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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Federal Executive Pay Compression Worsens

Despite a 5.5-percent salary increase in October 1979, the adverse effects of limiting or denying these increases to Federal executives have worsened.

Pay compression now extends further into the General Schedule and covers about 90 percent of Senior Executive Service (SES) members. This results in 6,100 of 6,800 SES members and over 10,000 other top Federal executives receiving the same salary despite wide variances in levels of responsibility. Executive pay purchasing power continues to decline and executive recruitment and retention problems for Federal agencies persist. The incentive to retire is also increased by generous cost-of-living adjustments to retirement annuities. The success of SES may also be threatened by salary limitations.

GAO recommends that the Congress allow annual pay adjustments, discontinue linking congressional and Executive Level II salaries, and allow bonus and rank provisions to take effect for SES members.

UNITED STATES GENERAL ACCOUNTING OFFICE

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To the President of the Senate and the
Speaker of the House of Representatives

This report, "Federal Executive Pay Compression Worsens," discusses the adverse effect that limiting and denying pay increases continues to have on Federal executives and agencies and suggests actions to alleviate these problems. We initiated this review because of our continued concern about the effect of executive pay-setting practices on the attraction and retention of well-qualified executives.

We are sending copies of this report to the Director, Office of Management and Budget; the Director, Office of Personnel Management; and other interested parties.

Comptroller General
of the United States

D I G E S T

During the last several years, Federal executives' pay problems have steadily worsened. Adjustments that were supposed to be provided to Federal executives under Public Law 94-82 and Public Law 90-206 have continuously been limited, reduced, or completely denied. The Senior Executive Service (SES)--hardly a year old--was to provide monetary rewards on the basis of many top Federal executives' performance. SES could be adversely affected if the Congress acts to limit these individuals' total remuneration. The number of SES positions eligible for performance awards has already been limited.

As a result of actions to limit Federal executive pay:

--Executive Schedule salaries have increased an average of only 35 percent since October 1969 as compared with increases of 84 percent in the General Schedule and 125 percent for private sector executives. (See p. 5.)

--The purchasing power of Executive Level I salaries has <u>decreased</u> 43 percent since October 1969, and salaries at the Level V ceiling have <u>decreased</u> about 31 percent. (See p. 7.)

--Pay compression extends further into the General Schedule and causes about 90 percent of SES executives to receive the same pay despite different levels of responsibility. (See pp. 7, 8, and 14.)

--Salary differentials are inconsistent for different levels of Federal executives. (See p. 8.)

If Federal executives are denied the projected 6.2-percent increase to be paid General Schedule employees in October 1980, as

proposed by the President, then pay compression will cover all GS-16s, almost all SES members, and the top five steps of GS-15. Continuing the pay ceiling in October 1981 would cause the compression to reach the top steps of GS-14.

Providing a 6.2-percent increase for top executives in October 1980 would amount to about a $68-million increase, or about one hundredth of a percent, in the estimated fiscal year 1981 budget.

PAY COMPRESSION PROBLEMS CONTINUE

Pay compression continues to be a major cause of recruiting and retention problems for Federal agencies. These problems are compounded by the attractive cost-of-living adjustments to retirement annuities which increase the incentive to retire. (See pp. 10 to 12.)

Personnel officials at Federal agencies consider low Federal executive salaries and infrequent adjustments as major sources of difficulty in recruiting well-qualified individuals from outside the Government.

Many Federal executives are reluctant to accept promotions because the increased responsibilities of the position are not recognized with higher pay. Also, such promotions often involve moves to high-cost areas of the country. Pay compression results in more payless promotions because executives at several different levels of authority make the same salary.

The Director of the Office of Personnel Management acknowledged that pay compression "leaves the Federal Government, as an employer, in the position of not being able to attract high quality executives from the private sector, nor to offer the most able mid-management Federal employees any reward for accepting increased responsibility." (See app. II.)

Many Federal executives with extensive experience are choosing to retire rather than continue working at frozen pay levels. In fact, the rate of executives retiring in the first 3 months of 1980 was much greater than the rate of retirements in the last 6 months of 1979. The Department of Health and Human Services alone lost 16 top executives in the first quarter of 1980 with combined Federal experience of over 500 years. (See pp. 11 and 12.)

SES COULD BE ADVERSELY AFFECTED

SES salaries' link to the Executive and General Schedules has resulted in about 90 percent of SES members receiving the same pay.

The compression of SES salaries undermines two important purposes of SES and may threaten its success. (See pp. 14 and 15.)

The Civil Service Reform Act of 1978 states that SES was created to

--provide for a compensation system designed to attract and retain highly competent senior executives and

--insure that compensation, retention, and tenure are contingent on executive success which is measured on the basis of individual and organization performance.

Failure of the Congress to insure that these objectives are implemented may be seen by civil servants as a lack of commitment to civil service reform. This perception could be critical when agencies begin implementing other aspects of reform, such as merit pay, which may affect as many as 125,000 GS-13s through GS-15s, and performance appraisal, which affects all Federal employees.

Recent proposals in the Congress to limit total remuneration, including performance awards, and actions to further limit the number of SES positions eligible for awards could be disastrous for SES. (See pp. 15 and 16.)

Prohibiting or limiting performance awards and ranks:

--Could nullify the success agencies have had in encouraging Federal executives to join SES.

--Is seriously affecting the morale of Federal executives.

--May stifle the incentive for excellence and superior performance.

--Can damage the credibility of the entire civil service reform legislation.

More importantly, many executives who have elected to join SES interpret the performance award limitation as a breach of faith. Responses to a questionnaire sent to senior executives indicate a large number are very concerned about proposals to limit performance awards and to continue the executive pay freeze.

