflecting a highly non-transparent system. Specifically, the NSPS website announced a headline figure with the misleading terms that, as the Washington Post reported, "The average pay raise under the National Security Personnel System was 5.9 percent plus a bonus that equaled 1.7 percent of base pay, officials said. The combination provided an average 7.6 percent boost in *compensation*."³¹ That "compensation" increase made NSPS sound more generous than Santa Claus.

However, the NSPS figures are quite suspect. First, lumping the bonus in as "compensation" obscures the significant difference. For key purposes, what matters for federal employees is the 5.9 percent average increase to pay. Unlike pay raises, bonuses do not figure into the formula for pensions – pensions being a big part of federal

³⁰ The DoD Fact Sheet explained:

Government-Wide Pay Increase (GPI)

The 2008 Government-wide pay increase (GPI) for Federal employees is 3.5% of which 2.5% is an increase to base salary and 1.0% is for locality pay/local market supplement adjustments.

Under NSPS, the GPI is allocated as follows:

- Sixty percent of the base salary increase (or 1.5%) is applied to pay band adjustments for employees who received a final rating of record of 2 or higher.

At http://www.cpms.osd.mil/nsps/docs/FactSheet_2008.pdf.

- Forty percent of the base salary increase (or 1.0%) is allocated to Element 2 of pay pools and paid out as performance-based base salary increases to employees who received a final rating of record of 3 or higher.
- Local market supplement adjustments are granted in the same manner and extent as GS locality pay for employees who received a final rating of record of 2 or higher.

Employees who did not receive a 2007 final rating of record receive the equivalent of the January 2008 GPI.

³¹ Stephen Barr, *For Many Defense Workers, A Day With Some Merit*, Wash. Post, Jan. 25, 2008, at D4.

employment benefits, particularly with a workforce of which much is nearing eligibility for retirement. And, bonuses do not even figure into the base for future pay increases. Bonuses are certainly not a promise, nor even in this context a suggestion or a hope, about what the employees will receive in the paycheck (whether as bonuses or pay increases) after the coming year. Bonuses, in short, are not like pay increases. The NSPS trend away from stable pay increases to unstable, easily non-renewed, temporary bonuses represents an unannounced turn away from a stable pay system hitherto built on the security of continuing pay rates figured into promised retirement benefits. To be realistic, the pay increase has to be figured while taking that temporary 1.7 percent component with a grain of salt.

Second, much of the actual pay raise (putting the bonus aside) had nothing to do with NSPS. Much of it consisted of the basic pay increases mandated by Congress, including sixty percent of the government-wide base salary increase (i.e., 1.5%) and (the equivalent of) locality pay supplements (i.e., an average of 1.0%), that Congress provides to non-NSPS and NSPS employees alike. For NSPS to take credit for the government-wide part of the increase ingenuously steals credit belonging solely to Congress and hijacks it for NSPS – especially considering Congress has tended to appropriate higher levels of such government-wide pay increases than the Administration seeks.

Mystery and Nontransparency

Third, the NSPS website³² suggests DoD translated identical ratings into different raises by nontransparent and potentially arbitrary methods. NSPS's funding mechanism takes away from NSPS-covered employees some GS pay raises (e.g., the Quality Step Increase or QSI, and 40% of the basic pay increase), with this money going into "pay pools." Then, figured differently from one "pay pool" to another, the performance raises (or bonuses) for NSPS-covered employees get distributed out of these "pay pools." From DoD's figures, the pay pools took an average government-wide pay increase of 3.26% (1.0 percent from the 40% of the government-wide pay increase, and 2.26% from the combination of QSI, within grade increases, combined with what would be GS promotions but are now within the pay bands) of base pay; and, thereby provided an average pay increase of 3.4% plus the 1.7% of bonuses. DoD does not spell out the explanation for this gap between 3.26% and 5.1%.

Did the Pentagon come up with temporary irregular funding, apart from the diversion of Congressional appropriated government-wide pay increases, despite its not expressly mentioning this?³³ It seems reminiscent of the finding by GAO that DoD's accounting of the supposedly limited cost of NSPS omitted key items. To the extent NSPS drew on such temporary irregular funding, (e.g., temporary slack in the system, such as pay for positions that remain vacant) it may have drawn on temporary irregular sources not dependable in future years. That is a special "one-time introductory funding" finagle that sugar-coats the introduction of NSPS.

