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Before The

House Subcommittee on
Federal Workforce, Postal Service and the District of Columbia

On

Personnel Reform in the Federal Government

February 12, 2008

Today's hearing examines the implementation and effect on personnel of pay for performance systems, at the Security and Exchange Commission, Internal Revenue Service, and Government Accountability Office. I will focus my attention on the Internal Revenue Service.

Congress gave the Internal Revenue Service the authority to create a pay for performance system for all its employees in the Internal Revenue Service Revenue and Reform Act of 1998. The IRS implemented a pay for performance system for senior (SM) and second level or departmental (DM) managers in March 2001. All other managers were brought into the system in September 2005. The IRS has made no effort to place bargaining unit employees in a pay for performance system.

The goals of the IRS system are simply stated:

1. Create a compensation system that supports better rewards for better performance
2. Create a link between organizational and individual goals and compensation based on individual achievement
3. Create a compensation system that is more flexible than the GS classification and pay system.

To determine whether the goals are being achieved, the IRS conducted employee surveys of Senior Managers and Managers of Senior Managers in 2003, and 2004 and Departmental Managers in 2003.

The results of both surveys reveal a system that has not achieved its stated goals:

A. Results of IRS Senior Manager Survey

1. Only one in four SMs agree that the pay for performance system is a fair system for evaluating or rewarding job performance. The managers of the senior managers, those responsible for implementing the system, hold the same view.
2. Fifty eight percent of the SMs stated the pay for performance system had no impact on their motivation to increase performance, and 18% stated it had a negative impact.
3. Sixty five percent of the SMs stated that the system had no impact on their motivation to apply for jobs with greater responsibility.
4. Only 35 percent of the managers of senior managers saw a link between senior managers' performance bonus amounts and their job performance.
5. Less than 20 percent of senior managers agreed that the pay for performance system is linked to organizational results or has improved business unit or IRS performance; 13 percent agreed that the system improved business unit performance; and 12 percent agreed that overall results were increased.
6. Only 17 percent stated their performance was linked to their pay, and only 16 percent stated it was linked to strategic business goals.
7. Three out of four do not believe the system will help them move to an SES job.
8. Forty six percent stated they preferred the GS system.

B. Results of IRS Departmental Manager Survey

1. Fifty six percent stated the new system had no impact on their motivation to increase their performance and 10 percent stated it had a negative impact.
2. Fifty four percent stated they system had no impact on their motivation to apply for a job with increased responsibility.

3. Only 12 percent “strongly agreed” or “agreed” that the system improved performance in the IRS
4. Only 28 percent stated they saw a link between their performance goals and IRS organization goals.
5. Twenty eight percent indicated that the link between their job performance and pay decreased and 31 percent stated it stayed the same with the introduction of the pay for performance system.
6. Only 24 percent felt their ratings were fair.
7. Sixty nine percent stated it was neither more nor less likely they would stay with the IRS based on the pay for performance system.
8. Forty seven percent favored the GS system while 27 percent favored the pay for performance system.

The “better rewards for better performance” goal has not been achieved because so many employees see the system as unfair. Similarly, the data reveals employees do not believe a link exists between individual and organizational performance and rewards. More importantly, the system does not provide motivation for improved performance, an assumption that is a bedrock rationale for a pay for performance system.

C. Why has the IRS been unable to achieve its stated goals?

1. **The fundamental assumption of a pay for performance system that rewarding high performance with higher pay motivates employees to even higher levels of performance, may not apply in the federal sector.**

A recent article by James Perry, Debra Mesch, and Laurie Paarlberg reviewed approximately 2,600 research studies concerning which factors motivate employees in the public and private sector to increase their performance (Perry 2006). Research found that in a private sector organization, financial incentives to improve task performance were moderately to significantly successful. However, “individual financial incentives are ineffective in traditional public sector

settings" (Perry 2006, 507). The authors speculate that the failure "is likely due to a lack of adequate funding for merit pay and an absence of the organizational and managerial characteristics that are necessary to make pay for performance work in traditional government settings" (Perry 2006, 507).