CONCLUSIONS

Changes in pay setting for Federal executives are critically needed if (1) the problems executives face due to diminishing real salaries are to be alleviated, (2) pay distinctions are to accurately reflect differences between levels of responsibility and performance, and (3) agencies are to avoid serious recruitment and retention problems.

Allowing annual adjustments to take effect would help alleviate compression, improve pay distinctions, and reduce agencies' recruitment and retention problems. SES's success also depends on the granting of annual adjustments to the Executive Schedule and granting performance awards within already established guidelines. Restricting these essential incentives could exacerbate current problems, foster Government inefficiency, and increase Government expenditures to a level that would far exceed the cost of regular pay raises and performance bonuses.

The congressional salaries' link to the Executive Schedule has adversely affected top executives at times when the Congress has, for a variety of reasons, held its own pay down. This has also helped to hold down the Level V ceiling on GS pay, compromising legislative mandates for pay comparability and pay distinctions to match work and performance distinctions.

The congressional salaries' link to Executive Level II salaries has no legal basis or foundation. Since there seem to be few parallels between the career patterns, career expectations, and responsibilities of Members of Congress and Level II Executives, GAO sees no compelling need to link their salaries.

RECOMMENDATIONS TO THE CONGRESS

We recommend that the Congress improve the pay-setting process for Federal executives by:

--Allowing the annual adjustments for executives under Public Law 94-82 to take effect.

--Discontinuing the practice of linking congressional and Executive Level II salaries.

--Allowing SES performance and rank awards to take effect.

Contents

ABBREVIATIONS

GAO	General Accounting Office
GS	General Schedule
OPM	Office of Personnel Management
SES	Senior Executive Service

CHAPTER 1

INTRODUCTION AND BACKGROUND

Although executives comprise only a small segment of the Federal work force and their compensation makes up much less than one percent of the Federal budget, few would dispute the claim that they are among the most vital factors for the successful performance of Government programs. It is virtually impossible to address national priorities and Government costs without recognizing the responsibilities and the effect of this relatively small group of individuals.

A recent Brookings Institution study 1/ states that the determination of Federal executive pay describes the kind of government Americans want and the relationship of government officials to the citizens they serve.

It is imperative that the Federal Government attract and retain highly talented, capable, and dedicated individuals for its top positions. The Government must therefore have a pay system which, while accounting for the nonmonetary benefits of public service, can be competitive in the market for top quality executives and can reward its executives for higher levels of responsibility and performance.

During the last several years, we have issued many reports pointing out the problems associated with Federal executive pay compression. Most recently in our May 17, 1979, report, "Annual Adjustments--The Key To Federal Executive Pay" (FPCD-79-31), we described the adverse effects of limiting or denying salary increases for Federal executives and recommended specific steps for alleviating the problem. Despite a 5.5-percent salary increase in October 1979, this situation has worsened.

The President has already announced his intention to limit the October 1980 pay adjustment for top executives. This would increase pay compression, extend it further into the General Schedule (GS), and increase the loss in executive pay purchasing power. Executive recruitment and retention problems for Federal agencies have persisted. Limiting or denying annual executive pay adjustments may also adversely affect the success of the Senior Executive Service (SES).

1/Robert W. Hartman and Arnold R. Weber, ed., "The Rewards of Public Service--Compensating Top Federal Officials" (The Brookings Institution, 1980)

PRESENT EXECUTIVE PAY-SETTING SYSTEM

Federal executives are covered by three pay schedules:

1. The Federal Executive Schedule includes positions at five different levels--Executive Levels I through V.

2. SES covers managerial and supervisory positions in the executive branch--classifiable at GS-16, 17, and 18 and Executive Levels IV and V (or their equivalents)--that do not require Senate confirmation.

3. GS covers nonsupervisory and professional employees at GS-16, 17, and 18; other positions at equivalent pay; and individuals who did not convert to SES.

Under the present system, Executive Schedule pay is set in two ways--by an annual adjustment and by a quadrennial adjustment. The rate established for Executive Level V serves as the statutory pay ceiling for other Federal pay systems, including GS.

The annual adjustment for executives was established by the Executive Salary Cost-of-Living Adjustment Act of 1975 (Public Law 94-82). The act provided that salaries for positions falling under the purview of the Quadrennial Commission--Members of Congress, Federal judges, Executive Schedule positions, and certain others--will be adjusted by a percentage equal to the average percentage adjustment for GS positions. But adjustments for the Executive Schedule, as well as for GS, are subject to changes or denial by either the President or the Congress.

Under the annual comparability adjustment process, the President receives a report from his Pay Agent based on a Bureau of Labor Statistics survey of private industry pay for the same levels of work as GS-1s through 15s. Rates for higher levels--GS-16 through GS-18--are extrapolated from this data. The President also receives recommendations from other groups. He considers these recommendations and, effective with the first pay period in October, adjusts the statutory pay rates accordingly.

If, however, the President believes that the comparability adjustments proposed by his Pay Agent are not appropriate because of national emergency or economic conditions affecting the general welfare, he may submit an alternative pay plan to the Congress by September 1. Unless either House of the Congress adopts a resolution within 30 days disapproving the plan, it then becomes effective. If the plan is not approved, the President must implement comparability adjustments on the first pay period beginning in October.