³² Performance Ratings for NSPS Employees Reflect a High Performing Workforce, at http://www.cpms.osd.mil/nsps/feature_stories.html.

³³ Or, did some of it happen another way: Did the 3.26% average include some statistical manipulation, like diverting into the pools what would have been a pay increase to higher-paid senior employees, and distributing it to lower-paid junior ones (this being a way that makes the same amount of money appear as a higher percentage pay increase)?

However, temporary irregular funding insures a morale-killing let-down when the temporary irregular funding stops. The OPM Status Report includes euphemistic but unmistakable warnings about how “cost discipline must be maintained as systems expand and mature;” “There is an assumption of fiscal responsibility and cost discipline”; “OPM will be working with DOD and monitoring payroll cost issues to facilitate NSPS regulation” and “OPM should play a central leadership role . . . [to] support cost discipline”³⁴ That is OPM-speak for: irregular funding will get cut off, and OPM will override managers at DOD to keep all raises down, penalizing the average employees by robbing them of their government-wide pay comparability increases to pay for the limited raises of other. It will take inquiry by this Subcommittee unmask these funding manipulations and worrisome OPM designs.

Basically, the NSPS system has a severe nontransparency problem. Employee evaluations translate into “shares” of what their pay pools distribute as raises. These pay pools can be quite small (OPM says they are “typically representing 75-200 employees”³⁵) and, hence, differ greatly from each other. “Shares” of one pay pool can differ very greatly from “shares” from another pay pool. So unless employee unions can get data on their individual operation, there is no way for employees (or anyone else) meaningfully to follow how pay-for-performance operates.

Yet, under NSPS, employees know little more than their evaluation number on the five-level rating scale,³⁶ and maybe not even that. (DoD appears to regard employees as entitled only to a narrative and not even to their own rating number, a treatment of employees that approaches what occurs in Kafka’s *The Trial*). 57% of employees, says DoD, had ratings that fell in the middle, Level 3, called “valuable performer.” So, the bulk of the compensation increase (including bonuses) went to this swollen middle group. But, this majority of employees have no way of verifying, or even understanding, how their common “level 3” rating led to their sometimes very different raises distributed out of the pay pools, which may be smaller or larger despite that common evaluation rating.

Apparently DoD took the distribution of rating sets from different supervisors, facilities, etc. within each pay pool, and normalized them statistically in some fashion. DoD wanted the aggregate of the different rating sets to fit the amount of funding for raises in that pay pool. None of that data, and none of those calculation steps, are getting disclosed to employees, nor, even in the aggregate, to the employees’ unions, GAO, or this Subcommittee. That means no checking, nor understanding, by employees or by those who normally check such matters – a degree of nontransparency that is the opposite of what is called for in a respectable form of pay-for-performance.

Without revisiting at length the previous discussion about race discrimination, recall the GAO study of racial statistics in the SES in DoD and elsewhere in the government:

Which (in Sept. 2006)	SES numbers	% Women	% Minorities
Government-wide	6,110	28.4	15.9
Dept. of Defense	1,133	21.0	8.0

³⁴ OPM Status Report at 39.

³⁵ OPM Status Report at 40.

³⁶ The five-level rating scale is discussed in the Fact Sheet cited above.

Clearly, the Defense Department has an especially low level of minorities (a mere 8.0 %) in its SES. That makes especially suspect the NSPS system in which raises get determined nontransparently, based on subjective evaluations. Unless NSPS becomes more transparent, it will give rise to the suspicion that the disproportionately white male management, by handling raises subjectively and nontransparently, could be awarding them arbitrarily in a way that will not inspire confidence in minorities.

IV. HCOP at DHS

As of a year ago, although pay-for-performance at the Department of Homeland Security (DHS), formerly known as MaxHR and criticized by testimony of mine in 2006,³⁷ had received major legal rejection by a unanimous D.C. Circuit decision,³⁸ DHS seemed determined to press on. Renamed by DHS as “Human Capitol Operational Plan” (HCOP), it was to set up a pilot project in 2008. And, a generous contract had gone to Northrop Grumman, according to a report by the Congressional Research Service, to support HCOP in 2007.³⁹ Stephen Barr reported in the Washington Post that if the Administration decided to expand the pilot, DHS in 2009 could still seek its old goal of shifting all its employees from the GS to pay banding.⁴⁰

