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Report To The Honorable Jeff Bingaman

Analysis Of OPM's Report On Pay
For Performance In The Federal
Government - 1980-1982

OPM's report concluded that the government's new performance appraisal and merit pay systems are functioning well, achieving a high degree of employee acceptance and should be expanded to cover the entire General Schedule work force. The data cited by OPM to support these conclusions are either outdated or not projectable to the universe of merit pay employees. The attitudinal surveys used by OPM to support its conclusions were made in 1979 and 1980 before merit pay was implemented in most agencies, and the actual experiences cited by OPM covered less than 3 percent of the merit pay population.



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UNITED STATES GENERAL ACCOUNTING OFFICE
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GENERAL GOVERNMENT
DIVISION

B-203022

The Honorable Jeff Bingaman
Ranking Minority Member
Subcommittee on Civil Service,
Post Office and General Services
Committee on Governmental Affairs
United States Senate

Dear Senator Bingaman:

This is in response to your request at the July 14, 1983, hearings of the Subcommittee on Civil Service, Post Office, and General Services, Senate Governmental Affairs Committee on the proposed Merit Pay Reform Act of 1983.¹ You asked for our analysis of the Office of Personnel Management's (OPM's) Report on Pay for Performance in the Federal Government - 1980-1982.² (See encl. II.) The OPM report concludes that

"All of the data available to date support two important conclusions: the Federal government's new performance appraisal system is functioning very well, less than two years after its establishment. And pay-for-performance, presently effective only for higher-graded managers and supervisors, has been effective in providing greater rewards for above average performers, while achieving a higher degree of acceptance among employees."

You asked (1) if we agreed with the report's conclusions, (2) if the conclusions were supportable by fact, (3) what results our reviews had produced on these questions, and (4) for our analysis of the OPM report.

We have reviewed the report and discussed it with OPM officials. In reviewing the report, we compared it with information we developed in a 2-year analysis of merit pay in three departments--Navy, Housing and Urban Development (HUD), and Agriculture--which together employ about 25 percent of the Federal

¹Senate Bill 958, March 24, 1983, 98th Congress, 1st Session.

²OPM made this report an official publication under the title, Significant Progress in Pay for Performance, publication number P-80, August 1983.

merit pay population. Our 2-year analysis included questionnaires to a scientifically selected sample of merit pay employees in these agencies, interviews with merit pay managers, reviews of agency rating and payout data, and analyses of employees' performance elements and standards for both 1981 and 1982. Questionnaire sample sizes were sufficient to yield an error rate of less than 5 percent at the 95-percent confidence level. We also reviewed studies of merit pay by OPM and independent researchers, and testimony from representatives of employee and management groups before the Congress.

Based on the information available to us, we generally disagree with OPM's conclusions. The studies and analyses OPM cites as the basis for its conclusions are either not current or not projectable to a governmentwide merit pay program. For example, the attitudinal survey used for OPM's study took place in 1979 and 1980, before merit pay was fully implemented. Also, the actual merit pay experiences cited by OPM were either from the eight agencies that implemented merit pay a year early for 2,200 employees, or from OPM's own merit pay experience for 400 merit pay employees. According to OPM, the 1982 merit pay population was about 108,000 employees.

Our reviews of the merit pay system identified many areas that need management attention, as well as negative employee perceptions and attitudes toward the merit pay systems in place. While pay-for-performance, or merit pay, may have been effective in providing greater rewards for employees rated above average in a particular merit pay pool, these rewards are not always equitable and proportionate when one compares merit pay increases between merit pay pools.³ The three agencies we reviewed were having problems with employees' acceptance of merit pay. In these agencies, 7 percent or fewer of employees in each agency in both years wanted to retain the merit pay system as implemented. The three agencies were still identifying problems in the development and use of performance standards, rating distributions, and use of the cash awards programs as an integral part of merit pay.

While our reviews have identified a number of areas in the government's merit pay system needing attention, it should be recognized that considerable time is generally needed before a pay-for-performance system operates smoothly. Consequently, it may take a few more years of operation, evaluations, and adjustments before the positive and negative aspects of the merit pay

³Merit pay employees are divided into organizational subunits or pools and compete with other pool members for merit increases.

system, and the feasibility of extending it to all federal employees can be adequately determined. Our specific responses to your questions are contained in enclosure I. Enclosure II is a copy of the OPM report.

As you requested, we did not obtain comments on this report from OPM. Further, as arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution until 7 days from the date of this report. At that time, we will send copies to interested parties and to others upon request. We would be happy to discuss these issues with you if you wish.

Sincerely yours,



William J. Anderson
Director

Enclosures - 2

1. Do you agree with these conclusions?

We do not have, and are not aware of, any evidence that would support OPM's broad conclusion that "the Federal Government's new performance appraisal system is functioning very well, less than two years after its establishment." To the contrary, we have two ongoing assignments directed at the performance appraisal systems of several executive agencies which have identified numerous issues with the performance appraisal systems that need management attention. For example, in one pool employees rated highly satisfactory received increases almost twice as large as employees rated outstanding in another pool within the same agency.

