Department of Defense National Security Personnel System:
The Transition to Pay for Performance

by

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SUBMITTED TO THE MIT SLOAN SCHOOL OF MANAGEMENT IN PARTIAL
FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF

MASTER OF BUSINESS ADMINISTRATION

at the

MASSACHUSETTS INSTITUTE OF TECHNOLOGY

June 2004

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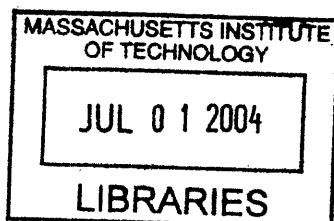
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Abstract

The 2004 National Defense Authorization Act (Public Law 10-136, November 24, 2003) gives the Department of Defense (DoD) authority to establish the National Security Personnel System (NSPS). This system will mark the most significant reform to civilian personnel management in 25 years. The DoD expects to implement the NSPS in a phased approach extending over two years, and is giving consideration to the Department of the Navy being the lead service. The NSPS will be built on best practices and lessons learned from nine DoD pilot programs that have been conducted in eight laboratories and one Pentagon acquisition organization. The NSPS is being designed to simplify an overwhelming job classification system, refocus performance appraisals, and link pay and retention to employee performance.

Such a dramatic change to a system that has endured for so many years is bound to pose tremendous challenges to the DoD. This thesis will explore the challenges associated with pay-for-performance and provide a series of considerations that should be addressed during the implementation process. The thesis begins by discussing the history of the civil service system and its evolution toward a pay-for-performance system, then focuses on the results of three DoD pilot programs that implemented pay-for-performance in the last 25 years. It continues by exploring the present need for civil service reform, discusses the Department's expectations for the new NSPS, and offers some insights into the preliminary implementation plan. The thesis concludes by presenting research on public sector pay-for-performance systems and makes a series of recommendations which the DoD may want to consider in the course of developing and implementing the new pay-for-performance system.

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Disclaimer

The personal views expressed in this document should be considered those of the author and under no circumstances should they be attributed to the Department of Defense.

Acknowledgments

I would like to thank my thesis advisor, Professor Lotte Bailyn, for her wisdom, guidance and professional advice throughout the development of this thesis.

I would also like to recognize my husband, Bill Davies, for his unwavering devotion and understanding during the past year.

Finally, I wish to express my deepest appreciation and gratitude to my wonderful parents, Bob and Gerri Peter, for their everlasting support and devotion to me and my endeavors.

CHAPTER

1

History of Civil Service

The history of the American public service extends back as early as 1789 when

George Washington began making appointments to fill federal public service positions.

Washington is generally credited with establishing the precedent by selecting people who

were considered to be highly competent and possessed fitness of character (Ingraham, 1995).

His federal public service employees were generally high-ranking officials appointed by the

president or workers such as clerks and accountants, but both types of employees considered

public service an honor and even a duty (Ingraham, 1995).

President Jefferson first initiated patronage in the system by using party service as a

valid criterion for making appointments to public service. He replaced many of the

Republican public service employees with Federalist employees. This action constituted the

beginning of the "spoils system" as the number of federal employees increased from 3,000 in

1800 to 20,000 by 1831 (Ingraham, 1995). This rapid growth, coupled with an ineffective

control system, gave rise to certain abuses in federal public service. Absenteeism, internal

promotions, and appointing friends of the party in power were common. These actions began

to tarnish the public's perception of public servants and caused concern among members of

Congress (Ingraham, 1995).

The spoils system in American public service became even more rampant between

the years 1845 to 1865 (Ingraham, 1995). Party patronage continued to thrive in the selection

of public service employees, and the public began to demand changes to federal service practices. In 1853, Congress passed legislation that required examinations for administrative clerk positions in the Post Office and the General Land Office, as well as a basic classification system (Ingraham, 1995). Using examinations to determine whether a potential employee possessed the necessary qualifications to perform the job was a radical departure from the party loyalty qualification that prevailed at that time.

In spite of these initiatives, however, the spoils system continued to flourish. The federal bureaucracy grew, and the number of employees on the federal payroll increased to over 53,000 by the end of the Civil War (Pendleton Act). Patronage became more indefensible as the appointment of unqualified individuals led to poor performance, corruption, and abuse of power. The Congress finally formed a Joint Committee on Retrenchment, which was charged with considering the use of examinations for entry to federal employment. Although the report issued by the Committee in 1868 condemned the spoils system, the recommendations were not adopted by Congress. The recommendations did, however; bring attention to the need for a more comprehensive effort to improve the public service system (Ingraham, 1995).

The Appropriations Bill of 1871 authorized the President to "prescribe such regulations for the admission of persons into public service for the United States as may best promote the efficiency thereof and to ascertain the fitness of each candidate in respect to age, health, character, knowledge, and ability" (Ingraham, 1995, 24). As a result of this bill, President Grant created the Advisory Board for the Civil Service, which consisted of seven members and was chaired by George William Curtis, an advocate of broad civil service reform. This Civil Service Commission, as it was later referred to, developed a framework

for the creation of a future permanent merit system. Once again, members of Congress wanted to continue patronage to ensure their stability in office, so they refused to fund the Commission. With no funding, the President disbanded the Commission in 1875.

Although pressure to reform the civil service system continued as the number of state and local reform leagues grew, it did not became an issue in presidential and congressional elections until 1880. President James Garfield's administration began pushing for reform despite Congressional opposition to any major reform. But after only six months in office, President Garfield was shot by a former disgruntled campaign worker who was seeking an appointment in the federal government. The circumstances of Garfield's death suddenly elevated the civil service reform issue, making it a top national priority.

The National Civil Service Reform League was founded less than one month after President Garfield's death. By the end of 1881, a reform bill was introduced by Senator Pendleton of Ohio, Chairman of the Senate Committee on Civil Service Reform. The bill's basic principle was that admission to the civil service would be through fair, open, and competitive examinations. A bipartisan majority passed the bill, which was signed by President Chester A. Arthur in January 1883. This piece of legislation established a merit system in federal offices that employed more than 50 employees (which covered about 14,000 out of 130,000 civil servants) and has had a lasting impact on civil service in the U.S. government (The Readers Companion to American History).

The Pendleton Act was successful in separating politics from merit. The merit system was expanded by each president and "by 1900 workers were becoming more professionalized, better educated people were being recruited, local political considerations

were giving way to national concerns, and political influence was being replaced by business interests" (The Readers Companion to American History, 2).

As the number of civil service employees increased, reforms to the civil service system resulted in better management practices that achieved employee efficiency and economy which in turn accelerated the trend toward a career service. By 1920, 80% of civil service employees were covered under merit system rules (The Readers Companion to American History).

In 1923, a retirement system for civil service employees was instituted. In 1949, a bipartisan commission recommended that the hiring procedures be simplified, that workers receive higher, more uniform salaries, and that the Civil Service Commission coordinate all personnel matters. That same year, the Department of Defense (DoD) was established, making the civil service and military personnel the largest workforce in the U.S. government.

The first major revision to the Pendleton Act did not come until the bipartisan Civil Service Reform Act of 1978 (CSRA) was introduced by President Jimmy Carter, which was "designed to foster a new era in human resources management" (Light, 2003a). The Act abolished the Civil Service Commission and divided its functions between the Office of Personnel Management (OPM), a Federal Labor Relations Authority to oversee labor-management relations, and an independent quasi-judicial Merit System Protection Board. The CSRA's changes included the following (Ingraham, 1995):

- establishing a performance evaluation system to increase productivity and establish a link between pay and performance;
- establishing a merit pay system for mid-level managers;
- creating a Senior Executive Service;

- providing greater protection for whistle-blowers;

- providing a new authority for personnel administration research and development; and

- committing to equal employment opportunity and a socially representative bureaucracy.

Prior to CSRA, pay raises were made through within-grade step increases. These pay raises were almost automatic, without any significant relationship between performance and scheduled pay increases. Under CSRA, merit pay for mid-level federal managers became goal oriented in order to create incentives for better performance and to reward merit on an individual basis. Under this system, only half of the pay increase was automatic. Any additional pay raise was to be awarded to employees according to their performance rating.

The creation of the Senior Executive Service (SES) was another major initiative of the CSRA. Members of SES are higher-level, elite civil servants, top-ranking managers who are selected, promoted, and rewarded on merit. The SES has its own personnel management system which includes pay-linked performance with performance-based cash bonuses.

The merit pay system was replaced in 1984 by the Performance Management and Recognition System (PMRS). PMRS was a pay-for-performance system that initially appeared to be an improvement to CSRA. The new PMRS performance appraisal system established five summary rating levels: Level 1 was "Unacceptable," Level 3 was "Fully Successful," and Level 5 was "Two Levels Above Fully Successful." Level 2 was defined as between "Unacceptable" and "Fully Successful." Level 4 was defined as one level above "Fully Successful" (U.S. Merit Systems Protection Board, 1987). An employee receiving a

Level 3 or higher was entitled to the full amount of any general pay increase authorized during the pay adjustment period and in addition could receive a merit increase as determined by the rating. In accordance with OPM regulations, employees who received a Level 5 rating were guaranteed performance awards between 2% and 10% of their base pay, and supervisors of employees who received a Level 4 rating were encouraged to receive a performance award. Employees receiving a Level 3 rating were permitted to receive performance awards.