However, it seems that DHS’s pay for performance system finally came to a halt under the climate of public disapproval of such systems in general, and at DHS in particular. This Subcommittee’s hearings, I think it is fair to say, contributed to the realization of that climate. In May 2007, the House adopted H.R. 1648, the FY2008 DHS Authorization bill, putting new life into Congressional oversight of DHS. The bill included a provision that repealed the authority for HCOP. Both the House and Senate versions of the 2008 DHS Appropriations bill included restrictions on funding for HCOP. So, the omnibus appropriation signed into law in January 2008 included such a provision. And, the Administration’s report in late January 2008 to the trial court that, years ago, first rejected that system (then MaxHR, later HCOP), indicated no plans to go ahead with the system.⁴¹

V. IRS, IC, and Other Agencies

³⁷ Before the House Homeland Security Subcomm. On Management, Integration and Oversight, May 18, 2006.

³⁸ *NTEU v. Chertoff*, 452 F.3d 839 (D.C. Cir. 2006).

³⁹ *CRS Report for Congress, Homeland Security Department: FY 2008 Appropriations* (updated Aug. 20, 2007), analyzed DHS reports to Congress to conclude the following: “that the contractor Northrop Grumman Information Technology (NGIT) received a contract worth almost \$3 million dollars to provide services through January 31, 2007, related to program management; pay, performance, and classification; and training, communications, and organizational change management at DHS. According to the [DHS] report, NGIT is being awarded another contract, worth more than \$16 million, to provide services to the department through September 30, 2007, in the same areas identified above and labor relations.”

⁴⁰ Stephen Barr, *A Symbolic Setback to Linking Pay With Performance*, Wash. Post, Feb. 26, 2007, at D1.

⁴¹ Brittany R. Ballenstedt, *Homeland Security Drops Proposed labor Relations Plans*, GovExec, Jan. 17, 2008.

IRS

The IRS started its new personnel system well before the Bush Administration push. Basically, its effort dates back to the 1998 IRS reorganization legislation. IRS implemented it in three phases: March 2001, Senior Manager Payband; November 2001, Departmental Manager Payment (for the “Campuses” or data processing arms); September 2005 (with March 2006 consequential revisions) for the Frontline Manager Payment.

In a report on July 3, 2007, the Treasury Inspector General for Tax Administration completed a major review of the IRS Pay-for-Performance System. Its title summarizes, in mild form, its scathing conclusions: “The Internal Revenue Pay-for-Performance System May Not Support Initiatives to Recruit, Retain, and Motivate Future Leaders.”⁴² More bluntly: “the current System may discourage both managers as well as nonmanagers from applying for management positions.” *Id.* at 2. As a result, “the IRS risks reducing the ability to provide quality service to taxpayers” *Id.* at 1.

Among the problems, the IRS’s Human Capitol Office (HCO) failed at trying to devise meaningful bands for frontline managers. So it threw in the towel, kept the GS grades as the bands, and “simply removed the incremental steps within each grade” (*id.* at 3) – just failing to improve on the old system and merely washing out its structure. The “HCO did not establish pay polices and procedures that ensured managers are compensated comparably with IRS employees in the GS Pay System or that the performance-based increases are commensurate with the managers’ performance,” (*id.* at 3), which abandons the supposed value of the change.

Finally, the HCO so botched the rollout that it “decreased morale and increased opposition to some of the provisions of the System.” (*Id.* at 3). Strikingly, “an overwhelming majority of the [IRS Managers’] Associations’ members, who responded to a survey, opposed any plans to reallocate the annual across-the-board pay adjustment” (*Id.* at 4).

The Inspector General’s strongly negative report lends objective, within-the-Administration credence to the criticisms of the Administration’s pay-for-performance systems. In particular, it shows the intensity of non-acceptance surrounding the Administration’s effort to reallocate the regular pay raises rather than supply any real new money. It is notable that the intensity of non-acceptance here is from managers, not lower-grade employees, who presumably start with the natural acceptance of managers, rather than the natural suspicion of employees, for management initiatives.

