The Florida Senate

Interim Project Report 2000-39 *September 1999*

Committee on Fiscal Policy Senator Roberto Casas, Chairman

DEVELOP PERFORMANCE INCENTIVE/DISINCENTIVE STRATEGIES FOR ALL PROGRAMS INVOLVED IN PERFORMANCE-BASED PROGRAM BUDGETING

SUMMARY

- Florida has made limited use of incentives to improve agency performance. Other governments have primarily used employee incentives as part of reforms of their personnel systems.

- Florida state agencies believe personnel incentives would be the most effective incentive, while restriction of budget flexibility would be the most effective disincentive.

- The Senate could use incentives and disincentives to highlight priority areas within state agencies. A possible procedure for using incentives and disincentives is detailed.

BACKGROUND

The Florida Legislature passed Government Performance and Accountability Act in 1994 to improve government accountability by incorporating performance information into the state budgeting process. Under performance-based program budgeting, agencies and the Governor propose a budget that quantifies the anticipated results of state programs based on the amount of resources requested. The Legislature approves performance measures and performance levels, referred to as standards, for each program funded in the annual state budget. Agencies then track performance as a part of administering their programs. In their legislative budget request, agencies report their past performance and propose adjusted performance standards for the new budget year. This budget reform has been phased in over a seven-year period beginning in FY 1995-96. There are currently 74 state programs administered by 24 agencies operating under performance-based program budgeting.

Chapter 216, F.S., does not specify the role performance information will play in setting the annual budget. Clearly, performance information is but one consideration in determining an agency's annual appropriations that must be weighed with the demands for service from the state's growing population and the priorities of the Legislature. In addition, there are structural limitations as to the role performance information can play in the budget as well. [1] Many believe that setting performance standards and performance monitoring are primarily management tools. One application of these tools by the Legislature is holding agencies accountable for performance.

Section 216.177(3), F.S., provides that the Legislature may annually specify any incentives and disincentives for agencies operating programs under performance-based program budgets in the General Appropriations Act or legislation implementing the General Appropriations Act. The incentives and disincentives may be financial, such as increases or decreases in appropriations, or non-financial, such as increases or decreases in budget flexibility. The Governor may include incentives and disincentives in his annual budget recommendations, but such recommendations have rarely been made in the past. Based on its program evaluations, the Legislature's Office of Program Policy Analysis and Government Accountability (OPPAGA) has recommended incentives and disincentives. Even though some programs have operated under performance-based program budgeting for four years and have been evaluated, the Legislature has made limited use of incentives and disincentives. The Legislature has not had a strategy to award agency incentives and disincentives. Such a strategy should be flexible so as to work for different agencies and programs, but also consistent and fair so as to be credible. This interim project attempts to present such a strategy.

METHODOLOGY

The General Appropriations Acts for the last five years and the Florida statutes were analyzed to identify past uses of incentives and disincentives. A review of recent research reports was conducted to identify the types of incentives and disincentives used in the federal, other state, and local governments. Performance incentive plans of the provinces of Ontario and Alberta, Canada were also reviewed.

State agency heads were surveyed and staff from the Senate, House and Governor's Office were interviewed to determine what incentives and disincentives could be most effective. A draft strategy was then developed that the Senate could use to award incentives and disincentives and comments were solicited from interested parties in the Senate, the House, the Governor's Office, and OPPAGA.

FINDINGS

Using Incentives to Improve Performance

Long used in the private sector, and validated by research in the field of psychology, incentives are a way to motivate employee behavior. The Legislature has used incentives such as tax exemptions, funding incentives, and reduced regulation, to further the state's economic development, education, environment, and health care policies. However, the Legislature has not made wide use of these tools to improve agency performance.

