Initial Reactions to Federal Merit Pay

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Few civil servants have been denied periodic salary increases, regardless of their job performance.

Merit pay, as enacted by the Civil Service Reform Act of 1978 (CSRA), bases the compensation of supervisors and management officials in grades 13-15 on their rated performance. Pay for performance has long been a goal of federal personnel policy, but in practice few civil servants have been denied their periodic salary increases, regardless of performance.¹

Merit pay continues to be controversial. Several members of Congress opposed a payout formula that included comparability increases, arguing that only within-grade and quality-step increases should be contingent on performance.² Several disputes about who should be included in the merit pay program have required a Federal Labor Relations Authority ruling.

More recently (September 8, 1981), the Comptroller General determined that the Office of Personnel Management's (OPM) formula for calculation of merit pay did not conform with CSRA. The Comptroller General required immediate corrective action, which delayed merit payments in many federal agencies.³

Two Roadblocks

Merit pay has probably been the most complex of the CSRA's provisions, for two reasons. First, the various payout mechanisms must be established. Such questions as the appropriate size of pay pools, whether managers at the various grades/steps should receive identical salary increases for identical performance ratings, appropriate reward ratios to ensure sufficient motivation, and so on, must all be determined before payouts can be made.

The difficulties of arriving at satisfactory solutions to these problems are reflected in the timing of OPM's comprehensive merit pay guidelines (released in draft form in February 1981,⁴ two and one-half years after the passage of CSRA), and in the last-minute Government Accounting Office (GAO) intervention to alter the payout formula.

Second, merit pay was implemented concurrently with the new objectives-based performance appraisal system, on which merit payouts would be based. This new performance appraisal system is significantly different from the trait-based systems used to rate most federal managers prior to the change. Now the ele-
ments, or components, of each job need to be specified, and objective indicators of relative performance on each element need to be developed.

Ratings on these individualized "contracts" are then combined for each manager so the performance of all of the managers in the pay pool can be ranked for merit pay purposes. Although there were objections to tying pay to a new, untested performance appraisal system, virtually every agency in the federal government was required by time pressures of statutory deadlines to implement, concurrently, the new performance appraisal and merit pay systems for managers.

**Pay for Performance?**

The merit pay provisions are based on a widely accepted perspective on motivation, which is drawn from Vroom's expectancy theory. In its simplified form, the theory posits that if individuals expect to receive a valued reward for high performance, they are more likely to strive for this level of performance than if there were no payoff.

Federal merit pay is expected to increase effort and, therefore, performance by changing the probability that performance will lead to a salary increase. Prior to merit pay, it was assumed that the probability of performance leading to a money outcome was virtually zero, whereas now the probability of performance leading to a money outcome is greater than zero. Therefore, the merit pay initiatives of CSRA are expected to result in higher overall managerial performance since many, if not all, federal managers will see more benefit in striving for high performance under this program than under the previous compensation system.

Previous evaluations of merit pay, especially those based on the eight federal agencies that implemented merit pay before the statutory deadline of October 1, 1981, have focused on characteristics of the payouts or implementation, but not on merit pay as a motivational program. Since the purpose of merit pay is to change managerial motivation, we want to know whether it makes a difference in the motivation of a wide cross-section of federal managers.

Using the motivational model on which merit pay is based to direct our inquiry, we seek answers to three questions:

1. Do federal managers value pay increases?

2. Are federal managers more likely to expect effort to lead to highly rated performance under the objectives-based appraisal systems?

3. Are federal managers more likely to expect good performance to lead to increased pay under merit pay, than under the previous time-in-grade compensation program?

**Survey Methods**

Our survey sampled the following agencies of the federal government: the Transportation and Public Utilities Service (TPUS) of the General Services Administration, Washington, D.C.; the Naval Ship Weapon Systems Engineering Station (NSWSES) in Port Hueneme, California; NASA-Ames Research Center, Moffett Field, California; 21 Social Security Administration (SSA) offices in the Southern California area; both the National and California state offices of the Department of Agriculture Farmers Home Administration (FmHA) and Soil Conservation Service (SCS); and the California offices of the Department of Agriculture's Federal Crop Insurance Corporation (FCIC) and Agricultural Stabilization and Conservation Service (ASCS). All agencies were voluntary participants in the study. The initial contacts with each agency began in spring 1980, through the Office of Personnel Management.

