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10 DOWNING STREET  
LONDON SW1A 2AA

From the Private Secretary

30 September 1986

**PERFORMANCE BONUS EXPERIMENT IN THE CIVIL SERVICE**

The Prime Minister has seen Mr. Luce's minute of 12 September about performance bonuses in the Civil Service, and the comments from the Chancellor of the Exchequer and Sir Robin Ibbs.

The Prime Minister was disappointed that the experiment does not seem to be working. She agrees that officials should be asked to consider the options, including the possibility of extending discretionary pay to grades 4 - 7, and to report as soon as possible.

The Prime Minister believes that every effort must be made to secure the commitment of line managers and employees to making any new scheme work. That is the key to success, and it is the responsibility of Permanent Secretaries to try to generate that commitment. That is their task as managers.

In the meanwhile the Prime Minister notes that consideration of range pay for grades 4 - 7 need not delay the introduction of range pay for grades 2 and 3. The decision taken in May was that range pay for those grades should be introduced if possible during the current financial year. The Prime Minister hopes that preparations for this are well advanced so that a decision can be taken very soon.

I am copying this letter to Tony Kuczys (H M Treasury), Sir Robin Ibbs and Michael Stark (Cabinet Office).

DAVID NORGROVE

Paul Thomas, Esq.,  
Minister of State's Office, Privy Council Office

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PRIME MINISTER

## PERFORMANCE BONUS EXPERIMENT IN THE CIVIL SERVICE

The present experiment with performance bonuses has not proved a success either with management or staff. A survey showed that 68 per cent disliked the scheme. There is also little evidence of a worthwhile direct effect on management performance. Mr. Luce, Sir Robin Ibbs and the Chancellor all agree that the present position is unsatisfactory.

Mr. Luce and Sir Robin Ibbs agree that it would be worth considering an alternative scheme for relating pay to performance. The Chancellor is willing to consider the options. George Guise of the Policy Unit (minute below) is not entirely convinced and argues that if some formal scheme is to be continued, it needs to be much more carefully thought out and to have the commitment of managers and employees.

The alternative scheme would be to extend to grades 4 - 7 (Assistant Secretaries and Principals) the range pay or discretionary increments proposal which was agreed for grades 2 and 3 (Deputy Secretaries and Under-Secretaries) as part of this year's TSRB award. He would like this to be explored in time for such an arrangement to be introduced from 1 April next year. Sir Robin Ibbs agrees and suggests that range pay would probably be the most effective method of relating pay to performance. The Chancellor is willing that the work should be done but does not mention the possible starting date.

Agree:

- (i) the performance bonus experiment does not seem a success but should not be abandoned with nothing in its place;
- (ii) officials from Treasury and MPO should be invited to make proposals for extending range pay to grades 4 to 7 in good time so that they could be introduced from April next year?

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*if it is  
not a  
success - abandon it  
forthwith*

*G.V. range pay compared  
with bonus pay?*

I have heard that Permanent Secretaries are being difficult about the introduction of range pay for grades 2 and 3. I prompted Sir Robert Armstrong about this after your conversation with Lord Plowden at dinner on Monday this week. But it might be worth including a reminder here. You might say that a consideration of range pay for grades 4 to 7 need not delay the introduction of range pay for grades 2 and 3. The decision taken in May this year was that range pay should be introduced if possible during the current financial year; you hope that preparation of a paper on this is well advanced so that a decision can be taken very soon on its early introduction.

Agree?

1 I think the real problem is the attitudes of those concerned.

1 I think the same attitudes will extend to range pay & we

need first to see whether

that works for grades

2 or 3 before we consider

whether to extend it

no

DAN

(DAVID NORGROVE)

26 September 1986



CCBG

DN

Treasury Chambers, Parliament Street, SW1P 3AG  
01-233 3000

PRIME MINISTER

**PERFORMANCE BONUS EXPERIMENT IN THE CIVIL SERVICE**

I have seen Richard Luce's minute of 12<sup>at trap</sup> September about the future of this experiment, and I have also seen Sir Robin Ibbs comment of 15 September.

