

TPM LTM PRG 2

CONFIDENTIAL

Prime Minister.



This is a controversial proposal, but the Lord President is not seeking a final decision at this stage. Even so, I think it would be sensible to wait a little to see how your Cabinet colleagues ~~are~~ react before you respond. There will in any case be a brief on Monday from Sir Robert Armstrong.

PRIME MINISTER

*MS*

PAY AND PERFORMANCE

*Full 31x.*

I was asked by E Committee to pursue the introduction of performance-related pay. This was in the context of improvements to the Civil Service system. The matter was also raised in Sir Derek Rayner's suggestions for "lasting reforms".

I attach a paper which proposes that officials proceed at once with work with the aim of introducing a scheme for performance-related pay for the Open Structure of the Home Civil Service from next April. Sir Derek Rayner has seen this in an earlier version and supports the paper. Many senior officials however have strong reservations both about the principles underlying the scheme and the speed at which it is proposed to introduce it.

I acknowledge that there are many practical difficulties to be overcome. But if you and colleagues are content I will press ahead with all speed and report back. Would you let me know whether you agree?

I also intend that work should go forward on bringing performance-related pay lower down the Service from April 1982. I shall report on that in the course of next year. I shall also be bringing forward, in due course, proposals on succession planning for senior posts.

The pay of the staff of the Foreign Service follows that of the Home Civil Service. No doubt the Foreign Secretary will wish to comment on how the proposals on merit pay should be applied to them.

Copies of this minute and its attachment go to Cabinet colleagues, including the Minister of Transport, Sir Robert Armstrong and Sir Derek Rayner.

*[Handwritten signature]*

## THE EFFICIENCY OF CENTRAL GOVERNMENT: PAY AND PERFORMANCE

The introduction of performance-related pay is one of the improvements to the Civil Service system which E Committee has asked me to pursue with the appropriate unions. It was also one of Sir Derek Rayner's recommendations for "lasting reforms" discussed by Cabinet on 1 May. This paper proposes that we should aim to make a start with this in pay for the Under Secretary grade from 1 April 1981 as a precursor of a more extensive use of performance-related pay in the non-industrial Civil Service. The scheme has been seen by Sir Derek Rayner who strongly supports it.

Background

2. At present all grades in the Open Structure - ie Under Secretary and above - are paid on flat rates. The Top Salaries Review Body (TSRB) makes recommendations about the level of those rates. There is no provision for varying the pay which any individual receives within his existing grade. Below the Open Structure the vast majority of Civil Servants are on incremental pay scales which are in practice fully automatic.

3. Following recommendations by TSRB that the introduction of performance-related pay should be considered for Open Structure grades and by the former Expenditure Committee for its introduction more generally in the Civil Service the last Administration commissioned two studies:

- (i) from the Office of Manpower Economics (OME), to investigate



the pay systems for senior management outside the Civil Service;

(ii) from the Civil Service Pay Research Unit (PRU), to determine the extent and success of performance-related pay systems in outside organisations below the most senior levels.

#### The Open Structure

4. There are good reasons why senior Civil Servants should be subject to variations in their pay according to the quality of their work. It is only fair that those who do better work should be paid more; and higher pay for better work may induce better work. Merit pay is very common among outside employers who clearly believe that pay incentives work: OME found that 93% of the private sector firms which they surveyed operated performance-related salary systems for their senior managers. Moreover we can make a start in the Open Structure very quickly. We do not negotiate pay for these grades (although it would of course be proper to consult the appropriate unions about changes). The comparatively small numbers should make it feasible to introduce merit pay from the next pay settlement date, 1 April 1981, provided that we take the necessary decisions without delay.

5. Nevertheless there are also good arguments on the other side. There is understandable concern that merit pay might undermine the spirit of mutual cooperation found at the top of the Service. Money is not the prime motivator for these staff. There will be inevitable problems of equity which could overall have "demotivating" effects which could lead to a lower level of effort, rather than an

improvement. Moreover since the increases we shall be able to make in the pay of the grade next year will be small the scope for introducing merit pay will be limited.

6. I accept that ensuring the necessary perceived degree of equity in the system, and its operation, will not be easy. In particular there will be a problem in devising criteria which apply fairly and sensibly to both generalists and to many different professions. But the difficulties should not be insuperable. The arguments based on the nature of the Service, and the problems in current circumstances of getting a range wide enough to be a real incentive are more difficult. But we came to office with a belief in rewarding effort and achievement. I do not believe that the spirit of public service requires people to be paid the same regardless of merit. And I do not believe that we can ignore outside practice on ensuring that good performance is rewarded. We must try to solve the technical problems.

#### Proposals

7. I therefore recommend that we should press on with work on the details of a scheme covering the Under Secretary grade with the aim of introducing it from April 1981. That grade is by far the largest in the Open Structure, and as at present constituted, represents a key block of both management and policy responsibilities. (The number and pay rates are shown in Annex A). My proposal is of course without prejudice to any future decisions we may take following the present studies on the grading hierarchy. Starting with this grade would enable us to begin the introduction of performance-related pay at the earliest possible date, and would provide an excellent starting point from which to extend the concept. We shall want to consider extension upwards to cover Deputy Secretaries in the light of



experience. In parallel with the work on the scheme I shall be bringing forward proposals, in due course, on succession planning.