Chapter 216.163, F.S., provides for the following incentives:

- Additional flexibility in budget management, such as, but not limited to, the use of lump sums, special categories, or performance-based program appropriation; consolidation of budget entities or program components; consolidation of appropriation categories; and increased agency transfer authority between appropriation categories or budget entities,
- Additional flexibility in salary rate and position management,
- Retention of up to 50 percent of all unencumbered balances of appropriations as of June 30, or undisbursed balances as of December 31, excluding special categories and grants and aids, which may be used for nonrecurring purposes including, but not limited to, lump-sum bonuses, employee training, or productivity enhancements, including technology and other improvements,
- Additional funds to be used for, but not limited to, lump-sum bonuses, employee training, or productivity enhancements, including technology and other improvements,
- Additional funds provided pursuant to law to be released to an agency quarterly or incrementally contingent upon the accomplishment of units of output or outcome specified in the General Appropriations Act.

Use of Incentives by Florida

Few incentives have been based on agency performance. From 1995-1999, a total of 21 instances were identified where the Legislature authorized incentives based on agency performance. The Legislature has primarily used incentives (17 of 21 instances) in the area of education where relatively small amounts of additional funds were made available to be earned based on performance. Other uses of incentives have related to state agency personnel. Instances where the Legislature gave increased budget flexibility to agencies initially undergoing performance-based program budgeting were not included in this analysis as an incentive provided based on performance. This has been an important incentive to agencies and is discussed in the section on "Using Disincentives to Improve Performance."

The magnitude of incentive funding has ranged from $1 million to $30 million. These incentives were financed using both existing resources and new resources. Incentive funds were distributed to individual colleges, universities, or schools based on specific performance measures. A recent program evaluation by OPPAGA on community colleges attributed an increase in productivity, in part, to two incentive funds.[2] The Legislature has also used incentive funds with the public school system and the State University System. Such incentives have not only rewarded high performance, but also improved performance. This is seen as a way to encourage lower performing entities to continue to improve.

The Legislature has made limited use of performance incentives in areas other than education. Incentive pay or bonuses to individual employees based on meeting established performance goals were authorized for the Departments of Law Enforcement and Revenue. In consultation with the Governor's Office and the Legislature, these agencies selected a few key performance measures and set performance goals. The Department of Law Enforcement concentrated on areas where performance was lacking while the Department of Revenue chose measures due to their importance to the programs' mission. Non-recurring bonuses ranging from $200 to $500 were paid to employees in programs that met their performance targets. The Department of Law Enforcement financed bonuses from existing salary and benefit funds while the Department of Revenue participated in a program that allowed the use of funding for innovative practices in state government. Both agencies saw performance improvements, and considered the incentives a significant factor. [3]

Agency Views on Incentives

A total of 37 agencies were surveyed as to which incentives would most motivate their agency's programs to improve performance. Based on the 32 agencies that responded, the most motivating incentive was additional funding for salary bonuses, followed by additional flexibility in salary rate and positions and additional funding for technology enhancements (see Table 1). Not surprisingly, incentives funded through additional resources were more highly ranked than those funded through retention of unspent funds. In total, incentives were rated higher, or more motivating, than disincentives.

Table 1:
Agency Ranking of Incentives (average score)

1.	Additional Funding for Salary Bonuses	2.78
2.	Additional Flexibility in Salary Rate and Positions	2.75
3.	Additional Funding for Technology Enhancements	2.66
4.	Additional Flexibility in Budget Transfer Authority	2.59
5.	Additional Funding for Staff Training	2.53
6.	Retention of Unspent Funding for Salary Bonuses	2.50
7.	Retention of Unspent Funding for Technology Enhancements	2.44
8.	Lump Sum Funding	2.41
9.	Retention of Unspent Funding for Staff Training	2.28
10.	Additional Funding Awarded Based on Performance	2.19
11.	Consolidated Budget Entities	2.19

N= 32
Scale: 1 = not motivating, 2 = somewhat motivating, and 3 = very motivating.