Also, we are not aware of evidence that would suggest there is a "higher degree of acceptance among employees" who are included in the merit pay system. In our 2-year review of the merit pay system, we found that most employees at three departments--Agriculture, HUD, and Navy--did not believe that merit pay had been successful, or that it had increased motivation or performance. For example, in both years in each agency, between 78 and 86 percent of the employees believed merit pay had not motivated them to better performance, and about 80 percent in both years in each agency believed they were no more productive under merit pay. Also, in both years, 7 percent or fewer of surveyed employees favored retaining the present merit pay system.

2. Are these conclusions supportable by fact?

OPM's report is based on (1) the Federal Employee Attitude Surveys for 1979 and 1980 which took place before merit pay was fully implemented in October 1981; (2) performance appraisal ratings distributions for a limited number of merit pay employees for fiscal years 1981 and 1982; (3) Merit Pay First Year Experiences in Eight Federal Agencies, an analysis of eight agencies representing about 2,200 merit pay employees which implemented merit pay a year early in October 1980; and (4) OPM's own merit pay experience involving 400 employees over the past 3 years. These studies and analyses are either not current or not projectable to a governmentwide merit pay system, which, according to OPM, covers about 108,000 employees.

3. What results have your reviews produced on these questions?

In 1982, ratings and payouts were made in a timely manner. However, we identified, and employees perceived, several problems with the performance appraisal systems. We identified instances where ratings were altered, apparently to meet a quota or preestablished distribution of ratings. OPM regulations prohibit forcing rating distributions to fit quotas. Between 37

and 43 percent of the employees in each agency in 1981, and from 39 to 52 percent in 1982 believed their ratings were inaccurate. Moreover, between 28 and 48 percent of the employees believed appraisals had become more subjective since the inception of merit pay, despite the fact that appraisals were to be more objective under merit pay. Over 40 percent of employees in each agency in 1982 cited inconsistencies in raters' judgments within the pool as a great or very great problem. Finally, in 1981, between 43 and 62 percent of the employees in each agency thought the performance appraisal system should not be retained even if it were not tied to merit pay. In 1982, between 47 and 59 percent in each agency held this view.

Our review of agency merit payout data showed that within a given merit pay unit, a higher rated employee generally received a larger merit pay increase than a similarly graded employee with a lower performance rating. However, such factors as the composition of employees--grades and positions in the salary ranges--in a merit pay pool, and the distribution of ratings in the pool all can, and did, cause the payouts to vary widely between pools. As a result, it was not uncommon for a lower rated employee in one pool to receive a larger increase than a higher rated employee in another. While these differences are permitted under the law they contribute to the negative employee perceptions.

Neither the performance appraisal nor the merit pay system is well accepted by the employees in the three agencies. Employees were particularly concerned over the systems' fairness, objectivity, and accuracy.

4. **Would you provide an analysis of the OPM report, and submit your finding to the committee?**

We do not believe that the OPM data fully support the conclusions in the report. Our comments on specific statements in the report follow.

On page 13, OPM states that

"Data regarding employee attitudes about performance appraisal are available from the Federal Employee Attitude Survey. . . . It is clear from this data that, as the new performance appraisal system was being implemented, employees found the new system more fair. . . . With three subsequent years of upgrading . . . it is just not credible to believe that employees can think the system is any less fair today."

The most recent Federal Employee Attitude Survey was conducted in November 1980, with a followup to nonrespondents in

March 1981, about 7 months before merit pay was fully implemented. Of the over 9,000 returned surveys, only 260 respondents had experienced a merit payout.

Merit pay employees responding to GAO questionnaires after the 1981 and 1982 payouts questioned the fairness of the system. Over 40 percent in each agency thought the merit pay and performance appraisal systems in 1982 were unfair or very unfair. Between 28 and 48 percent in each agency felt that ratings had become more subjective since merit pay/performance appraisal was instituted. Further, between 41 and 54 percent of the employees in each agency thought merit pay was not fairer in 1982 than in 1981. Also, a study contracted by OPM with Case Western Reserve University and published in 1982 concluded that, at the Environmental Protection Agency (EPA) there was a "substantial decrease in support for performance appraisal and merit pay between October 1980 and October 1981." EPA was one of the eight agencies that made merit payouts in October 1980.

On page 13, OPM concluded that

". . . the present performance appraisal system's integrity is infinitely better than that of the pre-CSRA evaluation system."

As support for this statement, OPM shows in a table that under the merit pay system ratings are spread out over more performance levels than under the old system. Many agencies now have 5-level rating systems instead of the 3-level system used before the Civil Service Reform Act, so it is a natural consequence that ratings would fall into more categories. Such a rating spread does not necessarily mean that the integrity of the system has improved. Further, in our view, the integrity of a performance appraisal system is a function of its ability to accurately differentiate employee performance. This, in turn, depends upon the quality and validity of performance elements and standards. Our work indicates that performance standards need to be improved to become valid measures of employee performance.

On page 15, OPM states that

". . . figures from the 1982 merit pay experience bear out the fact that the performance appraisal system is continuing to improve."