Several problems became apparent in the implementation of PMRS in 1985. The most severe problem was that OPM did not issue timely guidance, the guidance changed several times, and there was inadequate coordination with OPM in preparing the PMRS regulations. Although this deficiency was corrected when final written guidance on PMRS was issued in February 1986, the lack of initial guidance caused a major problem with the first performance-rating cycle, which ended in October 1985. During this rating period, more than two-thirds of employees subject to the PMRS received Level 4 and Level 5 ratings; indicating that they exceeded normal expectations (U.S. Merit Systems Protection Board, 1987). In October 1985, the OPM reported that of the 4,137 DoD employees (excluding Air Force, Army, and Navy civilians), 25.3% received a Level 5 rating and 45.3% received a Level 4. Therefore, over 70% of DoD employees were eligible or encouraged to receive a performance award.

The results for the individual services were not much different. The Navy reported 76.8% of its employees received a Level 4 or Level 5 rating. The Air Force and Army reported similar percentages for the same year, 64% and 60.4%, respectively (as cited in U.S.

Merit Systems Protection Board, 1987). For obvious reasons, agencies immediately became

concerned with these inflated and unrealistic performance ratings.

The disproportionate number of high ratings was attributed in part to the lack of

training provided for the new system. A survey in early 1986 asked 21,000 employees: "How

much do you know about the changes made to the merit pay system when it became the

current PMRS for supervisors and management officials at grades 13 through 15 in your

agencies?" Seventy-seven percent of employees responded to the survey question. The

results are presented in Exhibit 1.1 and clearly demonstrate a lack of understanding of the

PMRS by general manager employees.

**Exhibit 1.1 Knowledge of the changes made to the
Merit pay system when it became PMRS.**

Total Responses (N = 16,651)	"A Great Deal"	"Some"	"Little or Nothing"
GM Supervisors	28.6%	53.6%	17.8%
Nonsupervisors	19.0%	54.1%	27.0%
GM Combined	26.7%	53.7%	19.6%

Source: (U.S. Merit Systems Protection Board, 1987, 3)

By the end of 1993, PMRS was on an orderly termination track as the Clinton

administration's National Performance Review began to contemplate ways to reform the

government's performance management system. In January 1995, the OPM issued

regulations and recommendations that encouraged individual agencies to implement tailored

performance management and incentive award programs to better meet their organization

and workforce needs. Although these regulations offered greater flexibility, there is little

evidence to suggest that these agencies made significant changes to their performance management programs.

Personal experience supports this notion. I entered federal service in 1989 as a GS-12 Program Analyst with the Department of the Navy. After 15 years of service, I can report that I have not witnessed any significant changes in personnel management practices during the course of my career, including the administration of performance appraisals, performance awards, within-grade increases, or hiring and firing practices.

The federal government has had 25 years of further experience since the 1978 Civil Service Reform Act and there have been only mixed results. "On the one hand, its efforts to institute several variations of government wide pay-for-performance under the 1978 act have produced unacceptable frustration and unacceptable over-grading. On the other hand, the federal government has conducted a variety of successful experiments, including a half dozen at the DoD that covered more than 30,000 employees, many of which have shown great promise" (Light, 2003A).

CHAPTER

2

Federal Personnel System
Demonstration Projects

During the past 25 years, OPM authorized twelve personnel demonstration projects

for the purpose of implementing pay-for-performance systems (GAO, 2004). Three DoD

projects are presented in this section, which will highlight results obtained from a recent

Government Accounting Office (GAO) audit and Report to Congressional Requesters, which

was submitted on January 23, 2004. The projects include:

- the Navy Demonstration Project at China Lake ("China Lake"),

- the Naval Sea Systems Command Warfare Center ("NAVSEA") at Newport,

    and

- Civilian Acquisition Personnel Demonstration Project ("AcqDemo").

Each demonstration project pursued different approaches to designing and

implementing a pay-for-performance system that would work best for its workforce and

organization. However, each agency used some form of pay banding to replace the present

system of GS grades 1 though 15. Individuals transitioning into one of these projects had to

establish their position of record. Depending on their occupational series, their position

would be grouped into one of several different career paths, and then their current grade used

to determine the pay band (with set upper and lower dollar limits) within the career path.

Once the employee transitioned into the project, GS ratings were no longer applicable.

The projects differed in the way they:

- used competencies to evaluate employee performance,

- translated employee performance ratings into pay increases and awards,

- considered current salary in making performance-based pay decisions,

- managed the costs of the pay-for-performance system, and

- provided information to employees about the results of performance appraisal and pay decisions (GAO, 2004, 9).

A.   The Navy Demonstration Project at China Lake

The China Lake project began implementation in 1980 with three key objectives: "To develop an integrated approach to pay, performance appraisal, and classification; allow greater managerial control over personnel functions; and expand the opportunities available to employees through a more responsive and flexible personnel system" (GAO, 2004, 43).

Each employee and supervisor develops an individual performance plan that is tailored to the employee's responsibilities and expected results based upon his/her position. The criteria are set in two ways depending on the type of position. The first approach is a "task approach," which defines the individual's output. The second approach is a "function approach," which defines the required skills and how well they are to be performed. In addition, some positions require the supervisors to select several management competencies that best pertain to the skills and supporting behaviors the employee is expected to demonstrate as he/she carries out work activities. The consensus among China Lake officials is that tailoring the individual performance plans focuses the employees' attention on meeting expectations while core competencies send a message about what is important to the

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organization (GAO, 2004). Supervisors conduct two progress reviews during the annual performance cycle, and employees are encouraged to submit a self-assessment. Managers at China Lake hope to develop the ability to translate employee performance ratings to pay increases and awards.
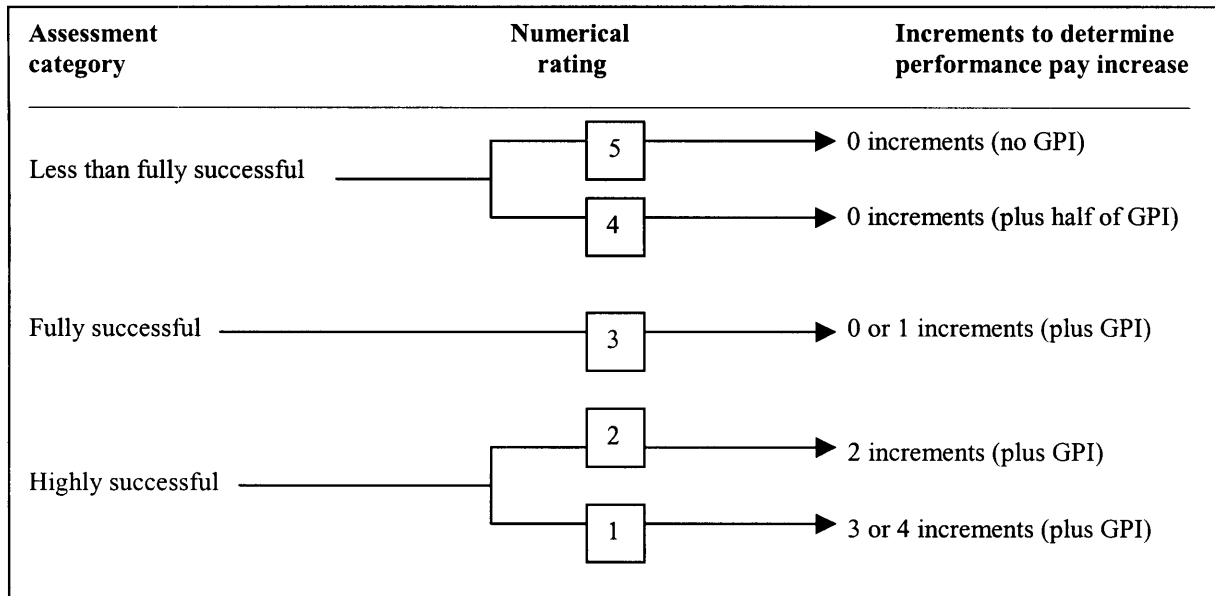
The China Lake project focuses on several management objectives:

1. To provide candid and constructive feedback that helps the employee maximize his/her understanding and realize the goals and objectives of the organization.

2. To provide management with the objective feedback information it needs to reward top-performing employees.

3. To provide the necessary information and documentation to deal with poor performance.

China Lake establishes predetermined pay increases, awards, or both depending on the specific performance rating. Appraisal ratings are given by supervisors who assign a numeric rating in three categories: "Highly Successful" (Level 1 or 2), "Fully Successful" (Level 3), and "Less Than Fully Successful" (Level 4 or 5). This rating system is similar to what existed under the PMRS. A second-level review is required for all performance evaluations, and an overall assessment of "Highly Successful" must be reviewed and approved by the department's Performance Review Board in order for the Level 1 or 2 rating to be approved. Employee grievances are submitted to a third-level supervisor for investigation and a final determination is required within 21 days.

The China Lake assessment categories are directly linked to a predetermined range of permanent pay raises as shown in Exhibit 2.1.

Exhibit 2.1 China Lake's Rating and Pay Distribution Structure

Assessment category	Numerical rating	Increments to determine performance pay increase
Less than fully successful	5	0 increments (no GPI)
	4	0 increments (plus half of GPI)
Fully successful	3	0 or 1 increments (plus GPI)
Highly successful	2	2 increments (plus GPI)
	1	3 or 4 increments (plus GPI)

Source: GAO, 2004:14

In 2002, China Lake rated 3,677 employees using this system. China Lake supervisors awarded "Highly Successful 1" ratings to 415 employees (11.3%), and "Highly Successful 2" ratings to 1,639 employees (44.6%). A "Fully Successful 3" rating was awarded to 1,617 employees (44%). Only six employees received "Less than Fully Successful 1 or 2" ratings (GAO, 2004). The 2002 pay distribution for China Lake is shown in Exhibit 2.2 .