Use of Incentives by Other Governments

Incentives most often used by other federal, state and local governments relate to public employee compensation. Unfortunately, there is little experience in other states in using incentives as part of performance management and budget reforms. Two recent research projects identified eight states as having legislative authority for incentives. [4]

California
Louisiana
Florida
Mississippi
Georgia
New Mexico
Illinois
Texas

No other states besides Florida and Texas however have used incentives. Texas has begun to allow agencies to use existing funds to pay salary bonuses when they meet 80% of their performance targets and have reliable performance data. In 1999, five of the 200 agencies earned this incentive.

More states have used personnel incentives as part of reforms to their personnel system than have used incentives based on agency performance. These personnel incentives base part of an employee's compensation on performance as is the case in many private sector companies. So called "pay-for-performance" programs can be aimed at different employee groups. Research from 1990 found that salary bonuses used by various state governments ranged from $400 to $2,831 per employee. Such systems are often part of reforms of civil service personnel systems. The federal government undertook a major effort geared towards its managers and supervisors in 1984. Evaluations of the program concluded that it did not meet its goals of increasing government performance. [5]

More recent attempts by local government have reported more success. [6] Local government officials believed the most effective incentives for non-managerial employees were performance bonuses, followed by promotions linked to training programs, performance based salary permanent increases, educational incentives, and attendance bonuses.

Other industrialized countries such as Australia, Canada, Denmark, Finland, France, Ireland, Italy, Japan, the Netherlands, New Zealand, Spain, Sweden, and the United Kingdom have used pay-for-performance programs as part of government reforms. Two specific performance incentive programs that have been used for several years by the Canadian provinces of Ontario and Alberta were reviewed. While no formal evaluation had been conducted, important points regarding these two programs are that they: are aimed at senior level managers, tie performance to government-wide, agency, and program performance measures, and are part of a compensation policy that attempts to make public sector manager salaries more competitive.

Research on pay-for-performance programs suggests that there are several lessons:

- Programs must be funded and the lack of funding has led to many of such programs failing,
- Awards must be meaningful in order to be motivating to employees, and
- The method of selection or evaluation for individual awards must be well developed to ensure such awards are fair.

Using Disincentives to Improve Performance

Using disincentives appears to be more problematic than incentives, due to the fact that disincentives have the potential of negatively impacting the beneficiaries of the program. For example, many legislators have recognized that cutting funding for poor performing programs could exacerbate the problems and lead to worse performance. This may explain why Florida and other governments have not used disincentives. Funding in some areas, such as administration, could be reduced in some cases without negatively impacting program customers. Some argue that not receiving an incentive when others do is in itself a disincentive. In addition, there is some potential of using disincentives such as taking back incentives such as budget flexibility that were previously provided. This possibility was raised in response to the survey of agencies.

Chapter 216.163, F.S., provides for several disincentives:

- Mandatory quarterly reports to the Executive Office of the Governor and the Legislature on the agency's progress in meeting performance standards,
- Mandatory quarterly appearances before the Legislature, the Governor, or the Governor and Cabinet to report on the agency's progress in meeting performance standards,
- Elimination or restructuring of the program, which may include, but not be limited to, transfer of the program or outsourcing all or a portion of the program,
- Reduction of total positions for a program,
- Restriction on or reduction of the spending authority provided, and
- Reduction of managerial salaries.

Use of Disincentives by Florida and Other States

No instances were identified where Florida or other states have used disincentives based on agency performance. Texas is the only state other than Florida that specifically authorizes disincentives. The Texas Legislature has authority to require an agency remedial plan, reduce, eliminate or restrict funding, reduce the ability of the agency to transfer funding, transfer the program to another entity, and place the program in conservatorship.

Agency Views on Disincentives

The survey of agency heads found that the most motivating disincentive was restriction of budget flexibility. Other meaningful disincentives included elimination of the program and reduction of agency manager salaries. In total, incentives were rated higher, or more motivating, than disincentives.