The Congress can influence Executive Schedule and top GS salaries in other ways, such as by enacting legislation specifically denying Executive Schedule positions the comparability-initiated adjustment or by using the appropriations process to deny the funds to pay them the adjustment. In the former case, the Executive Schedule pay rates would not increase and the imposed Executive Level V ceiling on GS rates would remain the same; in the latter case, in the absence of any other congressionally imposed restrictions, the established rates for the Executive Schedule would increase and the newly established rate for Executive Level V would serve as the new GS ceiling. The Executive Schedule positions would not actually be paid the increase because of the funds' restriction and, as a result, two rates would exist for them--an established rate and a paid rate. The Congress can also use the appropriations process to effectively limit GS salaries to the paid rate for Executive Level V.

The quadrennial adjustment procedure was initiated by the Federal Salary Act of 1967. Under it, a Quadrennial Commission recommends executive salary levels to the President who in turn submits his recommendations to the Congress. Before this procedure was modified in April 1977, the President's recommendations took effect automatically within approximately 30 days unless the Congress enacted a statute establishing different rates of pay or unless either House disapproved all or any part of the recommendations. However, with the 1977 changes, approval by both Houses is required before the President's recommendations take effect. Thus, both the President and the Congress play a significant role in the quadrennial adjustment process.

Since 1965, there has also been an informal link between congressional salaries and the Executive Level II pay rate. This link has sometimes affected the Congress' willingness to grant Executive Schedule pay increases. Efforts to break this link have not been successful.

The SES pay-setting process is linked both to the Executive Schedule and to the General Schedule. The lowest rate of basic pay for SES positions cannot be less than the minimum rate paid to GS-16, step 1. The highest rate of basic pay for SES positions cannot exceed the rate for Executive Level IV. These "floor" and "ceiling" amounts are determined independently--the former according to the GS comparability process (subject, of course, to the Executive Level V limitation or other congressionally imposed limitations on GS pay); the latter by the Executive Schedule pay-setting process, also subject to congressionally imposed limitations.

SCOPE OF REVIEW

We initiated this review because of our continued concern about the effect of executive pay-setting practices on executives and their agencies. Through discussions with agency officials and review of supporting records, we observed how five selected agencies attracted and retained well-qualified executives. We also reviewed relevant legislation, past pay actions and their effects, and previously issued executive pay reports. We analyzed responses to an Office of Personnel Management (OPM) questionnaire sent to former Federal executives on why they left the Government and responses of current SES members to a GAO questionnaire on SES performance appraisals. We conducted our review at OPM, the Federal Aviation Administration, the Nuclear Regulatory Commission, the Department of Health and Human Services, the Environmental Protection Agency, and the Department of Housing and Urban Development.

CHAPTER 2

EFFECT OF PAY RESTRICTIONS ON EXECUTIVES AND AGENCIES

The high rate of inflation in recent years has affected the value of most workers' pay. Federal executives appear to have been particularly hard hit. Despite receiving a 5.5-percent raise in October 1979, the first salary increase since March 1977, the economic plight of Federal executives continues to deteriorate. This situation affects executives' decisions to accept promotions and increased responsibilities without additional pay, and their decisions to retire. Low salaries also make it difficult to recruit well-qualified individuals from outside the Government. The Director, OPM, acknowledged that pay compression "leaves the Federal Government, as an employer, in the position of not being able to attract high quality executives from the private sector, nor to offer the most able mid-management Federal employees any reward for accepting increased responsibility." (See app. II.)

ADVERSE ECONOMIC EFFECT ON FEDERAL EXECUTIVES WORSENS

Federal executives have often not received the annual pay adjustments that other Federal employees have been granted and which are common in the private sector. Since "automatic" annual adjustments were established for the Executive Schedule in 1975, only one such adjustment has been allowed to take effect--the first one in 1975. The Congress has denied the funds to pay two "automatic" increases, limited them for another adjustment in 1979, and has once denied the entire adjustment. A congressional proposal currently being considered would again deny the adjustment in October 1980. In addition, the recommendations of all three Quadrennial Commissions have been scaled down by the President. One recommended increase was denied by the Congress altogether. A major factor affecting congressional approval of executive pay raises has been the link between congressional salaries and Executive Level II pay whereby the Congress is faced with increasing its own pay at the same time.

As a result of these actions, the salary for an Executive Level I position has increased only about 16 percent in the last 10 years. The other Executive Levels increased 39 to 43 percent, for an overall average increase of about 35 percent. The following table shows that, during the same 10-year period, GS rates increased about 84 percent and salaries for private sector executives, as reported by the Executive Compensation Service of the American Management

Associations, rose about 125 percent. Denying executives the October 1980 adjustment will worsen this situation.

Percentage of Salary Increases

Year	GS (note a)	Level V	Private sector (note b)
1970	6.00	0	6.7
1971	6.00	0	3.8
1972	10.88	0	4.9
1973	4.80	0	9.7
1974	5.50	0	10.2
1975	5.00	5.0	11.0
1976	5.20	0	6.9
1977	7.05	25.7	10.9
1978	5.50	0	10.1
1979	7.00	5.5	10.5
Total (note c)	83.90	39.2	124.9

a/Average GS increases.

b/Private sector increases obtained from the American Management Associations Executive Compensation Service Top Management Report, 1979-80, are for salary plus bonuses.

c/Represents the compounded value of salary increases which are greater than the sum value.

England, West Germany, and Canada all maintain separate pay adjustments for legislators and top civil servants because the jobs have different responsibilities. Attempts by members of Parliament in England to establish a link similar to ours were rejected because the legislators' jobs were considered unique and could not be compared to top civil service jobs. In 1969, Canada broke the link between legislators and top civil servants for the same reasons.

Large increases in the cost of living, as measured by the Bureau of Labor Statistics' Consumer Price Index, have significantly decreased the real value of Federal executives' salaries since October 1969.