Exhibit 2.2 China Lake's Rating and Pay Distribution Structure (2002)

Assessment Category	Numerical Rating	No. of employees receiving permanent pay increases	Increase as a percentage of base pay		
			Average	Lowest	Highest
Highly Successful	1	191	5.3	1.5	9.3
	2	929	3.4	1.5	5.6
Fully Successful	3	526	1.8	1.3	2.7
Less than fully successful	4	0	N/A	N/A	N/A
	5	0	N/A	N/A	N/A
Total		1,646			

Source: GAO, 2004:16

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It is significant to note that the average permanent pay increase at China Lake in 2002

rose with performance and ranged from 1.8% to 5.3%. The six employees who received

either a 4 or 5 rating received no performance allotment. Those employees already at the top

of the pay band for their GS grade could not receive a permanent pay raise but could receive

an incentive bonus.

After almost 26 years, the China Lake project was granted permanent status in 1994,

and in 2003 reported approximately 3,900 employees participating in the program (GAO,

2004). Employee satisfaction with the program has increased through the years with 71% of

employees in 1998 in favor of the demonstration project. These results are shown in Exhibit

2.3 .

Exhibit 2.3 Selected Employee Attitude Data for China Lake

		Demonstration Group		
		Agree (%)	Disagree (%)	N
"Under the present system, financial rewards are seldom related to employee performance."	**Baseline (1979)**	37	39	2,221
"Pay raises depend on how well employees perform their jobs	**(2003)**	40	40	1,149
"Job satisfaction—your pay"	**Baseline (1993)**	59	28	1,200
"All in all, I am satisfied with my pay."	**(2003)**	52	25	1,149
"I feel that my supervisor will rate my performance (and set my pay) in a fair, impartial manner."	**Baseline (1979)**	63	14	2,221
"My performance rating represents a fair and accurate picture of my actual job performance."	**(1993)**	56	26	1,200
"I am in favor of the demonstration project."	**Baseline (1979)**	29	no data	2,221
	(1998)	71	13	no data

Legend: N = number of respondents

Source: GAO, 2004:45

In October 1994, the OPM prepared a summary assessment of the project and reported the following significant outcomes:

- "Employees viewed performance improvements within their control and reported increased recognition and individual performance.

- The perception of pay for performance link was significantly strengthened under the demonstration project pay for performance system, but not in the comparison group.

- Pay satisfaction increased slightly at the demonstration sites and declined at the control laboratories.

- Employees and supervisors cited improved communication, a more objective focus, and clearer performance expectations as major system benefits.

- Employees and supervisors perceived their performance appraisal system to be more flexible than the comparison group, to focus more on actual work requirements, and thus to be more responsive to laboratory needs.

- Employees at the demonstration project reported having more input into the development of performance plans (than employees in the comparison group)." (GAO, 2004, 46)

B.   The Naval Sea Systems Command Warfare Center at Newport (NAVSEA)

The NAVSEA project began implementation in 1998 with five key objectives:

1. develop employees who can meet the changing needs of the organization,

2. help employees achieve their career goals,

3. improve performance in current positions,

4. retain high performers, and

5. improve communication with customers, colleagues, managers, and employees (GAO, 2004).

NAVSEA uses eight competencies to assess employee performance. Like China

Lake, NAVSEA translates employee performance ratings to pay increases and awards. In this

pay-for-performance system, supervisors rate employees as either "Acceptable" or

"Unacceptable." Employees who are rated as unacceptable do not receive pay increases or

awards. Those employees who are rated as acceptable are rated again and then placed in one

of three categories: Contributor, Major Contributor, or Exceptional Contributor. Supervisors

assign pay points, ranging from 0 to 4, depending on the rating category and each employee's

salary. This rating and performance pay distribution is shown in Exhibit 2.4.

Exhibit 2.4   NAVSEA Rating and Performance Pay Distribution Structure

Rating Category	Points to determine performance increase forward
Unacceptable ──────────────────➤	0 pay points
Contributor ──────────────────➤	0-2 pay points
Major contributor ──────────────➤	1-3 pay points
Exceptional contributor ─────────➤	2-4 pay points

Source: GAO, 2004:17

In 2002, NAVSEA rated 2,111 employees using this system. Supervisors rated 837

employees as "Exceptional Contributors," 851 employees as "Major Contributors," 423

employees as "Contributors," and no employees were rated as "Unacceptable" (GAO, 2004).

The NAVSEA pay increase and award distribution for 2002 is shown in Exhibit 2.5.

Exhibit 2.5 NAVSEA Pay Increase and Award Distribution (2002)

| Rating | Permanent Pay Increase | | | | Performance Award | | | |
| | No. of employees receiving permanent pay increases | Increase as a % of base pay | | | No. of employees receiving performance awards | Performance award amount | | |
		Average	Lowest	Highest		Average	Lowest	Highest
Exceptional Contributor	666	2.9	0.1	7.0	615	$2,216	$561	$5,680
Major Contributor	602	2.0	0.9	5.3	613	1,592	561	4,260
Contributor	124	1.6	1.2	1.8	143	1,089	519	2,212
Unacceptable	0	n/a	n/a	n/a	0	n/a	n/a	n/a
Total	1,412				1,371			

Source: GAO, 2004:19

It is significant to note that the average permanent pay increase ranged from 1.6% to 2.9% for employees who received a category rating of Contributor, Major Contributor, or Exceptional Contributor, and about 80% of employees were ranked in the top two categories. Projects like this one and China Lake have chosen to establish predetermined pay increases, awards, or both depending on a given performance rating. Therefore, one can see in the above table that the number of employees receiving pay increases and awards differs from those receiving ratings.

Regarding the review process for performance recommendations, second-level supervisors review all recommendations provided by first-line supervisors and make any necessary changes to achieve balance and equity within the organization. The second-level supervisors then submit their recommendations to pay pool managers who review the package using the same process and then forward their recommendations to the department head for final approval.

Six years after the NAVSEA project was implemented, it is still an active program

with more than 21,000 employees participating as of April 2003 (GAO, 2004). Although not

as convincing as the China Lake project, the employee attitude data in Exhibit 2.6 suggest

that the demonstration project is preferred over a traditional personnel system.

Exhibit 2.6 Selected Employee Attitude Data for NAVSEA

		Demonstration Group		
		Agree (%)	Disagree (%)	N
"Pay raises depend on how well I perform"	Baseline (1996)	23	56	6,372
	(2001)	50	32	2,606
"All in all, I'm satisfied with my pay."	Baseline (1996)	34	47	6,397
	(2001)	49	32	2,603
"My performance rating represents a fair and accurate picture of my actual performance"	Baseline (1996)	56	27	6,400
	(2001)	56	25	2,609
"I have trust and confidence in my supervisor"	Baseline (1996)	57	22	6,350
	(2001)	64	18	2,602
"I prefer the following personnel system": Demonstration system Traditional personnel system	(2001)	 43 36		2,563

Source: GAO, 2004:61

Legend: N = number of respondents

In August 2002, OPM prepared a summary evaluation of the DoD Science and

Technology Reinvention Laboratory Demonstration Program and reported the following

significant outcomes between 1996 and 2001:

- "The percentage of people who agreed that their managers promote effective communication among different work groups increased from 31 to 43 percent.

- On the other hand, NAVSEA employees' response to the statement, "High performers tend to stay with this organization" stayed constant at about 30 percent during this time.

- Additionally, the percentage of employees who said that they have all of the skills needed to do their jobs remained consistent at 59 and 62 percent, respectively." (GAO, 2004, 62)

C.   The Civilian Acquisition Personnel Demonstration Project (AcqDemo)

The AcqDemo project began a phased implementation in 1999 with four key objectives: "to attract, motivate, and retain a high-quality acquisition workforce; achieve a flexible and responsive personnel system; link pay to employee contributions and mission accomplishment; and to gain greater managerial control and authority over personnel processes" (GAO, 2004, 63).

Unlike China Lake, this system applies competencies across the organization to evaluate employee performance. Six factors (problem solving, teamwork/cooperation, customer relations, leadership/supervision, communication, and resource management) are used for all employees. "Discriminators" and "descriptors" are then used to further define each factor by career path and pay band, respectively. According to AcqDemo, "Taken together, the factors, discriminators and descriptors are relevant to the success of a DoD acquisition organization" (GAO, 2004, 10).

In AcqDemo, individuals are grouped into pay pools and all employees are evaluated together. Pay pools usually correspond to the organization, division, or directorate and usually contain individuals from different functional areas. Supervisors provide "contribution scores" to the pay pool manager who has final approval authority. Unlike some of the older evaluation processes, the AcqDemo system actually plots contribution scores against two curves: the employees' current salary and a "standard pay line." This plot is used to determine if the employee is being "appropriately compensated," "under-compensated," or

"over-compensated." To illustrate this system, Exhibit 2.7 demonstrates how the AcqDemo project makes its performance pay decisions.