It is encouraging that 78 per cent of those whose opinion was surveyed by HAY/MSL support the idea of relating pay to performance. But we must go about it in the right way. There are two avenues we are currently exploring; the performance bonus experiment which covers Grade 3 to 7, and the introduction of discretionary pay at Grades 2 and 3, which was announced when TSRB decisions were announced earlier this year. Like Richard Luce and Sir Robin Ibbs I too see attractions in seeing whether we could look at these together so as to produce a single scheme which commends itself to management and staff (which the existing experimental scheme, as currently administered, does not) while giving value for money. Officials in the Treasury and MPO have already been investigating what options are available, and I agree it will be worthwhile for these to be taken further, with a view to making specific proposals to us as soon as possible.

This development in the Civil Service pay structure, must be seen alongside the various other flexibilities which we are introducing or considering, in an attempt to get better value for money. Above all, performance-related pay, like these other flexibilities, must be an integral part of the pay bill, so we are not adding to it but instead seeking to direct it rather better.



If you agree I will ask my officials to proceed accordingly.

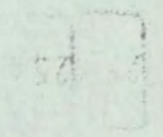
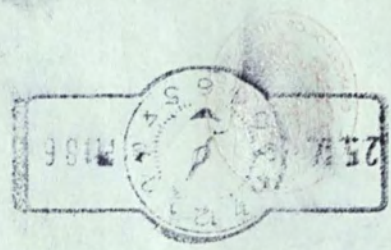
I am copying this to Richard Luce, Sir Robin Ibbs and Sir Robert Armstrong.

*M.*

N.L.

25 September 1986

CIVIL SERVICE Long Term PT19



CF TO KEEP.  
BONUS PAY.



CC GRIFFIN BOX  
September 23/56

House of Lords · Westminster

Dear Prime Minister

Thank you for a most interesting and pleasant dinner last night. I am glad you continue to find these occasions useful. As you suggested we are finding a suitable date around May of next year.

Once again thank you for agreeing to discretionary range pay for Under and Deputy Secretaries. I realise that there are natural inhibitions to be overcome - in fitting such a scheme into the civil service.

Nonetheless I know that such



a scheme will be a most valuable  
tool in managing the Service.

In addition, it will also save  
money, because if one rewards the  
brightest and most efficient in this  
way there will be no need to set the  
pay of the whole rank at a level  
which hopefully will keep and  
motivate the brightest and most  
efficient, but quite likely will not  
be high enough to do so.

Yours sincerely

John Rowden.





n bpm yet cc BGA

B

insisting comments  
don't know why

PRIME MINISTER

PERFORMANCE BONUS EXPERIMENT IN THE CIVIL SERVICE

I have seen Richard Luce's minute of 12th September 1986.

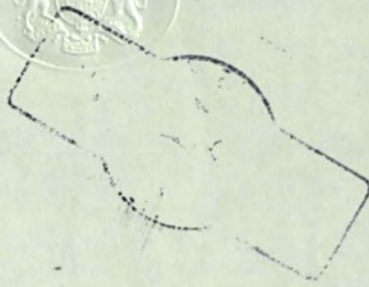
2. I agree with Richard that it would be quite wrong to abandon the existing performance bonus scheme without putting anything in its place. Quite apart from any direct incentive effect, performance related pay can be an important force in improving the quality of management in the civil service because it demands greater clarity in setting objectives and in regular monitoring of performance. When done properly it imposes a need for good face to face line management.

3. I was interested in the suggestion in the penultimate paragraph of Richard's minute that discretionary pay arrangements should be extended from grades 2 and 3 down to grade 7. I believe this would probably be the most effective method of relating pay to performance. I recommend you invite Nigel Lawson and Richard Luce to work up a scheme as a matter of urgency so that the suggested target date of April 1987 can be achieved.

4. I am sending a copy of this minute to Nigel Lawson, Richard Luce and Robert Armstrong.

ROBIN IBBS  
15th September 1986

CIVIL SERVICE : Long Term : Pt 19



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CC84  
 B / award committee from  
 the salary

## MINISTER OF STATE, PRIVY COUNCIL OFFICE

PRIME MINISTER

12/9

## PERFORMANCE BONUS EXPERIMENT IN THE CIVIL SERVICE

My minute of 29 November reported to you on the first stages of introduction of this experiment for paying performance related bonuses, averaging £800 before tax, to about 1 in 5 staff at senior levels (Grade 3 to Grade 7) in the Civil Service. I am now in a position to report further on the first year's operation of the scheme, which we announced as a 3 year experiment.

