



MINISTER OF STATE, PRIVY COUNCIL OFFICE

PRIME MINISTER

I have been considering with Sir Robert Armstrong and Sir Robin Ibbs the question of introducing performance-related pay into the Civil Service.

2. From the time when your first Administration took office, nearly five years ago, we have been committed to the idea of introducing performance-related pay into the Civil Service pay arrangements. There has been much study of performance-related pay systems in private industry and in other Governments. We asked the Megaw Committee to consider the question of merit pay, and they made recommendations. But we have made no move to introduce merit pay. Sir Robert Armstrong, Sir Robin Ibbs and I think that the time has now come to stop discussing it and start doing it.

3. Our proposal to you is that the Government should now commit itself to the introduction, within a defined time-scale, of merit pay arrangements at all levels of the Civil Service; and make an immediate start at the top levels. There are a number of reasons for going this way about it:

- (1) changes at the top can be made quickly, because there is no need for negotiation with unions;
- (2) they will be an earnest of the Government's determination to act;
- (3) the cost of changes at the top is negligible;
- (4) changes at the top can be treated and announced as intended and designed to give us initial experience in the light of which the further extensions of merit pay can be more effectively prepared.

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We propose that the whole operation should be, and be presented as, experimental, so that the Government is at liberty to change it in the light of experience or even abandon it if it is not having the results we hope for. But it is also important that in our introductory announcement we should present our proposals as intended to cover the Service as a whole. If (as we propose) we start at the top, we shall need at the same time to indicate how, where and when we expect to make further progress.

4. Our detailed proposals are:

- (a) that we should agree now to replace the existing flat rate of pay for Under Secretaries and their equivalents (Grade 3 in our new grading structure) with a scale of five steps. The scale would start below the present rate of pay for the grade, and newly promoted staff would normally move from that to the second point, equivalent to the present rate of Under Secretary pay. Progress beyond that to the top three points would depend on relative merit and performance in the management task. Such a system would be like that operated at this level by ICI and quite common in the private sector. Standard procedure requires us to ask the Top Salaries Review Body (TSRB) to 'price' the new scale, but this need not be a big task and their conclusions could almost certainly be incorporated in the report they are due to give us this spring;
- (b) that we should be ready to extend the new system downwards to Grades 4, 5 and 6 (ie to Senior Principal and equivalents) next year and should say so now;
- (c) that, following the Megaw recommendation that pay at higher levels should be based not on merit but on comparative job weight, we should introduce a simple form of job weighting for Permanent Secretaries (but not at this stage for Deputy Secretaries); the new rates would again be priced by the TSRB;
- (d) that we should announce our willingness to open discussion with the unions in the coming year on the introduction

For further details see para 9 of the draft Cabinet paper.

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of merit bonuses for grades up to SEO (again both a Megaw recommendation and widely used, in varying forms, in the private sector. ICI for example, particularly use them to recognise and encourage good service over a long period by people who have otherwise reached their ceiling).

We would make no commitment on method, extent or cost. But we have an interest in carrying the unions with us if we can; there are genuine uncertainties as to method; and, without some such move we would be open to the accusation that we see merit pay as giving more money to the top at the expense of the generality;

(e) given that we are breaking new ground, we should announce that we propose to review the new arrangements in three to five years' time to decide whether to expand, continue or retract them.

5. The cost of the Permanent Secretary change would be negligible; of the Under Secretary scheme about £ $\frac{1}{4}$ million a year; and of extension next year to Assistant Secretaries and Senior Principals about £3-4 million a year. At these levels therefore we are talking of very small sums indeed in relation to the total Civil Service pay bill (in excess of £4 billion a year). Extension of performance related pay to other levels would be potentially much more expensive; however, we should be able to control the amount of money if we advance by the 'bonus' route.

6. You will see that these proposals omit the Principal grade. This is not because performance-related pay has no role at this level (far from it) but because we will be considering in the course of the year the unification of the Principal and equivalent grades across professional boundaries. Given the wide range of jobs and job weights involved it may well prove necessary to split the unified grade into two separate pay scales. It would be sensible to defer decisions on performance-related pay in this area until we have come to conclusions about unified grading.

7. These proposals are a firm first step in the direction of performance-related pay. But we genuinely need to feel our way and avoid incurring major expenditure until we have established

the benefits through experience. We have already accepted in principle the case for the introduction of performance-related pay into the Civil Service. I think that the time is now right to make an early start. The attached draft Cabinet paper has been prepared on that basis.