As evidence for this conclusion, OPM cites the same table referred to above, which shows that the percentage of high ratings decreased slightly from 1981 to 1982, while the percentage of fully successful ratings increased.

According to OPM officials responsible for this report, the data shown for fiscal year 1981 came from a telephone survey of agencies. They could not tell us how many agencies were surveyed or what percent of the merit pay population they represented. The data shown for fiscal year 1982 came from an OPM study¹ which contained rating data from about 16 percent of the merit pay population. In contrast, our analysis of rating data shows that more employees were rated higher than fully satisfactory in 1982 than in 1981 at both Agriculture and Navy, which together employ about 24 percent of the merit pay population. At HUD, fewer employees were rated outstanding in 1982.

In its report, OPM equates a particular rating distribution with a good performance appraisal system. This overlooks other factors that go into determining whether a performance appraisal system is "good," such as the quality of elements and standards, the degree of employee involvement in setting the standards, and the perceived accuracy and fairness of the ratings.

On page 15, OPM says

"All the evidence, therefore, supports the conclusion that the performance appraisal system has improved so that it now is supported by employees, does distinguish between levels of performance, and has over time increasingly refined levels of performance."

As mentioned earlier, our questionnaire data, testimony from representatives of merit pay employee groups, and OPM's own contract studies raise doubts as to whether performance appraisal systems are supported by employees. There is no question that employee ratings in most agencies are now spread over more performance levels than before merit pay. However, refining performance levels, as mentioned earlier, is the function of performance elements and standards. Our studies have shown that these standards are often incapable of distinguishing between performance levels, and that improvements to the standards are needed.

On page 17, OPM states

"It easily can be seen from the table, however, that these [employee] perceptions of unfairness were related to the weakness of the performance appraisal systems in these two agencies [EPA and SBA] at that time."

¹This study, Fiscal Year 1982 Merit Pay Program Report was based on combined payout and performance appraisal data on 19,000 of a total 1981 population of about 117,000 merit pay employees.

OPM is equating the distribution of ratings with the strength of the system--the closer the system is to OPM's "optimum" rating distribution, the stronger the system is.

As shown in table 3 (p. 4) of the study, however, a higher percentage of employees in the Farm Credit Administration (FCA), whose rating distribution most closely matched OPM's optimum, thought the merit payouts were unfair as compared to the Civil Aeronautics Board (CAB), whose system OPM categorized as "too lax." In fact, in its 1980 report on the test study of the eight agencies that implemented merit pay a year early, OPM concluded that "employees at CAB and FCA appear to be the most satisfied with merit pay as it functioned in their organizations."

On page 18, OPM says

"Informal agency and employee comments, however, suggest the 1982 payout was successful."

This was not a scientific sample nor is this information projectable to the merit pay population. In contrast, our questionnaire results, projectable to the three agencies, showed employee dissatisfaction with merit pay in 1982 to be about as great as it was in 1981. For example, between 41 and 54 percent of employees in each agency believed merit pay was not fairer in 1982 than in 1981, and in both years, about the same percentage of employees in each agency (between 4 and 7 percent) wanted to retain the merit pay system as implemented.

On page 22, OPM states

"Clearly, outstanding performance is very well rewarded under the merit pay-for-performance system . . . nearly one fourth received substantially more than they would have been compensated without pay-for-performance."

As support for this statement about merit pay employees in general, OPM cites the increases received by a sample of OPM employees since merit pay began. OPM concluded that, in 3 years, top performers have gone up the equivalent of almost three within-grade steps, and that 24 percent of its employees received substantially more and 31 percent received less than if they had remained under the General Schedule over that period.

Table 6 in OPM's report shows that top performers went up two and one-half steps in 3 years. However, how an employee fares in the General Schedule depends, for the most part, on the employee's position or step in the salary range. For example, a General Schedule employee in the first step who is rated average would receive three step increases in 3 years

which is more than the top OPM performers, and an employee in the middle three steps would receive one and possibly two step increases over the same period. Table 6 of the OPM report also shows that employees with "average" performance ratings who comprised 68 percent of the merit pay employees, received less than a full step increase over the 3-year period. Thus, employees in the first six steps of their grade who were rated at least "average" may have been better off in the General Schedule.

Our questionnaire data showed that between 41 and 52 percent of the employees in each department in 1982 believed that they had earned less under merit pay than they would have under the General Schedule.

On page 22, OPM notes

"This conclusion for OPM can be generalized government wide by the agency data which are available in OPM's government-wide management information system."

The data presented, however, are only representative of OPM--the OPM merit pay population is about one half of 1 percent of the Federal merit pay population. Also, OPM does not cite any statistics from its management information system to demonstrate that the OPM experience can be generalized on a governmentwide basis.

On page 24, OPM states

"The experience thus far with the merit pay system, as shown in test year experience . . . demonstrates clearly the program's success."

Our work has shown that, for about 25 percent of the federal merit pay population, most employees are dissatisfied with many aspects of the merit pay system. The system has, according to a majority of employees and pool officials, failed to motivate employees or improve their productivity and has created morale problems. About 80 percent of our survey respondents in each agency in both years thought that the benefits of the new systems did not justify the time and effort required to operate them. In addition, an OPM-financed study by the University of Michigan concluded that "it [merit pay] is not now serving its purposes of promoting pay equity and stimulating improved effort and performance."