Exhibit 2.7 AcqDemo's Consideration of Current Salary in Making Performance Pay Decisions
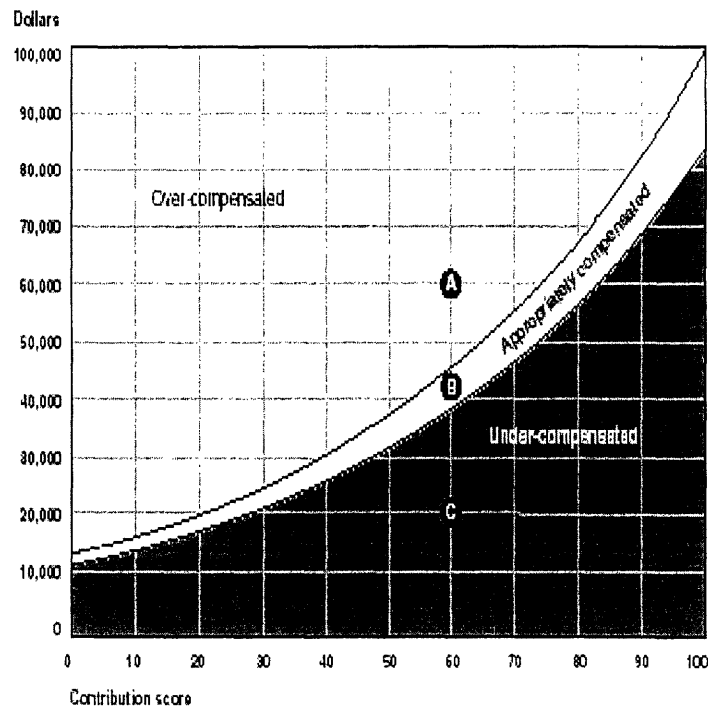
A = An employee who received a contribution score of 60 and earns a $60,000 base salary is considered over-compensated given his or her level of contributions and may receive a reduced or no GPI and will not receive a permanent pay increase or award.

B = An employee who received a contribution score of 60 and earns a $40,000 base salary is considered appropriately compensated given his or her level of contributions and receives the GPI and may receive a permanent pay increase, award, or both. However, the system is designed so that the pay increase does not move the employee outside of the normal pay range.

C = An employee who received a contribution score of 60 and earns a $20,000 base salary is considered under-compensated given his or her level of contributions and receives the GPI and is eligible for a permanent pay increase and award.

Source: GAO, 2004:24

According to the GAO, the AcqDemo project

> ...has made progress in matching employees' compensation to their
> contributions to the organization. From 1999 to 2002, appropriately
> compensated employees increased from about 63 percent to about 72
> percent, under-compensated employees decreased from about 30 percent
> to about 27 percent, and over-compensated employees decreased from
> nearly 7 percent to less than 2 percent (GAO, 2004).

Although employees were skeptical about the AcqDemo program when it began in

1998, Exhibit 2.8 shows clearly that in five years attitudes among employees have become

positive about the program.

Exhibit 2.8 Selected Employee Attitude Data for AcqDemo

		Demonstration Group		
		Agree (%)	Disagree (%)	N
"In this organization, my pay raises depend on my contribution to the organization's mission."	**Baseline (1998)**	20	54	2,748
	(2003)	59	28	2,027
"All in all, I'm satisfied with my pay."	**Baseline (1998)**	49	32	2,748
	(2003)	57	32	2,027
"My performance rating represents a fair and accurate picture of my actual performance."	**Baseline (1998)**	75	14	2,748
	(2003)	54	33	2,027
"I have trust and confidence in my supervisor."	**Baseline (1998)**	63	18	2,748
	(2003)	66	18	2,027
"I am in favor of the demonstration project."	**Baseline (1998)**	25	48	2,748
	(2003)	52	30	2,027

Source: GAO, 2004: 65

Legend: N = number of respondents

Six years after the AcqDemo project was implemented, it is still an active program

with more than 6,500 employees from various organizational units including the Air Force,

Army, Navy, and Marine Corps as well as the Office of the Under Secretary of Defense

(GAO, 2004). In 2002, the authority for the project was extended to December 2012 (GAO, 2004).

In July 2003, OPM prepared a management report on the DoD AcqDemo project and reported the following significant outcomes from the program:

- "Attrition rates for over-compensated employees increased from 24.1 percent in 2000 to 31.6 percent in 2002. Attrition rates for appropriately compensated employees increased from 11.5 percent in 2000 to 14.1 percent in 2002. Attrition rates for under-compensated employees decreased from 9.0 percent in 2000 to 8.5 percent in 2001 and then increased to 10.2 percent in 2002.

- Increased pay-setting flexibility has allowed organizations in AcqDemo to offer more competitive salaries, which has improved recruiting.

- Employees' perception of link between pay and contribution increased, from 20 percent reporting that pay raises depend on their contribution to the organization's mission in 1998 to 59 percent in 2003." (GAO, 2004, 66)

SUMMARY

After reviewing the data for each of the projects, three points merit further discussion since they are also relevant to the implementation of the NSPS. Exhibit 2.9 compares employee responses based on several statements regarding the demonstration projects: "Pay raises depend on how well employees perform their jobs;" "I am in favor of the demonstration project;" and "My performance rating represents a fair and accurate picture of my actual job performance." Although each survey worded these statements somewhat differently, the essence is the same.

Exhibit 2.9 Consolidated Employee Attitude Data

Statement	China Lake (% Agree)		NAVSEA Newport (% Agree)		AcqDemo (% Agree)	
"Pay raises depend on how well employees perform their jobs"	1979	37%	1996	23%	1998	20%
	2003	40%	2001	50%	2003	59%
"I am in favor of the demonstration project"	1979	29%			1998	25%
	1998	71%	2001	43%	2003	52%
"My performance rating represents a fair and accurate picture of my actual job performance"	1979	63%	1996	56%	1998	75%
	1993	56%	2001	55%	2003	54%

Source: Author, 2004

The employee responses indicate there was a significant amount of skepticism associated with pay-for-performance systems in the early years. Employees did not believe their pay raises reflected their performance levels. However, over time employee recognition of the link between pay and performance increased dramatically under the NAVSEA and AcqDemo projects, and slightly with China Lake. One explanation might simply be that as employees and managers acquired experience, familiarity, and knowledge about the system, they became more trusting and therefore gained a higher regard for the results.

A similar trend emerged with program preference. In the early years, employees were not in favor of the projects, but more recently employees have expressed a high regard for them.

It is interesting that in all three demonstration projects, employees believed that, over time, their supervisors rated them less fairly. One explanation for this, particularly in the AcqDemo project, may be that the demonstration projects developed more proficient managers who can, over time, better assess employee performance. If this is the case, it is highly likely that employees who received outstanding evaluations under the old system

would have more difficulty adjusting to not being considered one of the organization's top performers under the new system.

At the present time, the DoD operates under nine titles of the U.S. Code, orchestrates nine personnel demonstration projects covering over 30,000 employees, manages over 50 different pay plans, and supports several alternative personnel systems (DoD, 2003C). It is generally accepted that traditional personnel systems, all deeply rooted in the 1978 Civil Service Reform Act, are too rigid and inefficient to manage the federal workforce and at the same time meet the DoD's missions in the twenty-first century. The demonstration projects, however, lend credence to the fact that improvement is possible. The DoD believes there is no better time than now to reform the civil service.

CHAPTER

3

Why Reform the Federal
Civil Service Personnel System?

It is a widely held opinion that reform of the federal civil service personnel system is

necessary and long overdue. Countless authorities in the field have analyzed the federal civil

service system and documented their findings, but their recommendations, although noticed

by government officials, have gone largely unheeded. Only as a result of the terrorist attacks

on September 11, 2001, did the DoD recognize the need for greater flexibility in assigning

civil service employees to meet new and emerging requirements. The Secretary of Defense

proposed sweeping reforms within the Department to change hiring, firing, and paying civil

service employees, and converting military positions to civilian positions in order to keep the

U.S. military strong while maintaining the peace and security of the American people.

In November 24, 2003, the fiscal 2004 National Defense Authorization Act was

signed into law. This Act gives the DoD authority to transform the way the federal civil

service hires, pays, promotes, classifies, and disciplines its 700,000 civil service employees.

To implement the desired changes in the civil service system, it is critical for the Department

to resolve issues in the following areas.

A.   Employment Recruitment and Hiring

The current federal civil service system makes it virtually impossible for the DoD to compete for and retain the talent needed to accomplish its missions now and in the future. Young people no longer consider the federal service to be a desirable employer. A survey conducted by the Center for Public Service in May 2002, revealed that only 13% of liberal arts graduates in 2003 considered joining the federal government. The same survey indicated that top students do not believe the federal government offers the type of challenging and interesting work they are seeking (Light, 2003a).

Complicating the issue is the fact that the federal job application process is very complicated and much lengthier compared to private-sector competitors. It can take three to six months for a federal agency to write a vacancy announcement, advertise the position, evaluate candidates, conduct interviews, and make a final selection. Secretary of Defense, Donald Rumsfeld, speaking to the National Press Club in June 2003 said:

> The antiquated rules and regulations we cope with mean we are losing talented young people to private sector jobs. When DoD recruiters go to a college job fair, the person at the next table from a corporation can meet a promising young person, interview them, and offer them a job and a bonus right on the spot. When DoD interviews the same people, all we can offer them is a ream of paperwork and a promise to get back to them in three to five months. It should come as no surprise that the most talented young people end up working somewhere other than the Department. (DoD, 2003a, 2).

Data from the National Academy of Public Administration's Center for Human Resources Management shows that in the 1990s, 42% of federal entry-level jobs were not filled with new hires from outside of the government but were filled by personnel who were already part of the federal workforce (Light, 2003a).

B. **Employment Retention**

In addition to recruitment concerns, the DoD faces retention problems for entry-level and mid-level career civil servants. Paul Light, in testimony before the U.S. Senate Governmental Affairs Committee in June 2003, reported 35% of the federal GS-9 professional and technical employees who quit the government in 1997 had less than five years of service, and by early 2002 this had increased to 47%. In the same testimony, he reported that only 30% of the mid-career employees hired 20 years ago are still part of the federal civil service community.