Grade	Salary paid Oct. 1969	Salary paid Oct. 1979	Value of Oct. 1979 salary in 1969 dollars	Loss in purchasing power
Level I	$60,000	$69,630	$34,475	43%
Level V	36,000	50,112	24,811	31%
GS-16/1	25,044	47,889	23,711	5%

During October 1969 through October 1979, the price index has more than doubled from 111.6 to 225.4, but Executive Level I salaries have only increased from $60,000 to $69,630. In 1969 dollars, the current salary for Executive Level I personnel is worth $34,475, or a little more than half of the $60,000 they received in October 1969. This represents a 43-percent decline in purchasing power since October 1969. Salaries limited by the Executive Level V pay ceiling have incurred a 31-percent loss in purchasing power despite salary increases of 39 percent ($36,000 to $50,112) since October 1969. The chart on page 9 shows the impact of inflation on Executive Level V pay.

Limitations on Federal executives' salary levels have also resulted in lost pay, lost retirement benefits, and payless promotions for those affected.

Pay rates under GS and other statutory pay schedules may generally not exceed the rate established for Executive Level V. Pay in executive agencies and military departments, which is administratively determined, is also limited. As a result, as pay for top managers in these schedules is increased, it reaches the imposed ceiling rate and then remains at that rate. As pointed out in a recent Brookings Institution study, "an increasing share of the Federal workforce finds its pay governed by the ceiling rather than by comparability." The Congressional Budget Office estimated, in September 1979, that about 17,300 Federal executives were compressed at the pay ceiling. Compression now covers employees at Executive Level V; the top four SES rates; all GS-17 and 18 levels; GS-16, step 3 and above; and GS-15, step 8 and above. Many Federal executives with administratively determined pay rates are also limited by the ceiling. Thus, the number of Federal executives at the pay ceiling increases as they are denied the pay adjustments provided most GS employees.

The chart on the next page shows the salaries for the top GS levels as determined by the comparability procedure.

Steps	GS-15	GS-16	GS-17	GS-18
1	$40,832	$47,889	a/$56,099	a/$65,750
2	42,193	49,485	a/ 57,969	
3	43,554	a/ 51,081	a/ 59,839	
4	44,915	a/ 52,677	a/ 61,709	
5	46,276	a/ 54,273	a/ 63,579	
6	47,637	a/ 55,869		
7	48,998	a/ 57,465		
8	a/ 50,359	a/ 59,061		
9	a/ 51,720	a/ 60,657		
10	a/ 53,081			

a/ Limited to $50,112.

If Federal executives are denied the projected 6.2-percent increase to be paid General Schedule employees in October 1980, then pay compression will cover all GS-16s, almost all SES members, and the top five steps of GS-15. Continuing the pay ceiling in October 1981 would cause compression to reach the top steps of GS-14.

Because of the imposed salary ceiling, the present annual salary loss for a GS-18, based on comparability rates, is $15,638 ($65,750 less $50,112). A GS-18 who reached the salary ceiling in January 1971 suffered a cumulative salary loss over the last 9 years of $73,797. If the projected 6.2-percent October 1980 adjustment is again denied top executives, then the GS-18's loss will have increased to $89,435.

Retirement benefits for these employees are also affected since annuities are determined using the paid salary amounts instead of the comparability salary amounts. For a GS-18 retiring as of September 30, 1979, after 30 years of service, this could mean an initial annuity of $6,552 a year less than if the employee had received the comparability salary amount.

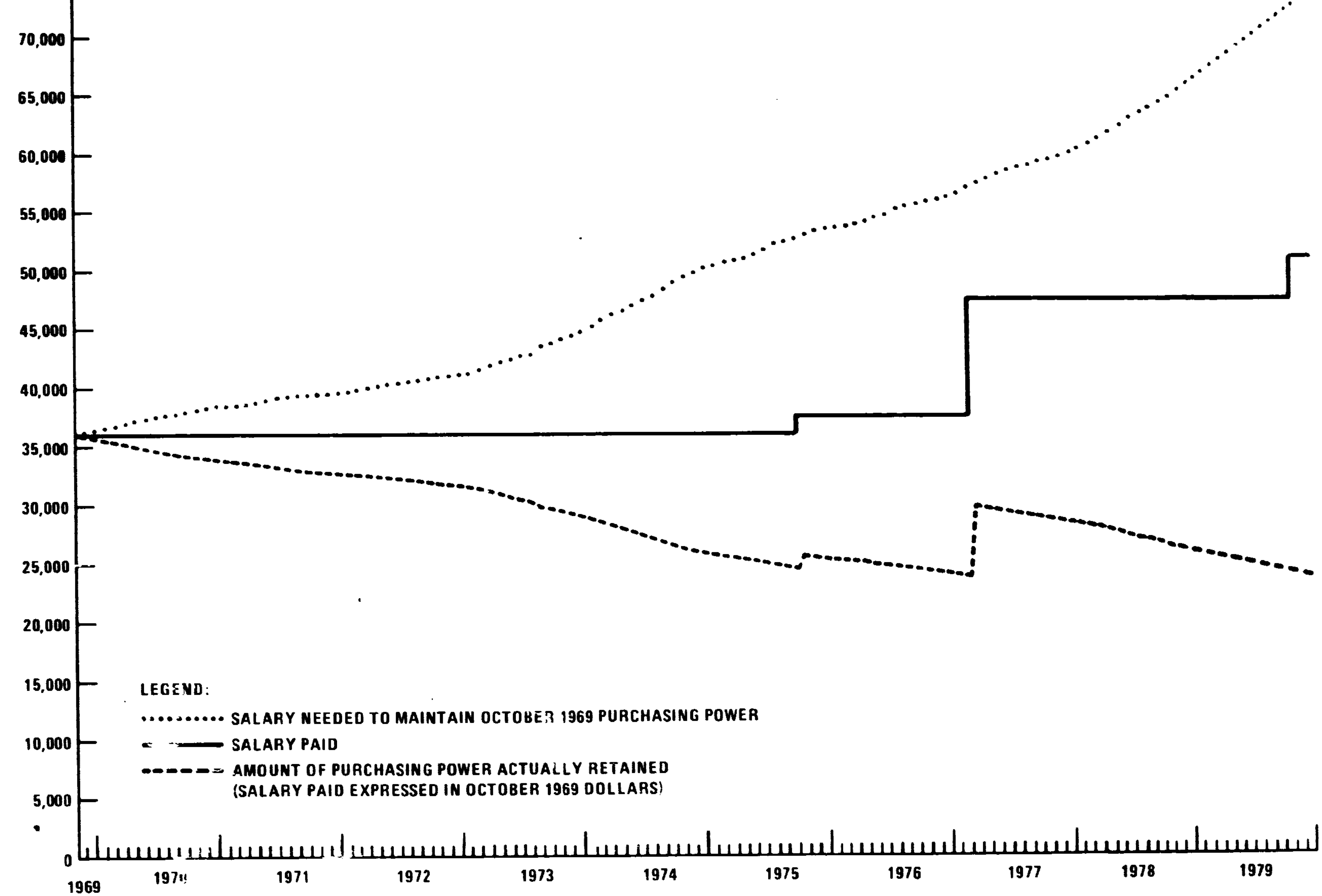
Pay compression has also resulted in inconsistent salary differentials between different levels of the Executive Schedule and no differentials for the top GS levels or the top four rates of the SES schedule.