This finding is supported by my work as the Director of American University's Institute for the Study of Public Policy Implementation and as a collaborator with the Partnership for Public Service. We found that the two most critical factors necessary to increase employee engagement are increasing leadership capacity and matching employee skills to agency mission.

Similarly, the Corporate Executive Board surveyed 50,000 employees in 59 organizations world wide and found that employees with lower engagement are four times more likely to leave their jobs than those who are highly engaged. Even more importantly, a highly engaged workforce can result in a 21 percent increase in productive performance.

The Corporate Executive Board, like the Best Places to Work analysis, found that the most important driver of engagement is a connection between an employee's success and the organization's succes

2. **A 2006 survey of the Senior Executive Service, the persons who must be counted on to implement a pay for performance system, revealed they are extremely unhappy with their own pay for performance system.**

    A. Eighty three percent stated it had no impact on their performance, and thirty three percent indicated it had a negative impact on morale.

    B. Fifty four percent indicated their pay for performance system had no impact on their motivation to increase performance and eight percent indicated it had a negative impact.

C. Forty four percent felt their ratings were fair and accurate, but 33 percent disagree, and 23 percent did not know.

D. The "don't know" answer is based on the fact that 72 percent of the respondents indicated their agency failed to share rating information.

Since the organizational change necessary to support the introduction of a pay for performance system is not enthusiastically endorsed by senior career leaders, it is no surprise that those they lead do not endorse it.

The latest OPM report concerning performance based pay in the federal government (OPM 2007) does not contain any data to refute the survey results from IRS managers or members of the Senior Executive Service.

3. **A critical component to successfully implementing any significant organizational change effort, and particularly with pay for performance, is trust. And trust is not present.**

The question is whether those who must change, trust those who seek change? Based on the Office of Human Capital's Federal Hyman Capital Survey, the answer is many do not.

Only fifty percent of the close to one quarter of a million federal employee respondents to the Federal Human Capital Survey answered "strongly agree" or "agree" to the statement, "My organization's leaders maintain high standards of honesty and integrity." Twenty percent reported either "strongly disagree" or "disagree."

With twenty percent of the workforce or 380,000 employees lacking trust in their leaders, it will be difficult, if not impossible, to successfully implement a pay for performance system.

In the IRS workforce only forty three percent “strongly agree” or “agree” with the statement, and twenty three percent “strongly disagree” or “disagree.” The IRS has even more work to do if it wants to successfully implement a pay for performance system.

4. The IRS pay for performance system was implemented before a credible, transparent performance management system was created.

The essence of a performance management system is the creation of strategic organizational goals and defining individual goals that link individual performance to organizational goals. The process for the creation of a performance management system is extremely difficult, and includes the following steps:

A. Defining organizational output and outcome goals,

B. Creating a plan for translating the goals by supervisors into individual goals linked to organizational goals,

C. Ensuring that supervisors spend time talking and listening to those they manage, coaching, evaluating performance, and monitoring organizational goal achievement, and

D. Successfully implementing the system.

The IRS Survey data reveals the steps in creating a performance management system were not successfully concluded. Without agreement about individual and organizational goals, we see results like those in the IRS survey: complaints about lack of fairness because goals are unclear and comparisons perceived as arbitrary, and a lack of linkage between individual and organizational goals. A pay for performance system is guaranteed to fail if it not bolted onto a transparent, credible performance management system.

There is little question that effective goal setting does increase performance. The Perry research also found it is virtually undisputed that goal setting does increase performance at all levels: individual, group, and organization. As Perry points out,” . . . [S]pecific and challenging goals are associated with higher levels of

performance, more so than either no goals or general 'do your best goals'" (Perry 2006, 509).

It should be noted that goal setting in the public sector is more difficult than in the private sector (Perry 2006). Output and outcome goals are difficult to define credibly to those who seek to achieve them, to those managing the effort, and to those benefiting from the goal achievement.