These trends are particularly worrisome for the DoD in light of the fact that 71% of the SES workforce, 50% of the GS13 to GS-15 personnel who eventually fill SES positions, and 35% of the remaining workforce will be eligible to retire in the next three years (Bilmes & Neal, 2003, 120). As a result of recruiting and retention problems already discussed and significant downsizing actions in the 1990s, there is not a sufficient workforce to draw from in the future to replace the civil servants who will be leaving.

C. **Complexity of Job Classification**

The Classification Act of 1949 was established to ensure equal pay for equal work. To ensure this occurred, jobs were classified into various series, and pay was linked to specific grade levels. Today, the federal wage system has 250 job series with 15 nonsupervisory pay grades, 15 leader grades, and many other grades. The general schedule has an additional 422 job series with at least five grade levels in each classification, bringing the number of ways a job can be classified to over 2,000 (Bilmes & Neal, 2003, 118). This classification system presents difficulties for both managers and workers.

Once a government worker is hired to a specific job classification, this usually becomes his or her career path. This is particularly true for Wage Grade employees. They may end up spending their entire career in the same job classification series with little opportunity for higher positions in a different job series that may actually offer increased job responsibility and pay. Since the federal civil service pay system is tied to this classification system, there is little flexibility in providing pay-for-performance; instead pay is determined by the general schedule grades and the within grade steps. Once an individual becomes "capped" there is virtually little he or she can do to improve their financial situation. As a result, managers have been known to inflate job duties and responsibilities in order to increase an individual's pay.

By the same token, it is feasible in today's environment for two employees to be in the same series and perform the same type of tasks; however, the level of difficulty and workload may not be identical for both jobs. Based on the current classification system and pay rules, they are required to receive the same pay. It is understandable that this system was effective 50 years ago when the majority of the workforce performed clerical tasks, but the system no longer supports a workforce that is highly skilled and knowledge-based (Office of Personnel Management, 2002).

D. <u>Lack of Employee Mobility</u>

The current civil service system does not give managers flexibility to move employees from one job to another when there are new requirements. Civil servants cannot be moved involuntarily to fill another position, even if that position is in the same series. They may however, volunteer for a lateral transfer, or they may be detailed for a set period of

time. If detailed, the individual must returned to his or her previous position once the specified period of time has expired.

This inflexible nature of the civil service system manifested itself during Operation Iraqi Freedom. Secretary of Defense Rumsfeld reported during a speech to the National Press Club in June 2003, that 83% of the civilians deployed into the theater were contractors and only 17% were civilian federal workers because,

> ...in most cases the complex web of rules and regulations prevents us from moving DoD civilians to new tasks quickly, and as a result, the Department managers understandably turn to the military or civilian contractors to do jobs that the DoD civilian federal employees could be doing. (DoD, 2003A, 2).

Secretary of Defense Rumsfeld stated at this same press conference that the Department currently has about 320,000 civilian jobs that are being filled by military personnel. It is far easier to place military officers in positions, train them, and move them around to meet mission requirements than it is to deal with rigid civil service personnel rules.

E.   Disciplinary Measures

There is a long history associated with the ability to effectively discipline and fire civil service employees. Secretary of Defense Rumsfeld talked about the difficult process that civilian managers must go through in order to deal with fraud. Speaking to the Senate Governmental Affairs Committee in June 2003, he described a situation where employees had used government credit cards for personal use—to purchase televisions, CD players, cameras, and refrigerators—and had not paid the credit card bills. Under current civil service rules and regulations, employees' wages cannot be garnished to recoup these unpaid funds. Indeed, the Department has spent over two years negotiating with more than 1,300 unions for

this ability and still has 30 union negotiations pending. It currently takes approximately 18 months and a mountain of paperwork to fire a civil servant. The military and private industries do not have similar restrictions.

In summary, U.S. national security concerns have brought to the forefront the need to revise the Department's civilian personnel system in order to efficiently and swiftly attract, recruit, hire, and retain top-quality individuals in all levels of the organization. The job classification system that puts employees in one job series for their entire career and ties pay to a particular grade no longer meets the needs of the Department and its employees. Jobs that are most suited for civil service employees should be performed by these employees and not by industry or the military simply because of rigid civil service rules. It is imperative that the Department be able to move individuals more easily to accomplish its critical and often time sensitive missions. Employees should be rewarded and paid for their performance and disciplinary actions should be swift and effective. The Department intends for its National Security Personnel System to be designed to address these and other critical issues that civil service reform has not captured in the past. During the period of system development, the DoD will draw upon years of lessons learned, results from 25 years of experience with demonstration pilot programs, and industry best practices.

CHAPTER

4

The Proposed National
Security Personnel System

The DoD is currently in the process of developing a new human resource

management system referred to as the National Security Personnel System (NSPS). This

system will create a framework for the way civil service employees are hired, compensated,

promoted, and disciplined within the Department. Although the system will be a significant

departure from traditional personnel systems, it will continue to honor merit principles,

respect the right of employees to bargain collectively, and accommodate veterans'

preference.

As stated in the public law, the Department is responsible for coordinating with OPM,

collaborating with employee representatives throughout the design process, and notifying

Congress prior to implementing the new system. The implementation plan is expected to take

place over the next two years and will address the Federal Wage System, GS employees, and

Senior Executives.

Since the fiscal 2004 Defense Authorization Act was signed on November 24, 2003,

the OSD has been working to develop the NSPS, which will initially be implemented for

300,000 employees. When the Department outlined the concepts of the new personnel system

at the end of April 2003, seven congressmen wrote Secretary of Defense Rumsfeld to express

concern about what they called "wholesale changes to the current federal employee labor

relations system, including changes to internal union procedures, which have no relation to the Department's national security mission" (Barr, 2004, B02). Although the Department disputes the accusations, progress for civil service reform has slowed down.

In March 2004, Secretary of the Navy, Gordon England, assumed a leadership role working with the Under Secretary of Defense for Personnel and Readiness, David Chu, to aid in developing the NSPS. Together, on April 1, 2004, they issued an open letter to the DoD's civilian employees. The letter indicates that the Department is taking a step back to regroup and is proceeding in a manner that ensures the implementation of the new system will be done right and with the collaboration and full participation of the OPM, the Office of Management and Budget (OMB), and the General Accounting Office (GAO). Likewise, stakeholders in the new system, including civilian employees, managers, and other representatives, will have an opportunity to give their thoughts, ideas, views, and concerns.

Although there are many aspects of the proposed NSPS that could be evaluated, the remainder of this thesis will focus primarily on the development and implementation of two key attributes: pay banding and pay-for-performance. The processes and information presented are based on preliminary planning documents from the DoD and the Department of the Navy and are subject to change.

The current personnel system classifies and pays civil servants according to grades and steps based on longevity. The NSPS will transition civil servants from the current grade structure to a broad pay-banding framework, similar to those tested during the demonstration projects. There will be a shift from longevity-based pay increases to a pay model that links salary increases and awards to annual performance. Together, these changes will give employees opportunities to earn higher pay and awards based on individual performance.

The mechanics for both pay banding and pay-for-performance will be discussed in detail in the following sections.

A. Pay Banding

Under the NSPS, pay banding will replace the GS grade structure that has been used for job classification and pay setting. All GS employees will most likely transition into one of three career groups based on their current occupational series, and into one of four pay levels based upon their current salary. Exhibit 4.1 illustrates one possibility for the conversion.

Exhibit 4.1 Transition from General Schedule to Pay Banding

Career Group (CG)	Career Group Name	Level 1	Level 2	Level 3	Level 4
CG1	Professional and Administrative Management	GS5-12	GS13-14	GS-15	Above GS-15
CG2	Engineering, Scientific, Medical Support	GS1-4	GS5-7	GS8-11	GS-12 & above to CG 1
CG3	Business and Administrative Support	GS1-4	GS5-7	GS8-10	GS-11 & above to CG 1

Source: OSD, 2004:3

B. Pay-for-Performance

The NSPS is implementing a pay-for-performance program designed to evaluate and compensate employees more fairly. The system is being designed with the following objectives in mind:

- Allow for more employee involvement in the evaluation process,

- Increase communication between supervisor and employee,

- Promote accountability of contribution by each employee,

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- Facilitate employee progression and link individual employee performance to mission and accomplishment, and

- Provide an understandable basis for salary and structural changes (National Archives and Records Administration, 2003).

The personnel appraisal cycle will begin on October 1 and end on September 30 of the following year. At the beginning of the rating cycle, the supervisor and the employee will identify and document performance objectives that correspond to seven performance factors. These performance factors will most likely include: (1) Technical Competence/Problem Solving; (2) Cooperation/Teamwork; (3) Communication; (4) Customer Care; (5) Resource Management; (6) Leadership/Supervision; and (7) Contribution to Mission. A proposed description for each performance factor is provided in the Appendix. The supervisor will weight each performance factor so that the value of the performance factors and their associated objectives do not exceed a total score of 100 points.

It will be essential that throughout the evaluation period, the supervisor gives feedback to the employee concerning his/her performance. This open communication will ensure that supervisor expectations and employee performance are well understood by both parties. If performance problems occur during the course of the appraisal process, it will be necessary for the supervisor to document the problems with the employee and develop a correction plan.

At the end of the performance period, a supervisor may ask the employee to prepare a self-evaluation. Although the self-evaluation is a tool for the supervisor to better evaluate the

employee, it is also a useful mechanism for the employee to evaluate how well he/she has met the performance objectives established at the beginning of the reporting period.