The present differentials paid are

--0 percent between GS-18, 17, many 16s and 15s, and Executive Level V;

--5.3 percent between Executive Levels V and IV;

IMPACT OF INFLATION ON EXECUTIVE LEVEL V PAY



--5.0 percent between Executive Levels IV and III;

--9.5 percent between Executive Levels III and II; and

--14.8 percent between Executive Levels II and I.

The Quadrennial Commission in 1976 suggested that, since those at the top of the Executive Schedule derive considerably more nonmonetary rewards or "psychic income" from public service than those at the lower part, salary intervals should be greater at the lower levels than at the upper levels. In a recent Brookings Institution study, the former executive director of the 1976 Quadrennial Commission noted that industry practice and the attitudes of Government executives both suggested that 10 percent is the minimum acceptable differential if real motivational differences are to exist.

We have long felt that pay distinctions should be maintained in keeping with work and performance distinctions. In June 1978, we endorsed certain provisions of H.R. 11774, a bill to amend the Federal Salary Act of 1967 to require pay rate distinctions for different grades, steps, schedules, and levels under statutory pay systems. The bill, in effect, proposed to create new pay ceilings for levels below GS-18 (and their equivalents) which would be progressively lower than the existing Level V ceiling. Pay differentials could be established by not granting the full comparability increases to employees in other GS levels. While the bill would certainly have created new impediments to comparability for employees who had not been affected before, it could result in a more equitable sharing of the effects of the ceiling.

We did note at that time and we still believe that, while a solution to provide both pay distinctions as well as adequate salary levels for these top officials would be preferable, it might not be possible as long as Federal pay (via the Executive Schedule) is linked to congressional salaries.

PAY RESTRICTIONS CONTRIBUTE TO RECRUITING AND RETENTION PROBLEMS

Pay compression continues to be a major cause of recruiting and retention problems for Federal agencies. This problem is compounded by the generous cost-of-living adjustments to retirement annuities which increase the incentive to retire. Many Federal executives leave shortly after attaining retirement eligibility and accept higher paying jobs outside the Government. As a result, the Government loses well-qualified individuals with many years of valuable experience.

Personnel officials at Federal agencies consider low Federal executive salaries and infrequent adjustments as a major source of their difficulties in recruiting well-qualified individuals from outside the Government. Despite extensive advertising for applicants outside the Government, agencies often get fewer than five well-qualified applicants. Many prospective applicants show little interest in job offers because they are making more money outside the Government. The greater the skill and responsibilities of a position, the more difficult it is to fill. Sometimes it can take over a year to fill top positions. For example, a top hospital director position in the Department of Health and Human Services 1/ has not been filled for 7 months because most well-qualified candidates are making more than $50,112 in jobs outside the Government.

Vacant executive positions are sometimes filled from within an agency with individuals who lack the desired level of experience and expertise. However, many Federal executives are reluctant to accept promotions because the increased responsibilities of the position are not recognized with higher pay. Payless promotions are occurring more often because pay compression results in five or more levels of authority making the same salary.

Last October, top officials' pay was increased by 5.5 percent (their first raise since March 1977), while other Federal employees received 7-percent raises. Moreover, Federal retirees received two increases totaling 10.8 percent in 1979 and received a 6-percent increase on March 1, 1980. Thus, it is not hard for an employee whose pay has been adjusted infrequently and in smaller amounts than others, to realize that he or she is better off retiring when eligible and receiving cost-of-living increases granted to Federal retirees every 6 months.

About 180 Federal executives chose optional retirement during the last 6 months of 1979. However, the number of retirements rose drastically during the first 3 months of 1980 to about 320. The Department of Health and Human

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1/ On May 4, 1980, the Department of Health, Education, and Welfare's responsibilities were split between the Departments of Education and Health and Human Services.