8. The scheme I propose to cover the entire Home Civil Service is outlined in Annex B. Equity and legal requirements alike point to covering all Under Secretaries, including specialists. Briefly the present flat rate for Under Secretary pay would be replaced by a salary range. Individuals would be moved to (or kept at) any place on the range, up or down, according to their performance. The Top Salaries Review Body (TSRB) would be asked to recommend an appropriate range for the grade together with a figure to which the average pay for the grade would be held. This would limit the total cost and avoid any tendency for the pay of the grade generally to drift upwards. A detailed scheme on these lines would be prepared in consultation with departments, the TSRB and, to the appropriate extent, the unions. I intend to report the outcome at the turn of the year.

9. Such a scheme would undoubtedly represent a major change in the pay and management philosophy of the Civil Service. It will be important to prepare those involved both as managers and managed. The timetable is now very tight and the detailed planning work must start now if the scheme is to be implemented in April. We shall be taking something of a leap in the dark and we do not want to implement an ill-considered scheme.

#### Grades Below the Open Structure

10. The arguments for performance-related pay extend well beyond the Open Structure. Indeed they are in some ways stronger at the levels just below it. My officials are engaged on preparatory work for other levels of the Service. But it is not possible to develop and introduce performance-related schemes for the middle and junior grades by next

April. The pay of the Civil Service grades at and below Assistant Secretary is negotiated and there are rights to arbitration for the middle and junior grades. Most of the staff are on incremental scales, and there will be legal problems in withholding or withdrawing increments from those who would have expected to receive them under the present arrangements. We are pressing ahead with resolving the difficulties and with formulating workable proposals. We cannot in any case take final decisions for these grades before we have the PRU report on outside practice due in December. But I will bring forward proposals next year with the aim of extending performance-related pay in the Civil Service from April 1982.

#### Conclusions

11. I invite colleagues to agree that:

(i) CSD officials, in consultation with departments, the Top Salaries Review Body and the appropriate Civil Service unions, should now press ahead with preparing a scheme on the basis of Annex B for relating pay to performance in the Under Secretary grade with the aim of introducing it from April 1981 should we so decide.

(ii) I should report the outcome of this work in the New Year;

(iii) I should bring forward proposals on the extension of performance-related pay next year.

Civil Service Department

October 1980

Annex A

## THE OPEN STRUCTURE GRADES AND THEIR PAY (HOME CIVIL SERVICE)

	<u>Present (1.4.80)</u> <u>Rates</u>	<u>TSRB 14 Recommended</u> <u>Rates for 1.4.80</u>
Permanent Secretary (top 3)	33,500	37,000
Permanent Secretary (23)	31,000	34,000
2nd Permanent Secretary (15)	28,500	31,000
* UIPP (Higher) (4)	26,500	
<hr/>		
Deputy Secretary (149)	24,500	27,000
* UIPP (Lower) (33)	22,110	
Under Secretary (567½)	20,500	23,500
<hr/>		

\* Unified Intermediate Pay Point



PERFORMANCE-RELATED PAY IN THE HIGHER CIVIL SERVICE: OUTLINE SCHEME

(i) Grades to be covered

All <sup>Unified</sup> members of the Under Secretary grade  
(and the/Intermediate Pay Point (Lower))

(ii) Pay Ranges

The grade will in future have a pay range, instead of a flat rate. The Top Salaries Review Body (TSRB) will be invited in its 1981 Review (and thereafter) to recommend the range. They will also be asked to recommend an average, or 'capitation' rate for financing purposes (see iv below).

(iii) Movement within the range

There will be no fixed points in the range. A member of the grade may be moved to any level within the range, either up or down, subject to certain constraints outlined in (iv) - (vi) below.

(iv) Costs

The scheme will be self-financing. Each department will have freedom to pay its Under Secretaries at appropriate points within the range provided that the total salaries bill for the grade does not exceed the capitation rate x number of staff in the grade in the department.

(v) Distribution

Subject to the financial constraint, Departments will be strongly encouraged to use the full salary range.



The importance of relating movement to performance rather than seniority will be stressed.

(vi) Transitional Arrangements

There would be legal problems in moving staff in the new scheme below the level of their current (1.4.80) salary entitlement. In the first year of operation this will be a constraint on downward movement in the range, especially if the 1981 pay settlement is a low one. However, as the ranges float clear of current salary levels in subsequent years, there will be full scope for distribution throughout the range.

(vii) Who to take decisions

Decisions on pay will normally be taken by the Permanent Secretary as part of the annual assessment of performance of senior staff in the department. Further work will be done, in consultation with departments, on the procedures appropriate for each grade and department, and on any special arrangements which may be needed in the first, transitional year. There will be no appeal machinery. Permanent Secretaries will have to accept the responsibility for telling individuals why a decision to "stay put" or "move down" went as it did.

(viii) Small Departments

Special arrangements will be needed in departments where the number of staff covered by the scheme is very small. Centralised decisions may be necessary.

(ix) Criteria

The Civil Service Department will prepare guidelines on the criteria for judging merit, and will review how they are applied in departments. Criteria will include

effectiveness and economy in the use of resources and other management skills, and qualities of initiative and judgement. But in the last analysis performance will be judged on achievement.

(x) Confidentiality

The range for the grade will be published, but strict confidentiality will be maintained about the salaries of individuals.

(xi) Pensions

Pensions will be based, as now, on whichever of the last three years of reckonable service gives the highest figure.

Civil Service Department

October 1980