The research team selected one of its members to act as primary liaison for each of the five agencies (the agriculture agencies were combined). The liaison, usually accompanied by another member of the evaluation team, visited the site at least three times a year — in June, September, and December 1980, and March, June, and September of 1981 — for one to two weeks. These site visits were supplemented with interviews of agency headquarters personnel — including personnel analysts responsible for implementing various provisions of CSRA, and top agency executives. All the merit pay managers had received at least one appraisal by September 1981, under the new objectives-based performance appraisal system. However, no merit pay awards had yet been made in these agencies.
Figure 1

The Importance of Organizational Rewards

<table>
<thead>
<tr>
<th>Questionnaire Item</th>
<th>Mean Response</th>
<th>T-Test Probability&lt;sup&gt;2&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pay</td>
<td>3.86</td>
<td>3.84</td>
</tr>
<tr>
<td>Challenging work responsibilities</td>
<td>4.54</td>
<td>4.36</td>
</tr>
<tr>
<td>Friendliness of the people you work with</td>
<td>3.91</td>
<td>3.84</td>
</tr>
<tr>
<td>Fringe benefits</td>
<td>3.57</td>
<td>3.50</td>
</tr>
<tr>
<td>Promotional opportunities</td>
<td>3.67</td>
<td>3.54</td>
</tr>
<tr>
<td>Job security</td>
<td>3.64</td>
<td>3.73</td>
</tr>
<tr>
<td>Opportunity for public service</td>
<td>3.22</td>
<td>3.16</td>
</tr>
<tr>
<td>Retirement benefits</td>
<td>4.06</td>
<td>4.01</td>
</tr>
<tr>
<td>Location</td>
<td>3.87</td>
<td>3.80</td>
</tr>
</tbody>
</table>

N = 164 N = 197 N = 195

Notes
1. Responses are on a Likert-type scale of 1-5, with 1 = not at all and 5 = a great deal.
2. The figures reported indicate the probability that the difference between the means of the two samples cannot be due to change alone. The closer the t-test probability is to 1.0, the more likely the difference between the means could have occurred by chance. The closer the probability is to 0, the less likely the difference occurred by chance. One-tailed tests were used, and the pooled variance estimate probability is reported unless otherwise noted.
   *Probability < .05, indicating that the results are significant.
   **Probability < .01, indicating that the results are highly significant.

The Federal Employee Survey

Two forms of the Federal Employee Survey (FES) were developed: one for employees GS-13 (or equivalent) and above, and a second for GS-12 (or equivalent) and below. This article reports data only from grade 13 to 15 managers and supervisors at the six sites. The instruments were pre-tested prior to field administration on a group of 30 federal employees from two different agencies. The final versions of the surveys could be completed in 30 to 45 minutes. Employees were notified by personal letter about the date, time, and location of the questionnaire administration. Questionnaires were administered in June and December 1980, and June 1981.

Interviews were conducted with a stratified, random sample of employees, managers, and union representatives during each quarterly site visit. The format of the interview included structured and open-ended questions. The interviews included questions about major CSRA initiatives as well as periodic issues (e.g., the hiring freeze, the Presidential transition).

Among the documents obtained were collective bargaining agreements, annual budget/expenditure reports, organization charts, personnel and other annual reports, annual employment levels, grade levels, turnover, annual leave usage, equal
employment data, grievances — and when possible, documents on work volume, labor productivity, unit costs, and quality indicators.

**Pay As a Reward**

Managerial positions offer many rewards in addition to salary: challenging work, promotions, status, and the satisfaction of making a contribution to a community or to national defense are just a few examples. If these other rewards are not contingent on high performance, and are valued more than the merit pay increase, high performance would not be expected.

Figure 1 shows how merit pay managers rated the various rewards available to them in June 1980, when only Social Security Administration managers were under merit pay; and in December 1980 and June 1981, when all federal managers were under merit pay. Although pay is not the most important reward to these managers, it is certainly among the most important. These managers ranked “challenging work responsibilities” and “retirement benefits” more important than their pay in June 1981.