On page 24, OPM concludes

". . . this information argues strongly for expanding pay-for-performance to cover the entire general schedule work force, and demonstrates clearly that the performance appraisal system is quite capable of bearing the additional 'weight' imposed by such a system."

We do not believe that data presented by OPM in this report support this conclusion. Attitudinal data presented by OPM are more than 2 years old and were collected before merit pay was fully implemented.

Further, OPM offers no evidence that the appraisal systems for the remainder of the General Schedule population are fair, accurate, or improving. Our review of General Schedule performance appraisal systems showed that refinements are needed to such systems and an OPM-financed study by the University of California concluded that "there is no indication that the merit pay experiment at grades 13-15 has been sufficiently successful to proceed with plans to include employees in grades 1-12." Further, another study published by OPM-financed researchers in January 1983 concluded that

". . . merit pay is not working in our two agencies or in most of the other agencies in which evaluations are taking place. By not working we mean that it is not widely accepted, it is not seen as an improvement, it is not rewarding deserving people fairly with significant raises, and it is not contributing to agency effectiveness."

Based on the difficulties we identified with OPM's report, we do not believe it provides support for the conclusions it reached regarding the extension of merit pay to other employees and agencies at this time. However, it should be noted that it takes several years of operation before the positive and negative aspects of a merit pay system can be adequately determined.



United States
**Office of
Personnel Management**

Washington, D. C. 20415

JUL 12 1983

In Reply Refer To

Your Reference

Honorable Jeff Bingaman
Ranking Minority Member
Subcommittee on Civil Service,
Post Office and General Services
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Bingaman:

During your last hearing on the subject, you inquired whether OPM would conduct a study on the subject of the relationship between pay and performance in the Federal sector. I have authorized such an examination.

I am happy to send you the results of that investigation, "Report on Pay for Performance in the Federal Government." The study, covering the years 1980-1982, is a review of the "pay for performance" concept under the Civil Service Reform Act of 1978. The data collected by OPM demonstrates the soundness of the pay for performance concept and improvements in the system during the past two years.

If I can be of any further assistance to you, please do not hesitate to contact me.

Sincerely,

Donald J. Devine
Director

Enclosure

REPORT ON
PAY FOR PERFORMANCE
IN THE FEDERAL GOVERNMENT
1980 - 1982

U.S. Office of Personnel Management
June, 1983

1. PERFORMANCE APPRAISALS

Pay-for-performance was established by the Civil Service Reform Act (CSRA) of 1978 for mid-level managers, GS-13 to GS-15. Pay-outs were to be based upon ratings under a new "performance appraisal" system for rating employees' performance. It was clear from the outset, that pay-for-performance was dependent upon fair and accurate performance appraisals.

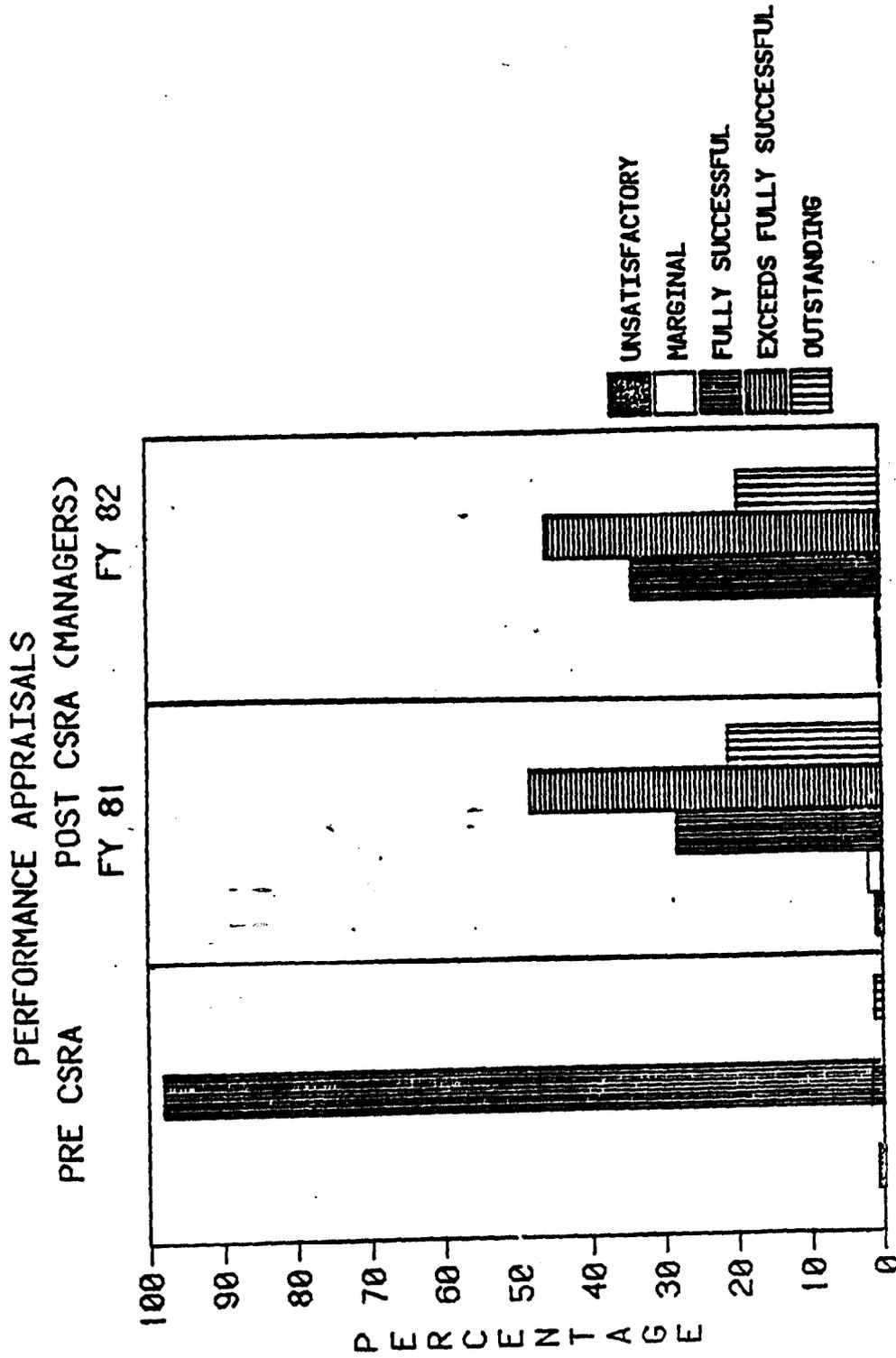
Data regarding employee attitudes about performance appraisal are available from the Federal Employee Attitude Survey, a scientific sample of Federal workers attitudes. It is clear from this data that, as the new performance appraisal system was being implemented, employees found the new system more fair. In 1979, slightly less than a majority found appraisals