Table 2:
Agency Ranking of Disincentives (average score)

1.	Restriction of Budget Flexibility	2.27
2.	Elimination of Entire Program	2.13
3.	Reduction of Manager Salaries	2.10
4.	Outsourcing Entire Program	2.03
5.	Reduction in Positions	2.00
6.	Appearances Before Legislature	1.97
7.	Appearances Before Governor and Cabinet	1.97

8.	Outsourcing Part of Program	1.90
9.	Reports to Legislature	1.70
10.	Reports to Governor and Cabinet	1.70

N= 32
Scale: 1 = not motivating, 2 = somewhat motivating, and 3 = very motivating.

Agency staff also provided numerous comments on using disincentives. Agencies cautioned that using disincentives could lead to further poor performance. Several agencies made other related comments such as suggesting that the Legislature consider fewer performance measures under performance-based program budgeting. Others stressed that some outcome measures are beyond the control of the agency, and that this must be considered in awarding incentives and disincentives.

Budget Flexibility

There is a natural tension between the executive and legislative branches over how resources are spent. Agencies argue that flexibility is needed to manage programs in order to get the best results. Agencies would further argue that too many restrictions on how they can spend resources creates inefficiencies. The Legislature on the other hand, would argue that it is to provide the policy direction for resource use. Some would even propose that controls over spending are needed to ensure that the agencies do not alter the priorities set by the Legislature.

Except for the health and human services part of the budget, the Legislature appropriated funds for the 1999-00 fiscal year to programs under performance-based program budgeting in traditional spending categories, but allowed transfer authority between most spending categories (salaries and benefits, expenses, operating capital outlay, other personal services, and data processing services). This allows agencies to move funds between these categories with notification of the Governor's Office of Planning and Budgeting and the Legislature rather than approval.

Budget flexibility could be restricted in several ways. The Legislature could restrict flexibility previously provided to agencies under performance-based program budgeting. Through revisions to Chapter 216, F.S., proviso language in the General Appropriations Act, or language in the implementing legislation, the Legislature could make budget flexibility contingent upon the agency meeting its prior year performance targets. Agencies that have not been granted additional flexibility still have the authority to transfer up to 5% or $25,000 between spending categories under s. 216.292(3), F.S. The Legislature could deny this flexibility to those agencies that did not meet their performance targets. Another way to restrict existing flexibility would be for the Legislature not to concur in agency requests for budget transfers. Finally, poor performing agencies could have their funding released on a monthly basis rather than the current quarterly release plan. Careful attention to the causes of poor performance would be needed. If poor performance was caused by transferring resources away from a legislative priority, restriction of budget flexibility could improve performance.

Principles in Using Incentives and Disincentives

To award incentives and disincentives, the performance measures must relate to the expected results of the program, performance data must be reliable, and performance targets must be reasonable. Once this is accomplished, the Legislature must have confidence that performance was due primarily to the agency's actions rather than external factors. The 1994 Government Performance and Accountability Act attempted to address this issue through section 11.513, F.S. This section requires OPPAGA assess agency progress towards achieving performance standards, explain the circumstances contributing to program performance, determine if measures and performance information relevant, and comment on whether controls exist to ensure that performance data are reliable. The 1994 Legislature also passed legislation requiring each agency to establish an inspector general who would ensure the validity and reliability of the agency's performance data.

Interim project oversight members and staff from the Senate, House, Governor's Office of Planning and Budgeting, and OPPAGA were asked about using incentives and disincentives. Based on their feedback and the comments of agencies from the survey, the following principles were identified to guide the Senate's use of incentives and disincentives.

C **Target Performance Areas.** While agencies should be accountable for the entire mission of programs, incentives and disincentives should be used on the most important aspects of programs, or critical areas where current performance is not satisfactory.

- **Reward and Sanction Highest and Lowest Performers.** The Senate should use incentives and disincentives for very high or very low performance as opposed to those programs who perform just above or below average.

- **Tailor Incentives and Disincentives to Individual Programs.** Not all agency programs are motivated by the same things, so incentives and disincentives should be specific to each situation.

- **Aim for Improvement.** Incentives and disincentives should be geared to improve program performance. Otherwise, performance problems may be exacerbated and customers may receive degraded services.