During the performance appraisal process, the supervisor will determine the level of performance actually accomplished by the employee and assign the appropriate point value. This overall performance score will be used to determine the number of shares the employee receives. Although the share ranges are still being developed, Exhibit 4.2 illustrates how they might be allocated.

Exhibit 4.2 Score Ranges and Shares for Payout

Score Range	Performance payout (shares)
98-100	13, 14, 15, 16
95-97	11 or 12
91-94	9 or 10
86-90	7 or 8
81-85	5 or 6
66-80	3 or 4
51-65	1 or 2
0-50	0

Source: National Archives and Records Administration, 2003:16132.

The supervisor and the employee will discuss at length the supervisor's appraisal and the number of shares that will be recommended. The supervisor will present the recommendations to a Performance Review Board which will also review the supervisor's scores and make recommendations before passing them on to the pay pool manager.[1]

The pay pool manager will use the number of shares recommended to determine the amount of basic pay increase and performance incentive an employee will receive. This value is determined by multiplying the number of shares an employee receives by the share value.

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[1] Much of the material in this section has been taken from National Archives and Records Administration documents, and several of their examples have been cited verbatim.

The share value is directly linked to the annual pay pool value, which requires some explanation.

Each agency will have the authority to establish pay pools, which will generally be a combination of divisions or branches within the organization. The numbers of employees in a pay pool will most likely range between 25 and 500 people. Each pay pool will have a designated pay pool manager who will be responsible for distributing basic pay increases and performance incentives and for ensuring that payouts reflect each employee's performance and contributions. Supervisors will be placed in a different pay pool from their employees.

The amount of money available for distribution within the pay pool is based on a pay pool payout factor and the total sum of the basic pay salaries of all employees in the pay pool. The pay pool payout factor is the percentage amount budgeted for basic pay increases and performance pay incentives. For example, if an organization budgets 4.2% for basic pay increases and 1.2% for performance incentives, the pay pool payout factor will be 5.4%. The formula for the pay pool value is shown below:

Pay Pool Value =
Pay Pool Payout Factor x Total Salaries of Employees in the Pay Pool

Once the pay pool value is determined, the employee's share value is calculated. The share value represents a fixed percentage of basic pay increase for each employee and is only determined once the rating and review board process is complete. The share value for each employee is determined by multiplying the number of employees in the pool by the pay pool value divided by the sum total of each individual employee's basic pay multiplied by the total number of shares. The share value formula is shown below:

Share Value =
Total Number of Employees x Pay Pool Value
Sum Total of Salaries x Total Number of Shares

An employee's total performance payout is equal to the employee's end-of-rating cycle basic pay salary multiplied by the number of shares multiplied by the share value. This formula is shown below:

Employee Performance Payout =
Salary x Shares x Share Value

The total payout will be distributed in accordance with the percentages that were determined by the organization earlier for performance increases (4.2%) and performance incentives (1.2%).

It is helpful to work through an example to understand how all of the elements link together. If an organization budgets 4.2% for basic pay increases and 1.2% for performance incentives, the pay pool payout factor is 5.4%. If there are 40 employees in the pay pool with a total of 255 shares and their combined salaries are $2,377,888, the total pay pool value is $2,377,888 x 5.4% which equals $128,406, of which $99,871 is available for basic pay raises and $28,535 is available for incentive pay raises.

The share value is determined by multiplying the number of employees in the pay pool by the pay pool value and dividing that number by the total number of employee salaries in the pay pool times their total number of shares. The share value for this example is 40 multiplied by $128,406 divided by $2,377,888 multiplied by 255 shares which equals 0.00847.

To determine the individual's pay raise, the current basic salary (assume $75,112) is multiplied by the employee's number of shares (assume 15) times the share value of 0.00847. Therefore, $75,112 x 15 x .00847 results in a pay increase of $9,544, of which 4.2% ($7,423) is given as a basic pay increase and 1.2% ($2,121) is given as a performance incentive.

While these calculations may appear cumbersome, a computer program computes the solutions quickly to determine pay raises for each employee in the pay pool.

Although the methodology for determining pay raises has not been finalized, the NSPS should improve the way personnel managers and supervisors deal with employees whose performance fails to meet expectations. Under DoD's pay-for-performance program, employees whose overall performance scores fall below 51 points will be considered to be performing in an unsatisfactory manner, and action will be required by both the supervisor and the employee. The employee will be notified in writing why his/her performance is unsatisfactory and the employee will be placed in a Performance Improvement Program. He or she will be required to submit in writing to the supervisor what he or she will do to correct the deficiencies in the performance evaluation and when, within the next 30-90 days. The supervisor must provide assistance and continuously monitor the employee's progress in the improvement program. If the employee corrects the deficiencies by the end of the trial period, no further action is required. If the deficiencies are not corrected by the end of the trial period and the rating score remains below 51, the employee is notified in writing of personnel actions that will be taken. The supervisor has several options, including reducing the employee's pay, reducing the employee's pay-band level, transferring the employee to another position or occupation at a lower rate of pay, and even removing the employee from federal service.

In addition to the annual basic pay increases and performance incentives, the NSPS will continue to make it possible for employees to be recognized for their extraordinary contributions or exceptional accomplishments. The awards may be provided to individuals, or to members of a team and may be monetary, non-monetary, informal recognition,

honorary, time off, or a combination of these. These types of awards are budgeted separately from the funds that make up the pay-for-performance budget. The amount of money available for the special awards must be equivalent to a minimum of 0.5% of the total salary dollars in the organization.

Until discussions with the labor unions have been concluded, it is uncertain if the pay-banding approach and pay-for-performance system described above will be implemented in their entirety. However, one thing is clear: "Moving too quickly or prematurely at DoD or elsewhere can significantly raise the risk of doing it wrong. This could also serve to severely set back the legitimate need to move to a more performance and results based system for the federal government as a whole"(GAO, 2003, 6). The next section of this thesis presents findings associated with pay-for-performance systems in the public sector.

CHAPTER

5

Is Pay-for-Performance the Right Solution?

Private industry has been using pay-for-performance management systems for a number of years. A 2003 survey shows that 90% of *Fortune* 1000 companies tied pay to output, while more than 75% of all U.S. companies reported that they pegged pay to performance in some fashion. In Europe, 93% of the largest 460 firms indicated that performance-based pay has increased in recent years (Bohnet & Eaton, 2003, 239). There is some question however, as to what fraction of pay is actually dependent upon performance. Stajkovic and Luthans (in Bohnet & Eaton, 2003, fn 4) suggest that this amount could be as little as 10%. In the public sector, the federal government has more than 25 years of experience with demonstration projects that have successfully implemented various elements of pay-for-performance.

The Department's decision to shift to a pay-for-performance system for its 700,000 employees is one of the most controversial issues surrounding civil service reform today. Many employees, supervisors, and union representatives are concerned and skeptical about the proposed changes and question whether the new system will be effective. A number of experts in the field of performance management have studied pay-for-performance in the public and private sectors. A review of their findings should prove beneficial to evaluating the construct of the NSPS and to identifying potential pitfalls in the system before DoD completes system development and implements the new pay-for-performance system.

Bohnet and Eaton (2003) suggest that although the government demonstration projects produced favorable results with pay-for-performance systems, most other federal and public-sector agencies should evaluate their organizations before implementing a pay-for-performance system. The authors' research showed that three key conditions need to exist in order for a pay-for-performance system to be successful:

- First, pay-for-performance works best if employees are responsible for one well-defined task that is clearly measurable and linked to a single individual.

- Second, pay-for-performance works best for employees who are motivated primarily by money.

- Third, pay-for-performance works best when employees are clear about what they do and who they work for.

These conditions do not generally exist in most federal organizations where the products and services are complex, where the demand for teaming and cross-agency collaboration has escalated, and where diverse social and personal factors motivate the government workforce.

Robert Behn, in remarks prepared for the 2000 Colorado State Government Managers' Annual Business Conference, indicated that pay-for-performance systems actually undermine organizational performance. He said that most people think of themselves as outstanding performers, and he referred to a psychological study cited by Peters and Waterman (1982) in their book, *In Search of Excellence,* to support his point. In the study, individuals evaluated themselves in terms of leadership. Seventy percent of the people ranked themselves among the top 25% in leadership, while only 2% thought of themselves as below average. Behn remarked that all individual performance evaluations are subjective and

"when people are told they are doing well, they improve their performance, but when people are told they are doing poorly, their performance drops" (Behn, 2000, 4). He reported that most pay-for-performance systems create many more deflated egos than swelled heads. Behn suggested that the performance of most organizations today is heavily dependent upon teamwork, and it is inherently difficult to measure individual performance, perhaps even impossible.

In addition to the issues already mentioned, Behn claimed there are three additional problems with implementing a pay-for-performance system in government agencies. The first problem occurs when the implementing agency specifically and significantly limits the number of people who can receive a raise or bonus. Typically, raises and awards are limited to no more than 20% of the employees in any department, agency, bureau, or work unit. Therefore, the remaining 80% of the employees are not recognized. This situation does not motivate either the employees or the supervisors. In 2001, it was reported that forced ranking was being practiced in approximately 20% of U.S. companies. However, after a number of lawsuits were filed citing race and gender, firms began to question whether the practice was discriminatory by nature (Gary, 2001). Behn proposed that most government pay-for-performance systems should limit the raise or bonus to an amount somewhere in the range of $500 to $2,000, but such a practice does little to motivate employees to improve their performance. In fact, he contended that it is easier and faster for employees to take on a part-time job than it is to earn the meager pay increase or award amount.