TABLE 1: Employee Attitudes on Performance Appraisal

	<u>1979</u>	<u>1980</u>
Percent who think appraisals are fair	49%	65%

fair, but 6 in 10 did in 1980. With three subsequent years of upgrading of the system, it is just not credible to believe that employees can think the system is any less fair today.

Table 2 shows that the present performance appraisal system's integrity is infinitely better than that of the pre-CSRA evaluation system. Whereas over 98 percent were rated at one rating before CSRA, the first year after implementation of the new appraisal system, ratings spread across at least three major categories. Although the new system is far from an ideal



distribution, it does make distinctions between levels of performance.

Figures from the 1982 merit pay experience bear out the fact that the performance appraisal system is continuing to improve. As Table 2 shows, the percentage of people rated fully successful increased over the 1981 results, while the percentage of those rated above fully successful decreased. While the percentage of those rated above the fully successful level continues to be higher than the roughly 30 percent which would appear in an optimum distribution, the progress to date is indicative of real improvement. The 1982 data show a mean performance result of 3.8 on a five point scale. Thus, the mean rating is now lower than the "exceeds fully successful" rating.

There is every reason to believe that the improvements in the performance appraisal distributions of 1982 over 1981 will be repeated in 1983. Supervisors and employees alike are becoming even more accustomed to the procedures used in the system. Agencies and individuals also have received additional training, and now have a better understanding of the rating system and its importance. All the evidence, therefore, supports the conclusion that the performance appraisal system has improved so that it now is supported by employees, does distinguish between levels of performance, and has over time increasingly refined levels of performance.

II. THE PILOT MERIT PAY STUDY IN 1980

Merit pay for managers was set for full implementation in 1981. To prepare for this implementation, a test study was done a year earlier in eight Federal agencies, to anticipate problems and to have a data base upon which to proceed for the full implementation of pay-for-performance the next year. Table 3 below summarizes the results of that study (for the six agencies for which complete data are available).

TABLE 9: ANALYSIS OF MERIT PAY IN TEST YEAR (1981)

	PERFORMANCE APPRAISAL		PERCENT PAY INCREASE		EMPLOYEE AT	
	% receive more than FS	Average Rating	for Outstanding	for Fully Succ.	% say Fair Pay'mt	f Unf
<u>GOOD</u>						
FCA	33%	3.2	16%	12%	58%	
CCR	36	3.3	19	11	50	
<u>MODERATELY GOOD</u>						
OPM	58	3.6	14	10	55	
<u>TOO LAX</u>						
CAB	80	4.0	15	9	49	
EPA	85	4.1	14	8	43	
<u>TOO SEVERE</u>						
SBA	17	3.1	20	11	47	

The first important conclusion from the table is that employees generally believe that the pay-outs under merit pay were fair, and only a very few thought they were unfair. There were two exceptions to this general finding: 42 percent of employees in EPA thought their distribution was unfair and 45 percent in SBA. It easily can be seen from the table, however, that these perceptions of unfairness were related to the weakness of the performance appraisal systems in these two agencies at that time. A good distribution of appraisals above the "fully successful" level is usually recognized to be about 30 percent. It should be noted that the two agencies that have this kind of performance appraisal distribution have a good distributions of performance pay-outs, and very high perceptions of fairness among employees.