Yet, if successful, goal setting increases employee engagement, individual and organizational performance, and taxpayer satisfaction. Thus, it is an outcome worthy of pursuit.

The challenge of goal setting is to craft individual and organizational outcome goals that are both consistent with agency mission and set at a level that drives innovation.

Since the 1993 the passage of the Government and Performance and Results Act (GPRA), agencies have been struggling to identify outcome rather than output or "working hard" goals. There has been a great deal of well chronicled difficulty and resistance in Government Accountability Reports.

Agencies and agency leaders find it difficult to reduce their mission achievement or outcome to clear and measurable standards. To complicate matters, President Bush created the Program Assessment Rating Tool (PART) to evaluate more than 1,000 programs across the federal government. Both GPRA and PART Program Managers have had a great deal of difficulty defining measurable program outcomes.

Assuming an agency is willing and able to set organizational outcome goals, the next step is for supervisors to link individual performance plans to agency goals: Once again, no easy task.

Managers must then communicate the individual goals to employees, and provide them with regular feedback on progress, coaching and development opportunities, and an evaluation based on results.

It is very easy to write a policy to achieve these goals; however, it is extremely difficult for 1.9 million federal supervisors and employees to redefine their relationship with each other in order to implement the policy.

Currently, supervisors generally evaluate an employee's performance on whether the employee "works hard." If an employee "works hard," he/she is likely to be rated highly. Under a performance management system, the standard would be "achieves results." This would entail a change from a subjective evaluation of performance to a significantly increased focus on the achievement of objective performance results.

Long term supervisor/employee relationships have been built on one set of expectations. Those relationships would have to evolve to accommodate another set of expectations. Supervisors will have to be trained to expect "results" and evaluate employees' work accordingly, and employees will want and expect support.

Achieving the desired change is further complicated by the fact that many supervisors spend the majority of their time "doing" rather than leading. This leaves little time or energy for employee performance discussions, development and coaching. It is the "doing" rather than the leading portion of their job that is often rewarded by the supervisors' superiors. For many managers, leaving a career of "doing" would be difficult, and would not occur unless they were convinced they had to give up what has made them successful and provided satisfaction for something that is unknown and difficult.

We see every aspect of the difficulty in creating a performance management system in the IRS employee surveys.

D. Can the IRS achieve its stated goals in the future?

Because the data shows that federal employees are not motivated to increase their performance solely because of monetary rewards, I believe it is highly questionable that the IRS can successfully implement a pay for performance system. Because federal employees are motivated to increase their performance when they are effectively led and their skills are matched to the agency mission, I believe, it is possible to increase individual and organizational performance results with the design, development, and implementation of a performance management system.

1. **The performance management system must be designed, developed, implemented, reviewed, and modified based on experience in collaboration with the employees whose performance must increase.**

Active, meaningful involvement of the affected employees – either through their supervisory or managerial association, through their elected representative in an organized workplace, or through non-supervisory employees in an unorganized workplace -- is critical if increased individual and organizational performance is the goal of a performance management plan.,.

It is difficult, if not impossible, to achieve necessary organizational change to improve agency performance without employees' active involvement, for the following reasons:

A. When employees understand the linkage between their efforts and desired agency outcomes, their engagement in their work and productivity increase. Employees want their work to be clearly linked to agency goals, according to an analysis of the Office of

Personnel Management's Federal Human Capital Survey (conducted by American University's Institute for the Study of Public Policy Implementation and the Partnership for Public Service). In existing systems, many agencies' failure to clearly identify output and outcome goals has left employees unsure of the impact of their efforts. Employee involvement in identifying agency output goals will identify any difficulty in achieving those goals, and will show employees how they can contribute to the goals' attainment.