Behn pointed out a second problem with implementing a pay-for-performance system in the government: there is no guarantee the system will continue in the future. Although legislatures support the general concept of paying people for their performance, he believes

legislatures do not like the long-term budget implications. There is always the threat that legislators will progressively reduce pay-for-performance funding over time.

The last problem Behn saw with implementing a pay-for-performance system in the government is that "when the watchdogs expose something as slightly off, the entire system can be wiped out" (Behn, 2000, 8). On this point, Behn returns to his belief that pay-for-performance decisions are highly subjective, and therefore it is likely these decisions could be challenged in court. If too many resolutions are settled in favor of disgruntled employees, the system could be proven ineffective and eventually terminated.

Taking a different perspective, research by Warren Stone and Gerard George (1997) clearly linked the power of reward systems to shaping performance outcomes in the public sector. They produced empirical evidence to show the need for aligning performance measures with organizational mission and consistently rewarding performance based on selected criteria. They indicated that the process used to establish these criteria can be a powerful tool in shaping the strategic direction of the organization.

Nina Gupta and Jason Shaw (1998) also indicate there is consistent evidence to show that financial incentives are associated with higher performance, and it does not matter what type of work people perform—the financial incentives will improve performance. After analyzing a host of scientific and practical sources, these researchers published a list of practices that should be considered and those that should be avoided when designing a financial incentive system. The main points of the "Do" list and the "Don't Do" list are shown in abbreviated form in Exhibit 5.1.

Exhibit 5.1 The Dos and Don'ts of Financial Incentives

The "Do" List	The "Don't Do" List
• Do tie financial incentives to valued behaviors • Do have good measurement systems • Do have good communication systems • Do make the system complete • Do use financial incentives to supplement other rewards • Do make meaningful differentiations • Do set realistic goals • Do provide relevant skills and resources • Do emphasize long-term and short-term success • Do accept reality • Do be systemic	• Don't give in to hype and fad • Don't be idealistic and unrealistic • Don't assume that working adults are identical to schoolchildren • Don't equate rewards and punishments • Don't rely on invalid behavior measurement tools • Don't keep things secret • Don't violate employee expectations

Source: Gupta & Shaw, 1998, 26-27

Edward Lawler (in Mohrman, Resnick-West, & Lawler, 1989) offers additional research to support the notion that financial incentives have a positive impact on performance. However, he goes one step further and says that "when pay and performance are related, individuals are motivated to perform more effectively, organizations develop performance-oriented cultures, and the attraction and retention of high performers are better" (p. 173). A 1986 study by Prince and Lawler (Mohrman, et al., 1989, 173) provides research-based insight into positive and negative aspects of linking pay to performance. Their study revealed that when pay is linked to performance, the employee and the supervisor both take the performance appraisal process more seriously and exchange better information about performance expectations and results. The same study also shows that because pay influences performance, employees tended to be conservative when setting their objectives which could

have a negative impact on their motivational level. In addition, this practice could also have a misleading effect on the strategic planning efforts of the organization.

They also found that supervisors do not escape the effects of linking pay and performance. Their research showed that supervisors tend to over-inflate an employee's performance evaluation when it is linked to pay in order to ensure that the employee receives a good increase or award.

Linda Bilmes and Jeffrey Neal (2003) promote the idea that the future government personnel system must evolve into a leading-edge "people" organization. Their research found that the most successful private-sector companies recruit employees carefully, nurture them, and invest in them. Such companies typically reward for accomplishments, create a good work environment; provide training and promotion opportunities, and supplying a pleasant social environment. The researchers contend that these people characteristics are severely lacking in the government, but that if the government would adopt a more "people" approach, it could actually double the number of students who would consider a career in civil service. The government must adopt the people factor as a management philosophy to make every employee feel valued and recognize his/her contribution to the success of the organization.

Most successful companies tailor their performance system—how they hire, train, evaluate, compensate, reward, and promote—to the individual employee and the specific job. The current civil service system cannot begin to compete with the private sector. This is clearly visible in Exhibit 5.2 which contrasts the desirable attributes of college students between a people-factor company and civil service.

Exhibit 5.2 Attributes of a "People-Factor" Company Compared with Civil Service

Attribute	People-Factor Company	Civil Service
Flexibility	Flexible	Inflexible
HR Benefits	Generous	Below industry standard
Training & Skills Development	Frequent	little, sporadic
Pay	Linked to performance; Benchmarked to competitors	Fixed to classification system Unrelated to private-sector equivalent
Recognition	Additional, for achievement	Few avenues of credit
Innovation	Risk-taking rewarded	Risk-taking discouraged
Organization	Flat structure	Hierarchical structure
Performance evaluation	Detailed	Perfunctory
Accommodation of individual	Accommodates need, variety	One side fits all
Culture	Caring about employees Makes good business sense	Focus on mission, not employees
Character of workforce	Versatile	Narrow job classifications, Stove-piped workforce
Career development	Aligned with long-term planning	Little, if any

Source: Bilmes & Neal, 2003

The authors contend that a flexible civil service system is necessary for meeting the needs of the future and to give agencies the opportunity to select proven alternatives in order to customize programs appropriate to their circumstances. They propose a system that:

- places greater emphasis on people,
- eliminates the classification system,
- replaces the general schedule with a flatter system,
- allows agencies to select policies for recruiting, hiring, promoting, performance measurement, and compensation from a menu of approved options,
- guarantees a minimum of two weeks of annual training for all employees,

- offers flexibility in working hours, telecommuting, etc., and
- modernizes the hiring process to include industry accepted resumes via the internet and reduced hiring time.

In summary, research indicates there are both positive and negative aspects of implementing a pay-for-performance system in the public sector. Pay-for-performance is considered a good system when tasks are well-defined, measurable, and linked to a single employee who values money and does not work for more than one boss. When work is accomplished in teams, as is the case with many public and private-sector organizations today, it becomes difficult for supervisors to distinguish each employee's contribution. Employees are generally motivated by financial incentives, but if a pay-for-performance system is going to work effectively, it must be well-funded. Otherwise, the system will be degraded and the employees will begin to lose their motivation.

The research presented in this section, coupled with lessons learned from studying the history of civil service and the federal demonstration projects, has prepared me to make some recommendations which I believe the Department should consider as they finalize the structure of the NSPS pay-for-performance model and prepare to move forward with implementation.

CHAPTER

6

Recommendations for the
National Security Personnel System

As the DoD moves forward with the development and implementation of the NSPS, I believe four actions are critical to the program's success. Although each action is discussed in detail, they are summarized below:

A. Develop an NSPS strategic plan

B. Create a new personnel management culture

C. Build more flexibility into the personnel performance appraisal process

D. Conduct training, training, and more training

A.   Develop an NSPS Strategic Plan

Authorization for the DoD to develop and implement a new personnel system was granted when President Bush signed the 2004 Authorization Bill. This bill is the most controversial piece of legislation affecting the federal civil service personnel system in the past 50 years. Due to the significant changes associated with NSPS and the large number of employees who will be impacted, the Department cannot afford to do a poor job developing and implementing the new system. The success of NSPS depends on how well the program is

managed, how involved management and employees become in the project, and how well the Department keeps the community informed.

The NSPS is managed by the Office of Personnel and Readiness, but must include members from other knowledgeable and experienced agencies. The NSPS should be managed just like any other major program within the Department. The NSPS Program Office must develop and coordinate a comprehensive NSPS strategic plan that includes a detailed program schedule, an appropriate budget, and an independent risk assessment. This strategic plan will keep the program team focused on their tasks at hand, allow program progress to be measured, and provide quality information to the thousands of employees who are concerned about the project. The Secretary of Defense must continue to speak openly about the program in order to keep the public focused on the need for the reform.

During my research period, I found that very little information on NSPS is flowing from the NSPS Program Office to the Services and in turn to their departments and field activities. The Department should address in the strategic plan a means to get the Services involved "up front and early." In 1987, Cowfer and Sujansky (in Mohrman, et al., 1989) found that including the individuals who are responsible for implementing new systems early in the design process is critical to the success of the system. At the moment, the Department is missing an opportunity to build committed team leadership and to foster relationships with employees who will implement and be managed by the NSPS.

Managers, supervisors, and employees alike generally do not have a high regard for new programs at the time of implementation. Most dislike change. Of the employees participating in the China Lake and AcqDemo projects, fewer than 30% were in favor of the

programs at inception. It was only over time, as they became more familiar with pay-for-performance, that their attitudes changed and they began to accept the new system.

The Department should also include in its strategic plan the widespread use of communication mechanisms to facilitate the learning process and ultimately influence employee buy-in much earlier. The Department currently maintains a NSPS website dedicated to keeping interested people informed about the objectives and progress of the project. However, this website contains only basic NSPS information and is far from comprehensive. In fact, it has remained virtually unchanged since the beginning of 2004. In my opinion, the Department could use this website to it fullest capacity to keep the public informed on elements of the NSPS strategic plan, the program's progress and related issues, the status of union discussions, the latest Congressional testimonies, and current GAO findings and audits. This level of communication is bound to generate more interest, create more discussion, and ultimately result in earlier involvement and acceptance by managers and employees.

B. Create a New Personnel Management Culture

The NSPS is a complete departure from the present civil service personnel system. In order for the transition to be successful, there must be a significant culture change within the Department. In the past, employees received their pay raises almost automatically, based on seniority. However, the new system is very "people-intensive" and shifts the burden of determining pay raises and awards to supervisors who may not be fully prepared for the job. The time has come for supervisors (military and civilian) to fully engage in the performance evaluation process—communicating the mission, setting realistic expectations, establishing

employee objectives, assessing employee performance, providing quality feedback, truthfully evaluating accomplishments, and awarding pay commensurate with performance.