It is extremely interesting to note that the two cases of high perceived unfairness represent two different and extreme problems with performance appraisals. In one case, the ratings were too lax--with 85 percent of employees rated above fully successful. The pay-out rates for outstanding performers under this lax situation were rather low, and even more interestingly, the pay-out rates for fully successful employees was quite low too. Good employees at all rating levels suffered from this "over-gaming" of inflated performance ratings. Moreover, these results were very unpopular among employees. In the other case, appraisals were too severe in the opposite direction. In order to guarantee outstanding performers a very high pay-out (of 20 percent), only 17 percent of ratings were given above fully successful. This, too, resulted in a perception of unfairness among employees.

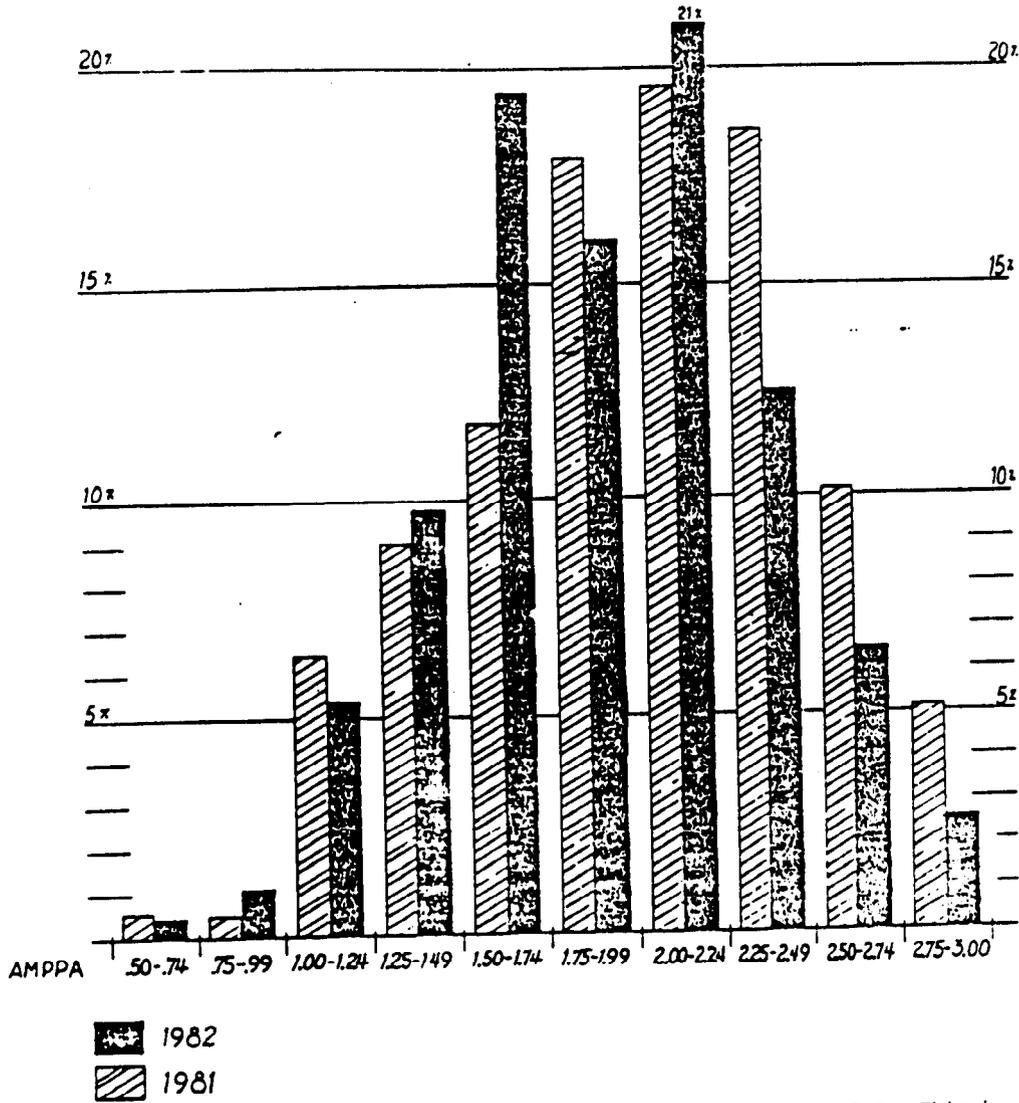
OPM is not aware of any current examples of the "too severe" distribution among agencies. There are agencies, however, that have a rating inflation problem. Most of these cases are closer to the CAB (80 percent above fully successful) level, which is less damaging for a performance pay-out system. All agencies have been informed of both of these problems and their adverse effects, and managers have been trained how to avoid them by good performance management. The result is that agencies are moving into the "moderately good" category and we, therefore, can anticipate the relatively good results shown for OPM in Table 3.