Services alone lost 16 top executives in the first quarter of 1980 with combined Federal experience of over 500 years. Many of these individuals were division and department heads or regional commissioners. The Federal Aviation Administration lost nine top executives with over 300 years of Federal service. Many of these individuals leave shortly after attaining retirement eligibility and accept higher paying jobs outside the Government.

Responses to a recent OPM questionnaire to former Federal executives who left the Government from October 1978 to July 1979 highlight the impact of pay ceilings on Federal executives. Over half the respondents cited concern about continued pay ceilings and lack of regular adjustments as an important reason for their leaving the Government. About 31 percent said the thing they liked least about working for the Government was the financial sacrifices they were forced to make. Finally, about 25 percent of the respondents left for higher paying jobs outside the Government.

CHAPTER 3

PAY RESTRICTIONS COULD UNDERMINE SES

SES was created by the Civil Service Reform Act of 1978 to improve the efficiency and effectiveness of the Federal Government. Those electing to join this elite cadre agreed to accept reassignments to areas where they were needed and give up some of the security offered other civil servants. In return these executives became eligible for improved pay-setting procedures and an innovative and appealing system of awards (bonuses and ranks) which members could influence on the basis of their performance. But, because of the link with GS and the Executive Schedule, the success of SES in improving its members' future pay depends on the extent to which Executive Schedule and GS increases are allowed to take effect.

EFFECT OF COMPRESSION ON SES PAY RATES

As we stated in our recent report, "First Step Completed In Conversion To Senior Executive Service" (FPCD-80-54, July 11, 1980), Public Law 96-86 has already affected SES pay rates. It stipulated that fiscal year 1980 appropriations could not be used to pay increases of more than 5.5 percent in rates of basic pay for offices and positions subject to fiscal year 1979 restrictions. As a result, pay compression continues under SES.

Executive Order 12165 of October 9, 1979, established new pay rates for SES, reflecting a 7-percent pay increase. However, these new rates could not be put into effect because of the fiscal year 1980 fund restrictions. Therefore, a substantial difference exists between the rates established by the President and payable rates resulting from congressional restrictions.

SES levels	Established rates	Payable rates
1	$47,889	$47,889.00
2	49,499	49,499.00
3	51,164	50,112.50
4	52,884	50,112.50
5	54,662	50,112.50
6	56,500	a/ 50,112.50

a/$52,750 for persons in offices or positions at Executive Level IV before conversion to SES.

The six payable rates pose several negative features:

--About 6,100 (or about 90%) of the 6,800 executives entering SES on July 13, 1979, at SES levels 3 through 6 receive the same salary despite differences in their responsibility and authority.

--Pay adjustments from one SES rate to another will mean little in terms of financial reward, and pay adjustments for poor performance or reduced responsibility will also have little meaning because most SES rates have the same salary.

--As noted in the table, some executives at SES level 6 receive $50,112.50, while others get $52,750, depending on their salaries before joining SES.

--In October 1980, practically everybody in SES could get the same pay if those at SES levels 1 and 2, who are not limited by the pay ceiling, have their pay increased to $50,112.50.

--The lack of salary differentials may lead to the use of performance awards to recognize higher levels of responsibility rather than top performance.

If annual adjustments for the Executive Schedule are continually denied or limited, agencies could face increasing problems with recruiting and retaining competent executives. Executives can be expected to continue to leave the Government for higher paying private sector jobs, while others may take advantage of early retirement. Also, OPM's role to foster mobility among SES members may be hampered by the absence of meaningful pay differentials among SES pay rates.

The compression of SES salaries undermines two important purposes of SES and may threaten its success. The Civil Service Reform Act of 1978 states that SES was created to

--provide for a compensation system designed to attract and retain highly competent senior executives and

--insure that compensation, retention, and tenure are contingent on executive success which is measured on the basis of individual and organization performance.

Failure of the Congress to insure the implementation of these objectives may be seen by civil servants as a lack of commitment to civil service reform. This perception could be critical when agencies begin implementing other aspects of reform, such as merit pay which may affect as many as 125,000 GS-13s through GS-15s, and performance appraisal which affects all Federal employees.

LIMITING PERFORMANCE AWARDS AND RANKS COULD CAUSE SES TO FAIL

The Reform Act also established performance awards and ranks to encourage and reward excellence. Career SES members with fully successful performance can receive lump-sum performance awards (bonuses) of up to 20 percent of the basic SES pay rate established by the President. Performance awards can be paid up to 50 percent of the number of SES positions in an agency. Career executives are also eligible to receive the rank of Meritorious Executive for sustained accomplishment, and the rank of Distinguished Executive for sustained extraordinary accomplishment. These ranks carry one-time, lump-sum payments of $10,000 and $20,000, respectively. However, recent congressional proposals to limit SES's total compensation, including ranks and performance awards, and actions to limit the number of SES positions eligible for awards could be disastrous.

On July 2, 1980, the Congress included language in the Fiscal Year 1980 Supplemental Appropriations Act which allows aggregate pay for SES executives up to the $69,630-level authorized by the Reform Act, rather than the previously proposed limit of $52,750, but limits bonus payments to 25 percent, rather than 50 percent, of SES positions. This action alleviates, to a large degree, the situation for fiscal year 1980. A House proposal still retains language which would prohibit the October 1980 adjustment and limit bonus payments to 25 percent of SES positions.

While SES is not designed to alleviate executive pay compression, it does provide the framework to make it easier for the Federal Government to attract and keep top managers, to use their abilities productively, and to pay them according to their contribution. In commenting on our report, the Director of OPM stated "that the Federal Government has an obligation to its employees to give fair compensation at all levels, and to the public to provide some incentives for outstanding performance."