RECOMMENDATIONS

1. Recommended Strategy for Using Incentives and Disincentives

a. Select Key Performance Measures. The executive branch would propose key performance measures and performance targets for each approved program. The substantive committees would choose up to three key performance measures that articulate the Senate's priorities. Selected program measures and associated data would have to be valid and reliable as evidenced by the rating assigned in the Florida Government Accountability Report (www.oppaga.state.fl.us) or some other independent assessment, such as that performed by the agency inspector general.

In selecting key performance measures, the Senate should avoid measures that may be considerably beyond the control of agency managers. New measures without sufficient data on past performance should be avoided as well. In addition, such a selection allows the Senate to communicate its priorities to the agencies. Agencies would still maintain a complete set of performance measures for management and to assist in determining the causes of poor performance.

b. Set Performance Targets. The substantive committee would recommend appropriate performance targets for key performance measures. Agencies would be required to provide a minimum of three years of historical data on key measures. Committees would recommend performance targets for key measures considering past performance, current resources, and external factors. For those measures that are resource sensitive, the appropriate budget subcommittees would set performance targets based on the program's final appropriations.

c. Select Incentives and Disincentives. The substantive committee, in consultation with the budget subcommittees, the Governor, and the agency, would recommend incentives and disincentives. The committee would at a minimum, consider those incentives and disincentives specified in Chapter 216, F.S.

d. Award Incentives and Disincentives. After the fiscal year has ended, the agency would report its performance to the Legislature. In some cases the incentives and disincentives could be self-executing. In others, the substantive committees would review performance and recommend selected incentives for programs that meet all performance targets and disincentives for programs that fail to meet all of the performance targets. Substantive committees would recommend incentives or disincentives that require policy changes, while the budget subcommittees would authorize financial incentives or disincentives.

2. Implementation Issues

In order for the Senate, the House and the Governor to implement a procedure for using incentives and disincentives to improve agency performance, a number of issues would need to be resolved.

a. Scope. The Senate must decide whether it wants to use incentives and disincentives for all programs operating under performance-based program budgeting or restrict their use to Legislative priorities.

b. Coordination. To be most effective, the Senate actions regarding incentives and disincentives should be coordinated with the House and Governor. This could be accomplished through the legislation or the annual instructions for legislative budget requests.

c. Timing. The fiscal year is the obvious time period for setting performance targets, but this means that the awarding of incentives and disincentives may take place in the following year.

d. Financing Incentives. To avoid a common problem cited in pay-for-performance personnel reforms, the Legislature should make specific appropriations for any financial incentives. Such resources could come from retaining unspent funds, redirecting existing funds, or new funding. CS/CS for SB 350 and 364 considered by the 1999 Legislature identified one source for new funding for performance incentives.

e. Evaluation. Incentive and disincentives should be evaluated for their effect on agency performance. Particular attention should be paid to the impact of agency functions not selected for incentives and disincentives to ensure that such functions are not de-emphasized.

f. Controls. Any incentive aimed at paying individual employees for performance must contain sufficient controls to prevent abuse.

1. PB^2 Status Report: Performance-Based Budgeting Has Produced Benefits But Its Usefulness Can Be Improved. Florida Office of Program Policy Analysis and Government Accountability, January 1999.

2. Review of the Community College System's Performance-Based Program Budgeting Measures and Incentive Fund Report No. 97-49, February 1998.

3. Other examples of personnel incentive pay include: salary incentive pay for education and training for state law enforcement personnel, sales incentives for the Department of Lottery's marketing representatives, and the State University System Teaching Incentive Program for faculty.

4. Willoughby, Georgia State University, 1998 and NCSL, 1999

5. Pay-for-Performance, State and International Public Sector Pay-For-Performance Systems, U.S. General Accounting Office, October 1990, GAO/GGD-91-1.

6. Pay-for-Performance in Local Government: Use and Effectiveness, Gregory Steih and Lloyd Nigro, Georgia State University, International City Management Association Municipal Yearbook 1993.

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