We can conclude that the merit pay program will indeed be using one of the more valued rewards. Yet, we need to know which other major rewards are in fact contingent on performance. For example, retirement benefits are not contin-

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**The Accuracy of Objectives-based Appraisals**

<table>
<thead>
<tr>
<th>Questionnaire Item</th>
<th>Mean Response</th>
<th>T-Test Probability²</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All in all, I feel that the current performance appraisal process is effective.</td>
<td>4.18</td>
<td>3.97</td>
</tr>
<tr>
<td>I am not sure what standards have been used to evaluate my performance.</td>
<td>3.47</td>
<td>3.45</td>
</tr>
<tr>
<td>The standards used to evaluate my performance have been fair and objective.</td>
<td>4.90</td>
<td>4.79</td>
</tr>
<tr>
<td>Overall, the current performance process helps me to improve my job performance.</td>
<td>3.98</td>
<td>3.82</td>
</tr>
<tr>
<td>The present performance appraisal system contributes to overall agency effectiveness.</td>
<td>4.13</td>
<td>4.02</td>
</tr>
<tr>
<td>I have no control over the factors on which my performance is judged.</td>
<td>3.05</td>
<td>3.27</td>
</tr>
<tr>
<td>It is difficult to document the actual performance differences among managers and supervisors.</td>
<td>4.93</td>
<td>4.58</td>
</tr>
</tbody>
</table>

N=165     N=194     N=198

Notes

1. Question responses are on a Likert-type scale of 1-7 with 1 = strongly disagree to 7 = strongly agree.
2. The figures reported indicate the probability that the difference between the means of the two samples cannot be due to chance alone. The closer the t-test probability is to 1.0, the more likely the difference between the means could have occurred by chance. The closer the probability is to 0, the less likely the difference occurred by chance. One-tailed tests were used, and the pooled variance estimate probability is reported unless otherwise noted.

*Probability < .05, indicating that the results are significant.

**Probability < .01, indicating that the results are highly significant.
gent on any workplace actions, only ten-
ure. Challenging work could well be con-
tingent on a manager’s performance (thereby
supporting the effectiveness of merit pay),
but it may also be contingent
nonperformance or even poor perfor-
ance actions (thereby counteracting merit
pay).

Rated Performance

It is necessary to focus on rated per-
formance since merit pay is contingent on
these ratings. Figure 2 presents the man-
gagers’ assessments of the extent to which
effort led to highly rated performance in
June 1980, December 1980, and June
1981.

Surprisingly, over this period, man-
gagers became less likely to agree that their
new “appraisal process is effective,” and
that the objectives-based appraisal system
“contributes to overall agency effective
ness,” but they do report that they are
sure of the standards used to evaluate
their performance. These managers have a
clearer understanding of the criteria on
which they will be judged, but they ap-
parently believe these criteria are not the
best ones to promote agency effectiveness.

This finding has important implica-
tions for merit pay. The merit pay program
itself is expected to increase the subjective
probability that performance will lead to a
valued outcome. Yet if the objectives-based
performance appraisal system imple-
mented concurrently with merit pay re-
sults in a reduced expectation that effort
will lead to increased rated performance,
overall motivation will remain the same or
be reduced.

Manager Expectations

Are federal managers more likely to
expect good performance to lead to in-
creased pay under merit pay, than under
the previous “time-in-grade” compensation
program? We can compare the expecta-
tions of managers in June 1980, when only
social security managers believed they
were under merit pay, with December
1980 and June 1981, when all managers
had begun their first performance period
but had not received ratings or payouts.

Managers’ beliefs concerning the ex-
tent of contingency of their pay on high
performance under the previous compensa-
sation system and under merit pay appear
in Figure 3. Managers apparently do not
believe that high performance will lead to
increased pay. Instead, they believe that
performance appraisal ratings are less
likely to lead to either rewards or punish-
ments, and good performance is less likely
to lead to pay increases under merit pay. In
their first merit-pay appraisal period, man-
gagers seemed less likely to expect
more pay for higher performance.