## OVERALL FINDINGS

The verdict so far, on the basis of the report to me below by officials, and the draft report from the management consultants (Hay/MSL) also attached, must be the Scottish one of "not proven". There are some positive signs of progress: 78% of those whose opinion was surveyed support the idea of relating pay to performance in the Civil Service, and there is less worry now that performance pay disrupts relationships between staff. The most senior managers, who may have had more frank and searching reviews of the performance of their staff than hitherto, are more positive than other eligible staff. But the overall response is still negative. 68% of those surveyed dislike the present scheme. There is little evidence so far of a sufficiently worthwhile direct impact on management performance.

## MANAGEMENT CONSULTANTS' FINDINGS

The consultants draw out clearly in the conclusions of their report (page 20 onwards) that there are a number of reasons why it is not easy to introduce performance pay into the Civil Service and why it has been something of an achievement simply to get the scheme up and running. But they also point to some areas where design and management changes are desirable if the scheme is to secure better value for money.

## OFFICIALS' VIEW

The report from officials accepts this analysis and endorses changes (paragraph 7 of their submission) which would give departments greater flexibility in designing the scheme to suit their own circumstances, but which will require them to do more to explain the criteria for awards and to manage the scheme actively, communicating its purposes and results more explicitly to staff. The scheme also needs to be linked more clearly with other management systems in use in departments.

In addition, responding directly to a point raised by you at the time of the last report, officials have looked at the

question of eligibility for bonuses of Private Office staff at Grade 7 level and above. A few departments had excluded them because they felt it was too difficult to secure a fair line management report and because such staff already receive Private Office allowances. But most departments saw no grounds of general policy for such exclusion, and operated schemes in practice which made them eligible. Officials believe this is right, and departments will be asked to ensure that Private Office staff at these senior levels are considered within their schemes in future.

## CONCLUSION

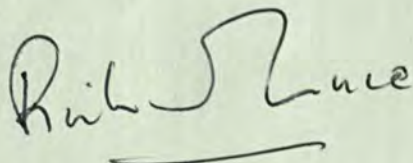
I believe that we must keep this experiment under critical review. The investment of £4 million each year (plus administrative opportunity costs of nearly another £1 million) which we planned to make over the three year period is not yet bringing sufficient return. We need to do what we can to improve the value-for-money of what is being spent.

Sir Robin Ibbs, who has been consulted in the course of the evaluation, agrees and believes that the changes proposed by officials, particularly those concerned with better communication, would improve the chances of a more successful outcome to the experiment. He has also pointed to the desirability of developing benchmarks to assess the effectiveness of the bonus scheme.

It may be argued in the light of the report that we should reverse engines at once and abandon the scheme without putting anything in its place. In my view this would be quite wrong. It would simply be interpreted as an admission of failure and would make it much more difficult to return to this subject at some later date. We are trying to improve the management of staff whose salary bill is around £400 million per annum, a process which is bound to take time; and we need to learn as many lessons as we can about the best way of using performance pay to reinforce our other management reforms, rather than give up hope at the first sign of difficulty.

There are of course other alternatives. <sup>otherwise known as  
range pay</sup> For my part, I would see attractions in extending the discretionary pay arrangements which we have recently agreed to introduce for Grades 2 and 3, down to Grade 7. If it were practicable to do so, the £4 million set aside for the third year of the performance bonus experiment could instead be used to finance a new arrangement on these lines from 1 April 1987. Time is short, however, and a good deal of detailed exploratory work would need to be set in hand at once.

I am copying this minute to the Chancellor of the Exchequer, whose officials have been closely involved in the development of the scheme, and to Sir Robin Ibbs.



RICHARD LUCE  
12 September 1986

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Sent to me in a  
personal letter by  
Peter Kemp, 12/19/87

**PERFORMANCE BONUSES/DISCRETIONARY INCREMENTS/ETC - THE WAY FORWARD**

There are a number of proposals currently on the table for decision in the general area of the linking of pay with performance which are worth considering together.

2. The main strands for consideration are the continuation or otherwise of the performance bonus experiment and the introduction of discretionary pay at Grades 2 and 3. But there are others.