Prohibiting or limiting performance awards and ranks for SES members could nullify, to some extent, agencies' success in encouraging Federal executives to join SES. Over 98 percent of those eligible have elected to join. A limitation will seriously affect the morale of these employees and can serve to stifle the incentive for greater excellence which the Congress was striving to stimulate through the Reform Act's pay-for-performance provisions. Since nearly all Federal executives receive the same salary because of pay compression, few, if any, incentives exist for them to seek or assume positions of greater authority and responsibility or to make special efforts to improve the productivity of their organization. SES would at least give the most deserving and productive executives an opportunity to receive lump-sum performance awards in recognition of their individual and organizational contributions.

Private sector experience shows that executive bonus systems take many years to develop and refine. The SES awards system needs the same chance to operate as originally designed before it can be reviewed and improved. Proposals to alter the innovative features of the SES compensation plan before it has an opportunity to work could be construed as a breach of faith by many executives who elected to join. This, in turn, would be devastating to morale and productivity and would severely weaken the SES system.

Returns from a questionnaire sent to a random sample of senior executives indicate a large number already have strong concerns about the proposals to limit performance awards and to continue the freeze on executive salary increases. This information is being gathered in our current review of SES performance appraisal processes, the results of which will be reported later this year.

CHAPTER 4

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

Changes in pay setting for Federal executives are critically needed if (1) the problems executives face due to diminishing real salaries are to be alleviated, (2) pay distinctions are to accurately reflect differences between levels of responsibility and performance, and (3) agencies are to avoid serious recruitment and retention problems.

Allowing annual adjustments to take effect would help alleviate compression, improve pay distinctions, and reduce agencies' recruitment and retention problems. In addition, these adjustments would reduce the burden on the next Quadrennial Commission to recommend the cumulatively large, politically unpopular increases which have characterized their past proposals during periods of high inflation and irregular adjustments. Annual adjustments of relatively small amounts appear to be more acceptable to the public than the large jumps recommended every 4 years by the Quadrennial Commission.

SES's success also depends on the granting of annual adjustments to the Executive Schedule and granting performance awards within already established guidelines. Without these increases, the success of SES could be undermined and the objective of greater excellence and improved program management envisioned by the Reform Act seriously impaired. Restricting these essential incentives will likely exacerbate current recruiting and retention problems by forcing highly skilled and experienced executives to retire or accept more rewarding private sector positions. Such action will not achieve the efficient Government the Reform Act sought to create. Instead, it could foster Government inefficiency and increase Government expenditures to a level far exceeding the cost of regular pay raises and performance bonuses.

The congressional salaries' link to the Executive Schedule has adversely affected executives at times when the Congress has held its own pay down. This has also helped to hold down the Level V ceiling on GS pay, compromising legislative mandates for pay comparability and pay distinctions to match work and performance distinctions. The congressional salaries' link to Executive Level II salaries has no legal basis or deeply rooted foundation. Since there seems to be few parallels between the career patterns, career expectations, and responsibilities of Members of Congress and Level II executives, we see no compelling need to continue linking these salaries.

Continuing efforts to compress executive pay and limit bonus and rank awards create turbulence and declining morale among senior executives. We believe that the innovative features of the compensation plan for SES executives, as stated in the Reform Act, should not be abandoned before they have been given a chance to work.

RECOMMENDATIONS TO THE CONGRESS

We recommend that the Congress improve the pay-setting process for Federal executives by:

--Allowing the annual adjustments for executives under Public Law 94-82 to take effect.

--Discontinuing the practice of linking congressional and Executive Level II salaries.

--Allowing SES performance and rank awards to take effect without further restrictions on payments.

We discussed this report with officials from the Office of Management and Budget, OPM, and the Advisory Committee on Federal Pay and incorporated their comments where appropriate. The Director of OPM's written comments are in appendix II.

CHRONOLOGY OF EXECUTIVE PAY ACTIONS 1967-1979

Federal Salary Act of 1967 (Public Law 90-206)

This act established the Commission on Executive, Legislative, and Judicial Salaries (the Quadrennial Commission). Its purpose is to review executive-level salaries in all three branches of the Government every 4 years and to recommend salary adjustments to the President. Before this, executive pay was set by statute with no definite schedule for adjustments. After receiving the Commission's recommendations, the President must then submit his proposed recommendations to the Congress for its consideration.

First quadrennial adjustment--fiscal year 1969

In 1968, the first Quadrennial Commission proposed substantial catchup salary increases for executives which would also improve the salary differentials between the various responsibility levels. The President proposed smaller increases.

Executive Level	1968 actual salary	Commission's recommendations for 1969	President's recommendations for 1969
I	$35,000	$60,000	$60,000
II	30,000	50,000	42,500
III	29,500	46,000	40,000
IV	28,750	43,000	38,000
V	28,000	40,000	36,000

The rates proposed by the President went into effect in March 1969 after disapproval resolutions in both Houses failed.

Second quadrennial adjustment--fiscal year 1973

The second Quadrennial Commission noted that compensation for non-Federal executives had increased about 30 percent since 1968; however, it recognized the need for moderation implicit in the economic environment at the time. The commission recommended increases for most executive positions about equal to the increase in the cost of living over the 5-year period, about 25 percent. The President proposed a single 7.5-percent increase in 1975 for Executive Level I and three increases of 7.5 percent each in 1974, 1975, and 1976 for Executive Levels II through V.