With the responses of all managers
taken as a whole, the results indicate that
merit pay managers do not expect their
pay to be based on their performance to
any greater extent under merit pay than
under the previous time-in-grade system.
There are two plausible explanations for
this finding. One, the merit pay system
was still too new this year. Perhaps these
managers need to see the actual merit
payouts to believe their pay really is con-
tingent on their performance. But this
would only account for a lack of change in
perceptions of contingent pay. These man-
gagers do report a change — that their pay
is less contingent on performance in fiscal
year 1981.

Not Performance Based?

The other explanation is that these
managers may believe that merit pay
awards will be made but that they will be
contingent on measures other than per-
formance or contribution to the organiza-
tion. Merit pay increases will actually be
based on a substitute for real performance
— a performance appraisal rating derived
from the new objectives-based performance
appraisal system. It is possible that man-
gagers who have had no experience with
this type of performance appraisal prior to
the introduction of merit pay do not trust it
to record genuine high performance. Man-
gagers’ beliefs in the accuracy of their new
performance appraisal systems are funda-
mental to their reactions to merit
pay compensation.

Our analysis of additional data not re-
ported here shows substantial support for
the view that those who feel most confident
that their appraisal process is effective are
also most likely to feel that good perform-
ance will be rewarded, and to favor merit
pay. Those reporting greater distrust of
performance appraisal — that it is inef-
fective, unfair, and subjective, and that
appraisals do not help them to improve
### Reports of Pay Practices

<table>
<thead>
<tr>
<th>Questionnaire Item</th>
<th>Mean Response</th>
<th>T-Test Probability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performance appraisals influence rewards and punishments in this organization.</td>
<td>4.95</td>
<td>4.26</td>
</tr>
<tr>
<td>If I perform especially well on my present job it is likely I would get a cash award or unscheduled pay increase.</td>
<td>4.07</td>
<td>3.92</td>
</tr>
<tr>
<td>Supervisors and managers are paid in proportion to their contribution to the organization.</td>
<td>3.11</td>
<td>3.11</td>
</tr>
<tr>
<td>Under the present system, financial rewards are seldom related to manager or supervisor performance.</td>
<td>4.38</td>
<td>4.24</td>
</tr>
<tr>
<td>All in all, current merit pay provisions encourage me to perform my job well.</td>
<td>3.42</td>
<td>3.41</td>
</tr>
<tr>
<td>I can believe that pay practices have significantly changed in the last six months.</td>
<td>2.80</td>
<td>3.48</td>
</tr>
<tr>
<td>I would probably work harder on my job performance if I thought I would then receive a cash reward or unscheduled pay increase.</td>
<td>3.95</td>
<td>4.13</td>
</tr>
</tbody>
</table>

N=165 N=187 N=193

Notes

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3. The separate variance estimate probability is reported.

*Probability < .05, indicating that the results are significant.

**Probability < .01, indicating that the results are highly significant.

their performance — also tend to report that pay is not contingent on good performance. Only one indicator of distrust of appraisal — reported difficulty of documenting managerial performance — was unrelated to expectations of contingent pay and attitudes toward merit pay.

These findings have important implications indicating that acceptance of merit pay depends on accurate appraisals, as perceived by those being rated. Without performance ratings that are perceived to reflect true performance, merit pay will not motivate good performance but only a striving for high ratings.

**Motivation Is Lacking**

These results indicate that a diverse sample of federal managers do not appear to be more highly motivated under merit.
pay than under the previous time-in-grade compensation policies. Using the motivational model on which the merit pay program was based, we have been able to identify a major weakness in the current approach. It is not that federal managers do not value pay as a reward, since they report that it is among the handful of important reasons for remaining in their current positions.

Where the present merit pay program fails as a motivational program is in the methods used to measure performance. These managers report that effort is less likely to lead to a good performance rating. Therefore, these managers believe that merit pay does not encourage them to perform their jobs well or contribute to their agency’s effectiveness.

Qualitative evidence from the Social Security Administration evaluation sites indicates disruptions can occur when merit pay is tied to an insufficiently developed performance appraisal system. Setting specific standards of performance for managers in local claims offices has had a large impact on the managers’ behavior.