Options

3. These various elements are discussed below, in paragraphs 5 to 14. It seems worthwhile at this stage in this paper setting out the options before Ministers, thus :-

- a. Seek to stand down the performance bonus scheme as at 31 March 1987, without putting anything in its place.
- b. Simply let the performance bonus scheme proceed for its allotted span (to 31 March 1988) without any fundamental change, meanwhile considering what might succeed it, but introducing discretionary pay at Grades 2 and 3 from 1987-88 as planned.
- c. Proceed as from next year with the far-reaching proposal discussed in paragraphs 14 to 18 below - essentially stand down the performance bonus scheme as from 31 March 1987 and introduce the discretionary pay scheme from same date in 1987-88 not just for Grades 2 and 3, to which we are committed, but for all grades down to Grade 7, coupled with a number of further changes aimed at tightening the link between pay and performance.
- d. As (c), but not immediately; leave the performance bonus scheme to run its full allotted course and then proceed with

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something on the lines of (c); it would be for decision whether or not some explicit or implicit statement was now made that this was the way that the Government would proceed.

The simplest of these, at least in the short-term, is Option (b). Option (a) is attractive to the Treasury, but would probably be very difficult to achieve. The Pay side of the Treasury think that Option (c) is most worth further effort. Option (d) is a form of halfway house, but has its awkwardnesses.

4. Whatever happens the question of money arises. The performance bonus experiment costs around £4 million per annum, which is just under 1 per cent of the pay bill of the grades in question or about 0.1 per cent of the whole Civil Service pay bill. If it is stood down, whether immediately or later, and nothing is put in its place, this amount would be saved on running costs. If something more elaborate is put in its place (ie Option (c) or (d) above) the aim would be to spend no more than had the performance bonus scheme continued. But we would have to note the upward pressures. Moreover there is a school of thought which says that any of these options including indeed the performance bonus scheme, is wasted money if no more sums of this order can be provided; either the Government as employer should do nothing at all in this area or should spend sums of money on a larger scale, if value is to be obtained.

5. The various elements entering into the picture are set out below.

Performance Bonuses

6. This scheme was embarked on by way of a three year experiment; we have had one full year and we are now in the middle of the second.

7. There are mixed views about the value of the scheme. A few think it has something. But generally there are serious doubts about whether it is giving value for money, shared by most Establishment Officers and the Consultants who have been engaged to monitor it. Moreover it got

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off on a very bad footing with staff generally (not just the unions but individuals) and this has inevitably lessened its value. Wearing its public expenditure hat and indeed pay bill hat the Treasury would not see any merit for letting the experiment run to its proposed end, and we would vote for standing the scheme down at the earliest possible moment which would be March 1987, at the end of the second year of operation.

8. But there are problems in the way of simply standing the scheme down. To start with, though we would have to look into this, there is just the possibility that we may be under some kind of implied legal obligation to let it run. Secondly, simply standing it down without putting anything in its place is going to look not just like a confession of failure (even though it was expressly an experiment) but also like an abandonment of the whole notion of linking pay with performance, which Ministers collectively are unlikely to agree to. And thirdly, to abandon the performance bonus scheme just at the time as we were introducing discretionary pay for Grades 2 and 3 would simply look like tilting the scales in favour of top dogs and would itself be very difficult.

Discretionary Pay at Grades 2 and 3

9. This is another thing the Treasury has never been very keen on. But Cabinet decided it should proceed and the Prime Minister has announced it. The debate now is about relatively detailed (though still not uncontentious) matters, and this goes on amongst Permanent Secretaries. But there seems no doubt that some kind of scheme will have to proceed.

10. One element of the original scheme which Cabinet turned down, but which we ought to try to resurrect, is the idea that "normal" progression up the present incremental scales (three steps for Grade 3 and two steps for Grade 2) should cease to be entirely automatic. What had been proposed was that while the presumption should be that these increases should be given to those who perform satisfactorily, a positive decision to this effect would have to be taken. The legal position means that this would be for new entrants to the grade only. Cabinet threw this

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refinement out, effectively on a side wind. But the proposal ought to be brought back.