III. THE OPM EXPERIENCE 1980 - 1982

It was decided not to analyze government-wide data on the merit pay system for 1981. The acting Controller General, just a few days before merit pay was to be implemented, ruled that approximately 40 percent of the discretionary pay pool could not be paid out under the merit pay system. OPM modified the system to make the best out of a bad situation, but recognized that the system could never work with full effectiveness with 40 percent of its bonus pool taken away. This experience in 1982 obviously gave a poor start for merit pay, and even had adverse effects for the agencies which had successfully tested it a year earlier. Yet, this obviously was not the fault of the system, but resulted from the fact that it was underfunded after the late GAO decision. So it did not make sense to do a full scale evaluation under those circumstances.

Informal agency and employee comments, however, suggest the 1982 pay-out was successful. These comments were especially common before the new reforms were announced. Yet, OPM has systematically studied its own merit pay system over the past three years. These data provide a good indication of the strengths of a pay-for-performance system.

Distribution of Average Merit Pay Point Awards (OPM)



The 1982 agencywide average rating was 1.9 on a scale of 0.0 to 3.0. This is a decline of 0.1 from the 1981 average of 2.0. The ratings, while normally distributed, i.e., "bell-shaped", are centered to the upper end of the scale. Note the sharp decreases in ratings above 2.24 and the increase in the 1.5 to 1.74 range.

The overall OPM performance distribution has marginally improved over the three years. At the end of the third year, it would still only fall in the "moderately good" range, with 61 percent of merit pay ratings above fully successful. However, Table 4 shows that there were important changes within the overall ratings. The average rating went down from 2.0 to 1.9, and the top outstanding rate ranges decreased from 15 percent of employees to a much more reasonable 8 percent. This trend toward more realistic ratings is further illustrated by data which show that from 1981 to 1982, 51 percent of the ratings were reduced, while only 29 percent increased.

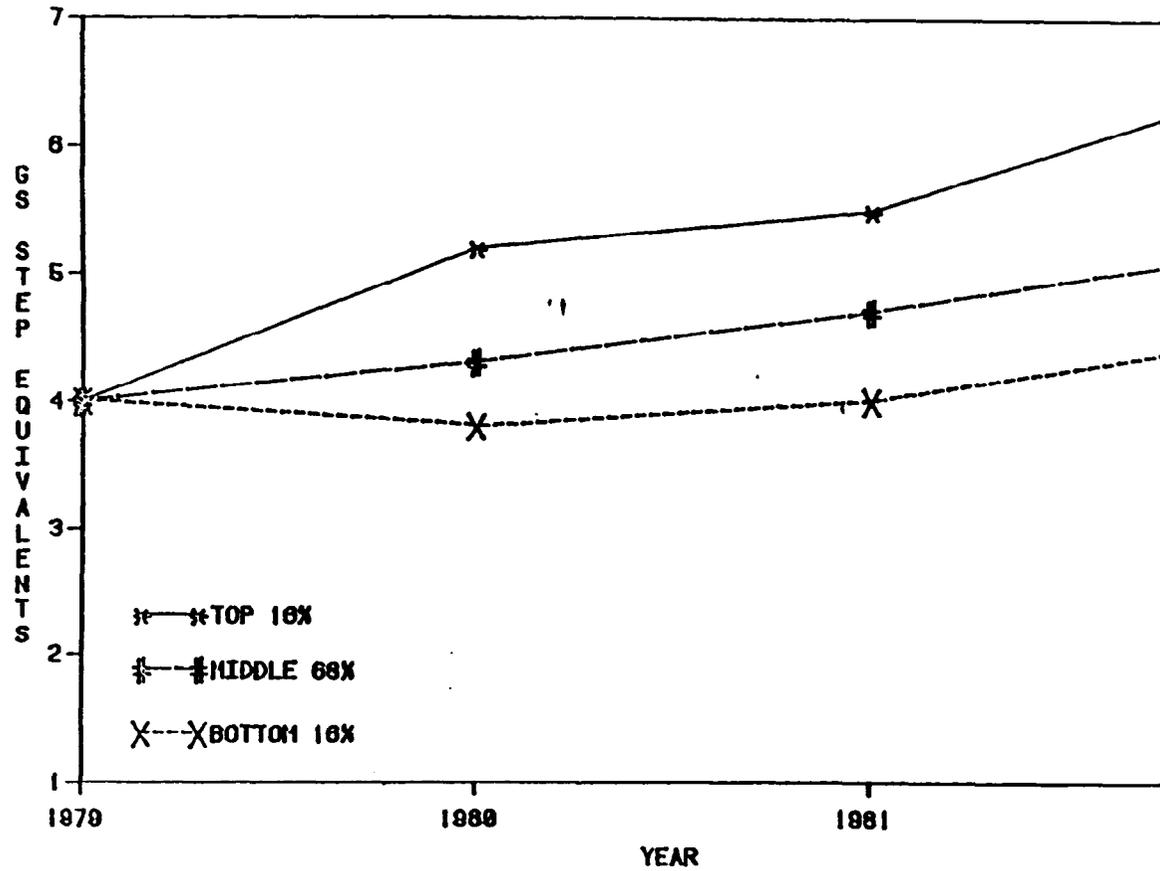
Senior executive ratings have changed even more dramatically, as shown in Table 5. In 1980, 23 percent were rated outstanding, compared to only 14 percent today. Those rated above fully successful dropped from an inflated 86 percent the first year to a more realistic 52 percent the third year. Fully successful ratings, meant to be the average rating, increased from 14 percent to a modal 41 percent.