Looking at this IG report on the IRS, one expects the Administration to run into intense non-acceptance throughout DoD, DHS, and elsewhere, as it tries to implement pay-for-performance without supplying new funding. And what could dishearten the public more, than reading the IG warning that pay-for-performance “risks reducing the ability to provide quality service to taxpayers” – when that is what the public most wants from the IRS. Typically, the OPM Status Report, in discussing the IRS, does not mention the IG report.⁴³

Intelligence Community

⁴² Treasury Inspector General for Tax Administration, Reference Number: 2007-10-106.

⁴³ OPM Status Report at 17.

My testimony last year noted that the Director of National Intelligence (DNI) had announced an intention in 2006, as part of a "Pay Modernization" project, to implement a pay-for-performance system across the disparate elements, some military, and some civilian, of the intelligence community (IC).⁴⁴ As I described, this is cause for concern. The unhappy experience of MaxHR at DHS shows that the Administration's enthusiasm for imposing pay-for-performance across disparate and diverse elements, in the name of security, can do more harm than good.

With particular respect to the intelligence community, pay-for-performance seems a formula for more top-down discipline. To the Administration, which would like to blame intelligence failures on lower-level unresponsiveness, top-down discipline may seem purely beneficial. However, those outside the Administration have tended to be skeptical that, for example, the 2003 fiasco of claiming intelligence showed stockpiles of weapons of mass destruction in Iraq came up from lower-level unresponsiveness, rather than coming down from top-level result-driven manipulation. A similar debate concerns whether the lack of anticipation of 9/11 was disproportionately the fault of lower level failures alone, as the Administration would like to have it, rather than, say, how top figures from the President and Condoleezza Rice down gave insufficient attention and sluggish action to warnings from the CIA and others at the working level.

From the OPM "Status Report," we have some detail about the planning process for the DNI's announced intention.⁴⁵ The Administration approved its plan on October 23, 2007, to be managed by the DNI's Chief Human Capital Officer through an IC Pay Modernization Project Office. It will be chartered by six Intelligence Community Directives, with implementation plans and schedules in the different IC elements.

The past year brought welcome Congressional attention to the DNI's announced intention. The House Intelligence Committee moved a provision, Section 307, in the annual intelligence authorization, to require detailed reporting before implementing a pay-for-performance system. In conference, the version that moved in December 2007 fine-tuned the House provision, in what became section 308 of H. R. 2081, Conf. Rept. 110-478 (153 Cong. Rec. 14462, 14465 (Dec. 6, 2007)). The provision envisages the element-by-element implementation. It requires particular attention to many aspects of great interest: budgeting; standards; consultation with employee associations; and, impact on women and minorities, among others.

I hope both the Intelligence Committee, and this Committee, continue their invaluable oversight. The elements in the section 308 reporting are a welcome outline of the focuses of such oversight. For example, the reporting must address the budgeting for the pay-for-performance system. As discussed in this testimony, the Administration proceeded with NSPS without new regular funding, particularly diverting 40% of the governmentwide pay comparability increase. This has a deleterious effect on employee acceptance and amounts to Administration self-sabotage of the effort. Congress generously funds the IC budget, but as with DoD, there has been a regrettable tendency to spend too much of that on big, lucrative contractor projects like satellites, and too little on personnel. And, Congress must not forget the unhappy past experience of pay-for-performance programs in intelligence. As reported in the press, CIA Director George

⁴⁴ The OPM Status Report sets forth that the DNI launched a planning phase in September 2006, which produced a Detailed Design and Implementation Plan. OPM Study at 22.

⁴⁵ OPM Study at 22.

Tenet had developed such a poor program that when his successor, Porter Goss, came in, “Goss canceled a pay-for-performance program that was almost universally disliked by employees.”⁴⁶

The Administration may tell this Subcommittee that the IC involves so much classified information that oversight cannot occur – although it would be strange for OPM to write extensively and glowingly in its (unclassified) Status Report about the “pay modernization” project and then to stonewall oversight. In any event, the claim that this Subcommittee cannot perform oversight because of intelligence agency sensitivities is simply not true. In 1996, GAO did a study for Rep. Patricia Schroeder: *Intelligence Agencies: Personnel Practices at CIA, NSA, and DIA Compared With Those of Other Agencies*.⁴⁷ The study reviewed adverse agency actions. “GAO found that very few adverse action cases involve sensitive information. Specifically, in recent NSA and DIA adverse actions reviewed by GAO, 39 of 40 cases files (or 98 percent) contained no classified national security information.”⁴⁸ I note that the 1996 study include extensive work on EEO cases, and percentages of minorities and women, in the 3 intelligence agencies. The 68 page GAO study was unclassified. It reflects careful attention to CIA requests to modify or delete text to make it so.⁴⁹

Congress must check the Administration’s potential to repeat the NSPS’s failing, and make sure that if the Administration believes in pay-for-performance enough to go ahead with it, the Administration budgets enough truly new funding for the pay increases, even if that has to come out of those contractor projects.