Personal Promotions

10. The MPO for some time have been writing up a scheme in this area, originally designed to mitigate "promotion blockages". It is a bit of a make weight. There are already provisions in our arrangements for what are known as personal promotions, whereby people who have been recognised consistently as deserving promotion but who are facing a substantial delay in achieving that promotion because of the shortage of opportunities, are given the rank and pay of the next grade on a personal basis albeit remaining in the job at the lower grade until they were offered ordinary substantive promotion. The idea is that this should be given a push with a bit more delegation to Departments, with particular reference to promotions from Grade 7 (formerly Principal and equivalent) and HEO.

12. We have gone along with this idea largely because it merely gives a shove to something which exists already. But nevertheless we are not particularly keen on it; it could be described as no more than organised grade drift and is in effect a very long way round to do what we essentially want to do; namely give good people more money. Our impression is that Departments generally (including the domestic Treasury), and even perhaps MPO, are keen on this scheme only for want of anything better.

Incremental progression - stopping, hopping and long service.

13. On the table there are proposals as yet unworked though which go further than the notion of holding up increments simply at Grades 2 and 3 (see paragraph 9 above) but which would relate to the whole of the Civil Service. These would involve the possibility of withholding increments, accelerating increments (giving increments either out of time or two year's worth at one time, for instance) or a kind of long service "loyalty" increment whereby somebody who has reached the top of his normal scale and has served there for, say, 5 years might get a further increment at that point, perhaps conditional on satisfactory performance.



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Losses of able people

14. Finally, there is the increasing rate of loss of able people particularly at Grade 7, but also Grade 5. The scale of this problem can be exaggerated, but there is something here which may have to be looked at sooner or later. We cannot match the sort of pay increases some people are, it is said, leaving for, but some modest move could be appropriate and effective. The FDA are bringing increasing pressure - so far resisted - on this point, but it is not confined to administration grades.

The way forward

15. The possible ways forward are summarised in paragraph 3 above. The paragraphs below set out Option (c) in detail.

16. This option is as follows :-

a. The performance bonus scheme would be stood down as from 1 April 1987.

b. Discretionary pay points above the maximum of the scale for the grade (described here as the "normally attainable maximum" or NAM) would be introduced as from, say, 1 October 1987 not just for Grades 2 and 3, but for all grades down to and including Grade 7. As with Grades 2 and 3, these discretionary increases would be explicitly withdrawable if performance fell off; this withdrawability would be real and would happen, and would not just be theoretical. Only staff on NAM would be eligible. The pay points themselves, and the number of discretionary awards which could be given, would be calculated so as not to spend more than the performance bonus scheme would have called for had it continued. A lot of detailed work is needed on the precise points but preliminary indications are that if 3 discretionary increments of £1,000 each at Grades 5 and 7 and 2 at Grade 6 were introduced about 2-3000 staff (about 10 - 15 per cent of the total in the grade but a bigger percentage of those who had

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reached their NAM could be in receipt of increments at any one time, for the same cost as the performance bonus scheme (assuming these points remain non-pensionable). Fewer points would allow bigger increments, and vice versa, for the same money.

c. For all these grades (Grade 2 to Grade 7) progression up the normal incremental scales to the NAM would no longer be entirely automatic and while the presumption would remain that these increments would be given they would require a positive decision each time. Following the exchanges we had with Treasury Solicitor earlier in the year this change would only be made for people who had been promoted into the relevant grades after the date of announcement of the new measures.

d. Personal promotions would continue, but the proposed specific new initiative would not proceed.

e. Increment stopping or delaying is dealt with at sub-paragraph (c) above. Increment hopping would be introduced under rules to be devised, not just to offset the "loss" to the group as a whole from increment stopping or delaying, but also so as to enable incentive to be given to people who had not yet reached their NAM (discretionary pay only being given once people have reached the top of their normal scales). Initially, these changes would apply only to Grades 2 to 7 but it would be made clear that they could be extended down the line in due course.

f. The idea of long service increments would as a general proposition be postponed sine die, though they might still have their place in certain limited areas (for instance it was not widely noticed that a long service increment for certain Civil Service cleaners - the lowest of the low - was introduced in the 1985 pay negotiations).

An example of what the resulting scales might look like is attached.