Executive Level	1973 actual salary	Commission's recommendations for 1974	President's recommendations for 1974	1975	1976
I	$60,000	$70,000	$60,000	$64,500	$64,500
II	42,500	53,000	45,700	49,100	52,800
III	40,000	50,000	43,000	46,200	49,700
IV	38,000	47,500	40,900	43,900	47,200
V	36,000	45,000	38,700	41,600	44,700

The Senate, however, passed a resolution rejecting these increases; thus, no increases were granted to executives.

Executive Salary Cost-of-Living Adjustment Act of 1975 (Public Law 94-82)

This law provides that positions under the jurisdiction of the Quadrennial Commission are to receive an annual "cost-of-living" salary adjustment equal to the average of the rates by which GS salaries are increased for annual comparability purposes.

First annual salary adjustment--October 1975

Under provisions of the above act, executives received the same 5-percent adjustment given to GS employees, as shown below.

Executive Level	Salary before adjustment	Salary after adjustment
I	$60,000	$63,000
II	42,500	44,600
III	40,000	42,000
IV	38,000	39,900
V	36,000	37,800

Second annual salary adjustment--October 1976

In October 1976, the Congress passed the Legislative Branch Appropriation Act (Public Law 94-440). This denied the funds to pay those positions under the jurisdiction of the Quadrennial Commission the October 1976 "automatic" increase (4.83 percent under the President's alternative plan) they would have received under the provisions of Public Law 94-82. It did not, however, prevent the "legal" rate for these positions from increasing, nor did it prevent paying other employees at these new rates. As a result, the ceiling for GS became $39,600 while the actual paid rate for Executive Level V remained at $37,800.

Third quadrennial adjustment--fiscal year 1977

The third Quadrennial Commission recommended substantial increases for executives, ranging from 7.1 to 35.7 percent. Executives had received only one salary increase in 8 years. The President reduced the Commission's recommendations.

Executive Level	1976 actual salary	Commission's recommendations for 1977	President's recommendations for 1977
I	$63,000	$67,500	$66,000
II	44,600	60,000	57,500
III	42,000	57,000	52,500
IV	39,900	53,000	50,000
V	37,800	49,000	47,500

The Congress did not disapprove the recommendations, and the President's proposals went into effect in late February and early March 1977.

Public Law 95-19--April 1977

This law amended the Federal Salary Act of 1967 and increased the role of the Congress in adjusting executive pay. It provides that future quadrennial salary recommendations of the President (but not the annual adjustments) would not take effect unless approved by both Houses of Congress within 60 days. The new rates would become effective about 30 days after the second House approves the rates. The law also provides that separate votes be taken on pay increases for each branch.

Third annual salary adjustment--October 1977

On July 11, 1977, the Congress passed Public Law 95-66 denying the October 1977 automatic adjustment for executives who had received increases under the 1977 quadrennial procedure. As a result, the legal rate for Level V, and thus the GS ceiling, remained at $47,500.

Fourth annual salary adjustment--October 1978

The 5.5-percent October salary increase given to most GS employees (under the President's alternative pay plan) was denied for Executive Schedule and certain other positions by the Legislative Branch Appropriation Act of 1979 (Public Law 95-391). The law generally denied the funds to pay salaries at a rate greater than that paid for the position at

September 30, 1978, for positions whose salaries were (1) fixed at a rate equal to or greater than Level V or (2) limited to a maximum equal to or greater than Level V. Thus, while the law did not prohibit the legal rates for the executive positions from increasing, it did, in effect, prevent payment of the increase to the Executive Levels and to GS and related positions already at the $47,500 ceiling.

Fifth annual salary adjustment--October 1979

In October 1979, the Congress approved a 7-percent salary increase for GS employees under the President's alternative pay plan. However, Public Law 96-86 prohibited the use of 1980 appropriated funds to pay for salary increases of more than 5.5 percent for those positions covered by the Executive Schedule. The resulting payable rates for the Executive Schedule are:

Level I	- $69,630
Level II	- $60,662
Level III	- $55,387
Level IV	- $52,750
Level V	- $50,112

The GS ceiling became $50,112.

United States
Office of
Personnel Management
Washington, D.C. 20415

In Reply Refer To Your Reference

July 22, 1980

Mr. H. L. Krieger
Director
Federal Personnel and Compensation Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Krieger:

I have reviewed your report entitled Federal Executive Pay--Compression Is Getting Worse.

You have laid out the problem very cogently. While it is tempting for some to attack the compensation of executive employees--who make up fewer than one-half of one percent of the Federal workforce--it is not only unfair but short sighted in the extreme. It leaves the Federal Government, as an employer, in the position of not being able to attract high quality executives from the private sector, nor to offer the most able mid-management Federal employees any reward for accepting increased responsibility.

Even more serious, we believe, is the fact that the Government's ability to differentially compensate individuals who manage their programs effectively is under challenge. While many Federal executives are willing to make substantial financial sacrifices because of their commitment to public service, there comes a point when the sacrifice demanded is too great to be tolerated.

You cite data indicating that over the last 11 years salaries alone of private executives have risen about 137 percent. While you do not give a directly comparable figure for those Federal executives now constituting the Senior Executive Service, it would appear from our own data to be approximately 90 percent. This comparison, of course, does not take into account the customary performance bonuses given in large private sector organizations.

I think it is appropriate to ask Federal executives to continue to make some financial sacrifices (i.e., full comparability with six-figure private sector executive salaries is unrealistic). It seems to us, however, that the Federal Government has an obligation to its employees to give fair compensation at all levels, and to the public to provide some incentives for outstanding performance. It has been some years now since we have done either. The compensation features of the SES, if permitted to take effect, would accomplish these ends and stimulate productivity throughout the Federal service.

Sincerely yours,

Alan K. Campbell
Director

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