There is clear evidence that the setting of these specific standards has focused managerial actions on their attainment; managers work hard to obtain good ratings on those standards that are measured. Yet not all of those actions could be considered good management. There is also some evidence that a few managers are “gaming the system” to improve their ratings on those statistics (see explanation below).

Statistical measures of performance account for 43% of a district manager’s rating. The overall scores on these statistics have dramatically improved over the last two years. Although the improvement is dramatic, it is important to note that the national goals have become more difficult and the trend toward improved performance began before the new performance appraisal system.

**Other Behavioral Effects**

There are other indications of behavioral effects. One of the ways managers have found that they are able to improve processing time is to increase the division of labor — more claims representatives become “specialists” in developing a specific type of claim. Two district managers have stated in interviews that they have improved their documentation and payment accuracy by 100% verification of claims (i.e., one employee rechecks all of another employee’s work). These approaches have clearly improved statistical performance.

Finally, each manager and supervisor interviewed related stories of “gaming” the statistics when asked if merit pay had created increased pressure. “Gaming” is another form of goal displacement; i.e., when the goal is no longer “effective management” but “a good score on the statistics.”

Most of Social Security Administration’s statistics can be “manipulated” with no direct harm (or benefit) to a claimant. For example, a processing clerk can simply fill out an application but not let the claimant sign it until the earnings records and proofs are received. Therefore, the two weeks it takes someone to obtain a birth or marriage certificate are not counted in processing time statistics, and the claimant experiences no delay in payment.

The most controversial statistic has been the overall disability processing time, since the state Disability Determination Service office itself is taking much longer than the manager’s standard. Here gaming can take the form of completing an application for someone who is obviously not qualified, and then making a “technical denial” in the office. These take only one day to process and can help bring the monthly processing time average down.

**An Untested System**

Why are these objectives-based performance appraisals creating so many difficulties? There seem to be several reasons. The new performance appraisal system was not adequately pretested. The fact that pay was tied to an unknown performance appraisal system exacerbated the implementation problems. There are bound to be problems — for example, unanticipated effects of certain measures and difficulty in developing accurate measures for certain job elements — in any new performance appraisal system.

All of these problems create stress for those who are being evaluated. Yet, under normal circumstances, most managers can assume that their own supervisors will be aware of these temporary imperfections and will not withhold salient rewards because of them. Under merit pay, supervisor
flexibility was either removed or made so administratively cumbersome (as in the SSA example) that the effort was simply not worth the heavy investment. Furthermore, the reward tied to this untried appraisal system was a very visible, very salient one.

These managers attend to changes in their pay, and the merit pay spotlight focused on the new appraisal system, heightening the manager’s anxiety over the apparent imperfections. Under these circumstances, implementation of both merit pay and objectives-based performance appraisal were more stressful and prone to failure than if performance appraisal had been fully implemented prior to attaching merit pay to it.

A Fatal Contradiction

There is an inherent contradiction in the guidance that calls for accurate appraisals based on consultation with the ratee, along with managed ratings to ensure against payout inequities. Performance appraisal ratings must be accurate representations of a manager’s performance, and they must also be managed by pay-pool managers and personnel specialists to maintain equity across pay pools, with a sufficient dispersion of ratings within a pool to ensure that the size of the increase received by the best managers is large enough to motivate their effort.

This represents a significant contradiction in the merit pay system. If the ratings are accurate, why should they be manipulated? Will this not make them less accurate? In fact, this contradiction seems to be based on several assumptions: that all pay pools contain the same proportion of high/average/low performers; that managerial performance is naturally distributed in a manner that allows high performers to receive increases two to four times greater than the low performers; and, finally, that the only reason actual ratings do not reflect this is that raters either willfully, or through ignorance, distort their ratings. These assumptions seem tenuous at best, and deserve to be more openly debated before they are acted upon.

For merit pay to meet its objective of matching performance with pay, the motivational ties for managers will need to be strengthened. We suggest a continued delay in the computing of any of the federal comparability adjustment into the merit portion of pay increases until the new performance appraisal systems have been in place and proven themselves over several years. Once the performance appraisal systems become accepted indicators of actual performance, then, perhaps, a motivating link between performance and pay will be realizable through the concept of merit pay.

References


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