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17. This would be a fairly dramatic move. It has its disadvantages, thus :-

a. The many opponents of the performance bonus scheme (including staff interests) could try to make embarrassment out of a change now, even though the scheme was an experiment and known to be one.

b. A scheme for discretionary pay on these lines would be more difficult to drop than a performance bonus scheme, once introduced, it could in practice only be stopped by consolidation into the main scale.

c. As compared with performance bonuses, for Grades 3 through to 7 pressures to increase the value and cost of the scheme may be stronger and more continuous. (The figures mentioned in paragraph 16(b) may immediately be criticised as too small, especially in relation to the retention of people tempted into other jobs.) In addition even if the formal rules are not relaxed the risk of drift into automaticity would be high unless very rigorous criteria were devised and enforced. And for any particular individual the discretionary increases, even if withdrawable, are obviously more durable than one off bonuses when performance falls off.

d. The change over from the performance bonus scheme to this scheme could be an additional burden on Departments at a time of much other change.

e. Some of the defects found in the performance bonus scheme apparently stem not from the nature of the scheme itself but from Departments' slowness in learning to manage the cultural and other problems involved in operating a performance related pay scheme. Some of these may carry over into any such scheme.

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f. It may be less easy to resist pensionability if the scheme for discretionary pay is extended in this way. Pensionability would add substantially to the cost of the scheme, and to the benefit accruing to individuals in their last year, and must be resisted.

18. Against that there are advantages, thus :-

a. It seems unlikely that the performance bonus scheme would be renewed if the three year experiment were allowed to run. But something would almost certainly have to be put in its place and the sort of scheme I outline above is what we might see. Thus we would only be advancing things by one year. If Departments are going to have all the trouble of introducing discretionary pay points for Grades 3 (it looks as though Grade 2 will be dealt with centrally) they might as well simultaneously introduce something which goes down the line.

b. Running the rump of the performance bonus scheme in tandem with discretionary pay at Grades 2 and 3 is going to look odd generally: and specifically is awkward at Grade 3 level.

c. There are some problems of retention of people at Grade 7 and Grade 5 - the Treasury is not alone in Departments in finding this. Performance bonuses have not worked; discretionary increments might.

d. Nobody is particularly keen on the new personal promotion initiative, which is on the whole a bit of a gimmick, and better dropped.

e. An initiative like this gives us a chance to get flexibility into the incremental system, by way of increment stopping and increment hopping; and coupled with the discretionary points it would be a useful step towards a long-term system of

CONFIDENTIAL

progression up pay scales by merit. It would be impossible to do this save in the context of some total package.

f. A move now would sit well with our initiative on geographical pay and other flexibilities.

19. There would have to be consultation with staff interests. It is possible that this might be easier in a total context which includes standing down performance bonuses, and there are indications that some unions are keener on discretionary pay than bonuses. On the other hand there are unattractive elements in this package such as increment stopping or delaying, the "quota" system for discretionary increments and non-pensionability. On the whole we think we would get this package through though there would certainly be pressures for concessions en route.

Conclusion

20. The essential question for the Treasury is what is likely to give best value for money. Any scheme for linking pay with performance is largely an act of faith and we have been consistently sceptical. Thus all other things being equal we would probably want to go for Option (a) in paragraph 3 above - stand down the performance bonus scheme as from March 1987 with nothing in its place. But assuming that for various reasons this is not possible, we are left with the other options

- simply letting the performance bonus scheme run without anything very active being done for the time being except discretionary pay for Grades 2 and 3 as planned (Option b)

- something radical on the lines above as from April 1987 (Option (c))

- something on these lines but deferred until April 1988 (Option (d)).

21. A certain amount depends on Ministers feelings for their handling of the Civil Service and their wish to rock, or not rock, the boat at

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this stage. The Pay side of the Treasury would vote for Option (c), not because it is in any sense perfect, but because it points in the right general direction and seems better than the alternatives, including Option (d).

Pay 1 Division

11 September 1986

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## EXAMPLE OF A GRADE WITH DISCRETIONARY PAY: GRADE 7

The attached diagram gives an illustration of the scale for Grade 7 resulting from the discretionary pay proposals.