Transportation Safety Administration – the PASS System

The Transportation Safety Administration (TSA) launched, in 2006, a pay-for-performance program called the Performance Accountability and Standards System (PASS). A 2007 GAO report on airport security found TSA had a high attrition rate, with a deleterious effect on security. It attributed the high attrition rate, among other factors, to TSA’s personnel system.⁵⁰ Union testimony last July further elaborated on the dismal state of TSA morale under PASS.⁵¹

Conclusions

To summarize, I suggest further lines of inquiry.

1. A Proposal for Reducing the Mystery and Nontransparency

There is every reason not to go ahead with NSPS and other pay-for-performance systems, unless the Administration reduces the deliberate mystery and nontransparency surrounding it. I suggest an authorization provision, either in bill text or in report language, that conditions the inclusion of any unit in NSPS (and other systems) with the availability of aggregate figures, and an opportunity of follow-up, for an employee

⁴⁶ Faye Bowers, *Behind CIA’s Personnel Changes*, Christian Science Monitor, Nov. 17, 2004, at 2.

⁴⁷ GAO/NSIAD-96-6

⁴⁸ *Id.* at 5.

⁴⁹ *Id.* at 53.

⁵⁰ GAO-07-299

⁵¹ “[PASS] was unveiled in 2006 and is already in disarray. TSA’s PASS system is one of the largest concerns for TSA employees. . . . Allegations of favoritism and cronyism surround the system. . . .” Testimony of Colleen Kelley, National President, National Treasury Employee Union, *Hearing Before the Federal Workforce Subcommittee of House Oversight and Government Reform*, July 31, 2007, at 11.

organization seeking to bargain, to petition other authorities, or to file a grievance, regarding arbitrariness in the implementation of the pay-for-performance system.

The aggregation would break down the department- or agency-wide figures along divisional and/or regional (or other geographic) lines – a breakdown to the organizational unit level making discussions feasible roughly along something like union local lines. Thus, a union local would be able to tell, from the aggregate breakdown for a unit's members, their distribution of evaluation numbers; how that distribution had been translated or normalized into shares of the relevant pay pool; how funds had gone into that pay pool; and what individual raises had emerged. The opportunity for follow-up would include, upon request by the union local(s) for that unit, an opportunity to review individual evaluations (perhaps subject to an opt-out provision)⁵² to determine the validity and fairness of the evaluation and raise-distribution methods. This would greatly increase the transparency of the system, de-mystify it, and correct its arbitrariness and unfairness.

Also, as previously described, the GAO's Strategic Issues office should be commissioned to study minority (including age) statistics as to pay-for-performance on a multi-agency, cross-cutting basis.

It is possible that the two approaches could be combined, by having either the GAO, or the agency, break down the minority (and age) statistics as to pay for performance on a unit level. This would facilitate rooting out those units, like the SEC, in which the statistics indicate a agency-wide prima facie discrimination situation, leading either directly to corrective action, or to a grievance or other trial for a ruling about discrimination.

2. Freezing or Rolling-Back Pay for Performance

Whether on an agency-wide basis, or more selectively, the problems described above may warrant either freezing the pay-for-performance system as it is (without further roll-outs), or even returning some units or agencies to GS. I am a firm believer in the necessity of transparency and checks on hidden arbitrariness, especially when there is also a background of systemic discrimination risks, along the lines scribed above. Accordingly, I would recommend either or both of the following: (1) that a freeze or roll-back apply to agencies or units that fail to achieve this transparency by a deadline; and/or, (2) that a freeze or roll-back apply to agencies or units for which transparency reveals either arbitrariness or a prima facie situation of discrimination.

⁵² Perhaps an individual employee could opt-out by asking that their particular evaluation not be made available for such analysis. But, the experience of the SEC arbitration that found age and race discrimination based on statistical evidence pulled together by an employee union shows there is no substitute for allowing meaningful union scrutiny.