TABLE 5. OPM Senior Executive Performance Ratings

	1980	1981	1982
Outstanding	23%	20%	14%
Exceeds Fully Successful	63	57	38
Fully Successful	14	22	41
Minimally Successful	0	0	7
Unsatisfactory	0	0	0

Table 6 tracks the merit pay-out over a four year period--from the old within-grade system through the three years of merit pay. Starting from an average of step 4 on the old range, the table shows that different levels of performance clearly have resulted in different pay-out patterns. The largest group, the average performance employees, has increased about one step, approximately what they would have earned under the old within-grade system. More importantly, the top performers have gone up almost three steps!

EFFECTS OF PERFORMANCE ON PAY CHANGES 1980-1982



Clearly, outstanding performance is very well rewarded under the merit pay-for-performance system.

Table 7 looks at the net effect on employees over the three year period. Nearly half of employees (45 percent) received approximately what they would have received under the old within-grade system. About 31 percent received less. But nearly one-fourth (24 percent) received substantially more than they would have been compensated without pay-for-performance. Hence, 7 out of 10 employees are being compensated as well or better after three years of merit pay than under the old within-grade system.

This conclusion for OPM can be generalized government-wide by the agency data which are available in OPM's government-wide management information system. These data show that across government there is a statistically significant relationship between the dollar amounts of individual merit payouts and the summary results of performance appraisals for individual employees. These, together with the OPM results, provide face validity for the ability of the appraisal process to support a meaningful pay for performance system.

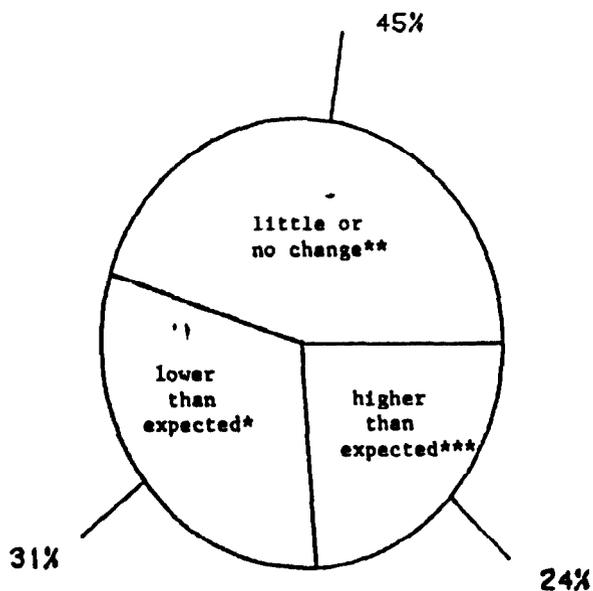
IV. CONCLUSION

All of the data available to date support two important conclusions: the Federal government's new performance appraisal system is functioning very well, less than two years after its establishment. And pay-for-performance, presently effective only for higher-graded managers and supervisors, has been effective in providing greater rewards for above average performers, while achieving a high degree of acceptance among employees.

The performance appraisal system established by the Civil Service Reform Act, and implemented fully on October 1, 1981, is a major

TABLE 7

EFFECT OF THREE YEARS OF MERIT PAY ON SALARIES
1980-1982 400 EMPLOYEES



- * INCREASE LESS THAN STEP EXPECTED
- ** INCREASE LESS THAN 1 STEP HIGHER
- *** INCREASE 1 STEP OR MORE HIGHER

improvement over the system previously used, and has benefited from a determined effort to upgrade elements and standards by agencies since that time. While the gains are small in some instances, others are greater, and all of the change is in the direction of significant improvement.

In fact, improving and upgrading the performance appraisal system has been the top priority of the Office of Personnel Management over the past two years: it has been the subject of Cabinet deliberations on two separate occasions, it is discussed on a regular continuing basis with assistant secretaries for personnel and agency personnel officers, and a large number of training sessions have been held to upgrade the performance management skills of agency managers.

The experience thus far with the merit pay system, as shown in test year experience, as well as OPM's regular evaluations, demonstrates clearly the program's success. Where the performance appraisal system on which merit pay is based is sound, or even marginally sound, the system gives the desired payouts, and is perceived as fair by employees. Outstanding performers easily can receive the equivalent of step increases three steps above where they would be under the old general schedule within-grade system. Most employees do as well as they would have under the old system, while more than one-quarter of employees are better off under pay-for-performance because of the financial rewards given them for their better-than-average performance.

Taken together, this information argues strongly for expanding pay-for-performance to cover the entire general schedule work force, and demonstrates clearly that the performance appraisal system is quite capable of bearing the additional "weight" imposed by such a system. The Federal government is ready to join the private sector in basing pay on how well employees perform.

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