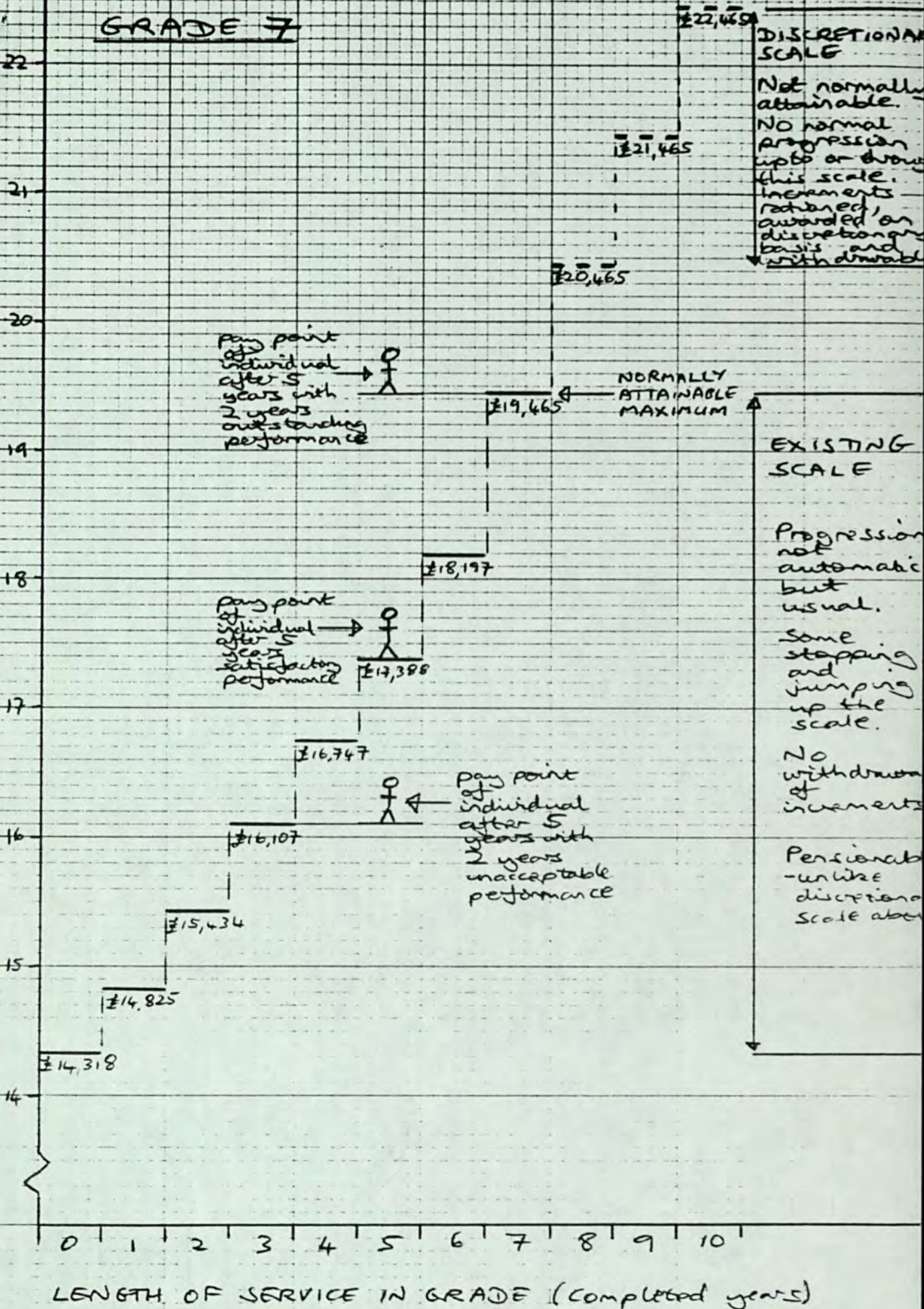
The existing scale points are shown as thick horizontal bars. The dotted horizontal bars above the existing maximum of the scale are examples of the type of discretionary points being proposed.

The diagram also shows the relative pay points of three individuals after five years, assuming for the sake of this example that they all joined on the minimum. With the existing automatic annual incremental progression, these individuals would all be on the same pay point but in this illustration of increased discretionary use of normal increments within the existing scale, the three individuals are on different pay points reflecting their performance in each of the five years they have spent in the grade.

EXAMPLE OF A GRADE WITH DISCRETIONARY PAY

GRADE 7

SALARY £000s



Note For ease of illustration this example assumes that staff enter on the minimum. This is not necessarily the case