Based on my research, I do not believe managers are sufficiently ready or prepared to assume their new role in the NSPS. In fact, research shows that in general employees are concerned about their supervisor's personnel management abilities. In a survey released by the U.S. Merit Systems Protection Board in 2003, employees gave their immediate supervisors high marks for their technical skills; however, the employees gave these same supervisors very low personnel management marks. Of the approximately 7,000 employees surveyed, here is what the survey found:

- only 55% believed their supervisor looked out for the personal welfare of members in the work unit;

- 47% thought their supervisor had good management skills;

- 46% felt their supervisor kept them informed about their performance;

- 41% felt their supervisor encouraged their career development;

- 35% felt their supervisor dealt effectively with misconduct; and

- only 22% of the employees thought their supervisor dealt effectively with poor performers.

These results are a clear indication that a culture change is needed in the area of personnel management. The culture needs to be more focused on its people.

In order for a pay-for-performance system to be effective, managers must be proficient at linking pay to performance and dealing effectively with poor performers. These practices do not come naturally. In fact, evidence suggests that supervisors tend to inflate employee performance over time (Zeller, 2004). This tendency is substantiated by reviewing

the data associated with the CSRA and PMRS personnel systems; even some of the federal demonstration projects reported signs of over inflated performance appraisals. Likewise, managers find it difficult to take appropriate action against poor performers. The U.S. Merit Systems Protection Board, in their 1996 report to the President and Congress, indicated that even a small number of poor performers can have a disproportionately large impact on the productivity of a work unit. Therefore, it is imperative that federal policymakers create a culture that makes it unacceptable to ignore poor performance.

The personnel management responsibilities associated with implementing a pay-for-performance system are instrumental to its success. The Department should immediately initiate a comprehensive training program for its personnel managers, at all levels in the department, and for its employees. Unless the Department is committed to developing competent personnel managers and knowledgeable employees, the NSPS will experience problems from the outset.

C.   Build More Flexibility into the Personnel Performance Appraisal Process

The NSPS proposes seven factors that will be used to evaluate an employee's performance. These factors are (1) Technical Competence/Problem Solving; (2) Cooperation/Teamwork; (3) Communication; (4) Customer Care; (5) Resource Management; (6) Leadership/Supervision; and (7) Contribution to Mission. If a supervisor determines one or more of the factors are not appropriate to an employee's position, that performance factor can be eliminated. However, no new performance factors can be added. The stringency associated with this part of the performance process needs to be questioned. Is it really possible that these performance factors are the most appropriate for all 700,000 employees in

the Department? While I do not claim to know what performance criteria are appropriate for every work series that exists in the government today, I cannot help but think more flexibility is required in the system.

I am particularly troubled by the seventh performance objective, Contribution to Mission, which will be used to evaluate how well an individual contributes to the mission of the organization. Although it sounds good for the Department to say it wants every individual to contribute to the mission, it is not clear exactly to what mission each individual should contribute. The GAO pointed out, in its preliminary observations of DoD's proposed personnel reforms, that strategic plans and mission objectives for individuals are currently not linked to those of the Department and as of yet, there are no guidelines on how this task is to be accomplished (GAO, 2003). Until there is clear understanding of how the mission filters down from the Department through the Services, components, and various organizations, setting clear performance objectives that enable individuals to meet mission objectives will be difficult at best, and highly subjective. The Department is in the very early stages of undertaking a department-wide human capital strategic plan to integrate military, civilian, and contractor workforces. This performance factor should be clarified to ensure that clear and measurable objectives are applied.

I also believe there is a need for a more flexible appraisal feedback process. During my research, I did not get the impression that the Department plans to encourage or facilitate the use of 360-degree evaluations or to include customers and/or outside experts in the feedback and rating process. I think it is imperative that the Department—even if not in the context of the basic operating procedures—should train and offer managers alternative

methods for evaluating performance and gathering feedback to support employee performance.

I highly recommend that the Department take another look at structuring a more flexible performance appraisal process. A "flexistyle" option, similar to one proposed by Bilmes and Neal (2003), offers some attractive features that could strengthen many civil service processes, especially the performance appraisal system. As envisioned, each agency would select from a set of pre-approved options to design a personnel performance appraisal system to meet the needs of their organization and workforce without needing to seek Congressional approval each time. This flexibility might even create an environment that encourages the development of better relationships between supervisors and employees. The traditional government personnel system has already demonstrated that a single system does not work for everyone—the trick is finding the right balance.

D. Conduct Training, Training, and More Training

As indicated earlier, the NSPS is a people-intensive program that will require the participation of every member of the organization to make it successful. The implementation will be stressful because whenever there is change, there most assuredly will be stress. A timely, thorough, and progressive training program can help to eliminate some of the stress associated with the transition and will help foster early buy-in from the participants.

The Department is working with outside agencies to develop a training program with two objectives in mind. The first objective is to provide instruction on the fundamentals of the NSPS. The second objective is to provide leadership, managers, supervisors, and employees with essential training on setting expectations, establishing effective and

measurable performance objectives, providing and receiving constructive feedback, conducting appraisal reviews, and communicating effectively. The Department envisions using a variety of training tools, including classroom instruction, role-playing, coaching and mentoring demonstrations, web-based learning, and "town hall"-type meetings. Surprisingly, the first wave of training for 300,000 of the Department's employees is targeted to start at the same time the initial pay-for-performance program is being implemented.

The Department appears to have done a thorough job of assessing the training needs associated with the implementation of the NSPS and is in the process of developing its comprehensive training program. However, I believe the Department is sorely behind in implementing a robust training program and is attempting to train too many people at the same time.

Lessons learned from demonstration projects like AcqDemo show clearly the importance of a well-planned and fully resourced training program. Richard Haney and Glenn Sutton (2003) point out:

> Each target audience has its own unique set of learning objectives: personnelists must learn how to implement the flexibilities inherent in the new system; managers and supervisors must be trained to fairly and effectively exercise their new responsibilities; and employees must learn how to participate successfully in the process. (p. 1)

It is my recommendation that the Department should not proceed with NSPS program implementation until the training curriculum is fully developed and has been tested with a much smaller group. Training 300,000 employees during the first implementation is going to be difficult. The success of NSPS will be determined on how well the training program is delivered, and the support received by the implementing agencies during the first year of operation will be critical. The Department would not put a pilot into the cockpit of a fighter

aircraft unless he was well trained to fly. So, the Department should not put managers,

supervisors, and employees into a new personnel management system until they have the

proper training to make it succeed. The process cannot be rushed.

Appendix

National Security Personnel System Performance Factors

1. <u>Technical Competence/Problem Solving</u>: Demonstrates the knowledge and skills required to execute the position's assigned duties and responsibilities; ability to apply knowledge and skills to solve problems. Exhibits and maintains current technical knowledge, skills, and abilities to produce timely and quality work with the appropriate level of supervision. Makes prompt, technically sound decisions and recommendations that add value to mission priorities and needs. Flexibility, adaptability, and decision-making are exercised properly.

2. <u>Cooperation/Teamwork</u>: Demonstrates the traits of flexibility, adaptability, and decisiveness and the ability to exhibit and foster cooperation in team efforts and organizational settings. Personnel and organizational interactions exhibit and foster cooperation and teamwork. Accepts personal responsibility for assigned tasks. Is considerate of others' views and open to compromise on areas of difference. Exercises tact and diplomacy and maintains effective relationships, particularly in intermediate work environment and/or teaming situations. Readily/willingly gives assistance. Shows appropriate respect and courtesy.

3. <u>Communication</u>: Demonstrates effective listening, writing, and oral communication skills. Provides or exchanges oral/written ideas and information that are timely, accurate, and easily understood. Listens effectively so that resultant actions show understanding of what was said. Coordinates so that all relevant individuals and functions are included in, and informed of, decisions and actions.

4. <u>Customer Care</u>: Demonstrates effective interactions with internal and external customers. Demonstrates care for customers through respectful, courteous, reliable, and conscientious actions. Seeks out, develops, and/or maintains solid working relationships with customers to identify their needs, quantifies those needs, and develops practical solutions. Keeps customer informed. Within the scope of responsibility, seeks out and develops new programs and/or reimbursable customer work.

5. <u>Resource Management</u>: Demonstrates effective use/management of personal and organizational resources such as time, personnel, equipment, and/or funds. Meets program schedules and deadlines, and accomplishes work in order of priority (set by the employee's supervisor or team leader); generates and accepts new ideas and methods for increasing work efficiency; effectively utilizes and properly controls available resources; supports organization's resource development and conservation goals.

6. Leadership/Supervision: This factor is mandatory for supervisory/designated team leader positions using (a) and (b). This factor is optional for all other employees using description (a) only.

     (a) Demonstrates effective individual and organizational leadership to access situations realistically; identifies and recommends or implements needed changes. Actively furthers the mission of the organization. Exercise leadership skills within the environment to include sensitivity to diversity and to insure equity and fairness, as appropriate. (This description may be applied to all employees, e.g., employee leads work group on special projects insuring organizational mission and program success; employee effectively represents the interest of the organization on inner-agency groups, etc.)

     (b) Works toward recruiting, developing, motivating, and training quality employees; initiates timely/ appropriate personnel action; applies EEO/merit principles; communicates mission and organizational goals; by example, creates a positive safe, and challenging work environment; distributes work and empowers employees.

7. Contribution to Mission Accomplishment: Executes the position's assigned duties in a manner that contributes to the successful outcome of strategic goals and objectives. Within the scope of job responsibility, develops approaches or solutions to tasks and problems impacting mission in a positive manner.

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