B. Employee participation will lead to a more accurate mutual understanding of the work. Because most employee position descriptions are woefully outdated, any manager beyond the first level of supervision has little understanding of what employees do day-to-day. Only the employees who do the work can clearly describe it. Position descriptions need to be written more clearly and more accurately. Upper level management and employees need to understand better how their work is linked to that of others, and whether it impacts agency goals. Once both employees and managers understand the linkages between a given job and agency goals, the program will have more credibility.

C. Employee participation allows managers a chance to leverage their employees' desire to make a difference to improve agency goal achievement. With dialogue, managers will learn how the work is performed, and employees will see how their work affects the achievement of agency goals.

In addition to being active, employee participation must be meaningful. It is not good enough for managers to listen to employee suggestions, retire to their offices, make a decision, announce it, and expect acceptance and enthusiastic implementation. Employees must be actively involved in the decision-making process. Dialogue, mutual listening and learning, statements of stakeholders' interests rather than of their positions, and sharing of all information used for

decision-making are all critical to making the best possible decision -- and having that decision accepted and readily implemented.

Although many substantive issues in the creation of a performance management plan are outside the mandatory scope of bargaining in the federal sector, a union does have the right to negotiate the impact and implementation of any such plan. The union also has the right to negotiate "the appropriate arrangements of employees adversely affected" (5 U.S.C. 7106(b)(3)) by the creation of such a plan. Further, the plan may not be implemented until all bargaining -- including all appeals to the Federal Service Impasses Panel, which has the authority to resolve all negotiating impasses -- is completed.

When employees through their union representatives are actively and meaningfully involved, fewer issues will be submitted to impact and implementation negotiation, and those issues bargained would take less time to resolve. The net result is faster implementation with better results.

2. **The President must spend his/her most valuable asset – time – assisting the IRS and any other agency interested in successfully implementing a pay for performance system.**

All Presidents have exhorted the Executive Branch to improve their performance, and blamed the Executive Branch for poor performance. Presidents spend almost all of their time creating public policy. They have typically been engaged in the traditional activities of marshalling support for new legislation, issuing new regulations that distinguish their ideas from those of their opponents, and resisting the legislative thrusts of their opponents.

Although Presidents Clinton and Bush have done more to systemically focus the Executive Branch on performance improvement than any other Presidents, they have not changed their behavior to be consistent with their role as the Chair of the Board of the Executive Branch. This role requires spending their personal

time ensuring that a vision of performance is created, performance goals are set, goal achievement is monitored, and political appointees are held responsible for public policy implementation performance goals.

If a President is serious about creating a performance management system, he/she must model the behavior he/she seeks from his/her appointees by spending his/her personal time on performance improvement. I suggest few political appointees will change their attention from public policy creation to public policy implementation without changed behavior from the President. Similarly, unless Presidents and their political appointees change their behavior, agencies' senior executives do not have either the authority or the incentive to make the changes necessary to implementing a performance management system. Even if they did, few would take the risk unless they were supported by the agency's political appointees.

3. Congress has a role to play to assist the IRS and other agencies interested in implementing a performance management system.

Congress, as an equal branch of government, has a role to play in creating a performance management culture in the Executive Branch.

Congress has appropriately spent time telling the Executive Branch what it does not want in connection with significant program failures (e.g. Katrina); however, Congress has not spent much time telling agencies what specific performance it does want in the future – and, just as importantly, it needs to allocate the funds to achieve it.

Comptroller General David Walker urged Congress to change this:

> We [the GAO] have long advocated that congressional committees of jurisdiction hold oversight hearings on each of the major agencies at least once each Congress and preferably on an annual basis. Information on

the linkages among plans, programs, budgets, and program results – which should become available as agencies' implementation of performance based management moves forward – could provide a consistent starting point for each of these hearings (Walker 1999, 27).

E. Conclusion

Increased performance is a goal sought by presidents, political appointees, members of the Senior Executive Service, mid-level managers, union leaders, and employees. Harnessing that energy to actually improve performance in the Executive Branch requires the collaborative involvement of all parties.

It is possible to increase performance, but it is not easy.

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