8. In coming to their decisions on the proposal to go ahead with performance-related pay arrangements, and in considering the particular proposals in the paper, colleagues will be concerned with public presentation as well as with the managerial case for action. One presentational issue which may concern them is whether the present package is not too heavily weighted towards senior staff (action for them but discussions only for their juniors). If colleagues thought that this was a real difficulty, we could no doubt defer the implementation date for senior ranks to 1985, in the hope that we could then combine it with the implementation of other parts of the proposals - including perhaps a start on performance bonuses at lower levels. But I would hope that colleagues could be persuaded to make an early start, as we have proposed. The time is right, in the sense that the proposals are in the spirit of the financial management initiative and follow Megaw recommendations; and Sir Robin Ibbs attaches particular importance from the point of view of the drive to improve efficiency to motivating those at the top on whose commitment and effectiveness the spread of efficiency down the line crucially depends.

9. Some colleagues may argue that performance-related pay arrangements are likely to demotivate the generality of staff who are not able to benefit. This risk is inherent in the introduction of any performance pay system but private sector experience indicates that it does not occur in a good system that is properly introduced. We need to be robust about this; we are looking to link rewards to performance. If we are not prepared to accept that, we had better abandon the whole idea of performance-related pay. But in presenting our proposals it will be important to avoid providing any handle for criticism on these lines.

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10. If you are broadly content with these proposals, I would put my paper, amended as necessary, to Cabinet for early decision.

11. I am sending copies of this minute to the Chancellor of the Exchequer, in case he has any comments to offer, Sir Robin Ibbes, and Sir Robert Armstrong.

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LORD GOWRIE
2 March 1984

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February 1984

CABINET

LINKING PAY AND PERFORMANCE

Memorandum by the Minister of State, Privy Council Office

The Government is committed to considering ways of introducing performance-related pay into the Civil Service, in the light of the report of the Inquiry into Civil Service Pay (the Megaw Report). This commitment was made in the statement of personnel priorities announced in Parliament on 14 July 1983, and was repeated in the White Paper on Financial Management in Government Departments.

2. We are engaged upon a profound change in the style and professionalism of management in central Government, with much greater emphasis on value for money and on the dispersion outwards and downwards of financial responsibility and a sense of that responsibility. We have already taken a number of important steps, including the Financial Management Initiative and the introduction of a programme of reform of personnel work. We need to support this programme of change by encouraging good performance and by increasing motivation in the Civil Service to accept this change of style and make it effective.

3. This implies a system of rewards for especially good performance and penalties for unsatisfactory performance. I am looking separately at the disciplines and penalties for poor performance. In this paper I deal with rewards for good performance.

4. Hitherto the main incentive to good performance in the Civil Service has been the prospect of promotion to a higher grade. This is no longer a sufficient incentive, with the sharp diminution of promotion prospects which is the inevitable consequence of our reductions in the size of the Civil Service, particularly at the higher grades. One consequence of this is that about two-thirds of the Civil Service are now at the maximum of their present pay scales, with much reduced prospects of promotion and no alternative possibility of improved personal reward other than the general annual pay increase. This strengthens the case for the early introduction of some form of performance-related pay system.

5. Ever since we took office in 1979 we have accepted in principle the case for a scheme of merit pay. So far we have done nothing, partly because of the uncertainties and differences of opinion about the best system of merit pay for the Civil Service. I now invite the Cabinet to approve an experimental and evolutionary approach, based upon that suggested in the Megaw Report which envisaged:

- (1) performance-related pay ranges in place of rates or scales for staff at Grade 3 (Under Secretary) down to Principal level;
- (2) a closer matching of pay to the job weight of individual posts at Permanent and Deputy Secretary levels;

(3) performance bonuses for non-industrial staff at Senior Executive Officer and below.

6. Performance-related pay should, if it is to be introduced at all, be available at all levels in the Civil Service. It will not be possible to introduce a fully-fledged comprehensive scheme at a stroke. If merit pay is (as I think it has to be) introduced in stages, it will be desirable to introduce it at the highest possible levels in the Civil Service, both in order to demonstrate that the incentives and disciplines of performance-related pay apply at the highest no less than at the lower levels of the Service, and in order to motivate the senior managers on whom the speed of the drive for efficiency especially depends. There would be some difficulty in introducing a merit pay scheme at Grade 1 (Permanent Secretary) or Grade 2 (Deputy Secretary) level without involving Ministers directly in setting the pay of individual officials: something I take it we should want in principle to avoid. Hence my proposal, following Megaw, to start at Grade 3 (Under Secretary) level. But we should consider the Megaw proposal for job weighting for Grades 1 and 2.

7. I recommend that we regard and announce anything we decide to do now as experimental, and subject to review after (say) three to five years. We shall need to review whatever schemes we introduce now, to see if they are working as we intended and producing the results we want them to have.

8. My proposals, again following Megaw, are for performance-related pay ranges at the higher levels and performance bonuses at the lower levels. A performance-related pay range scheme

would arguably be less feasible and more expensive than a performance bonus scheme. Nonetheless I recommend that we follow the Megaw proposals, not just because they have the authority of Megaw, but also because:

- (1) they would give us experience of the different kinds of merit pay scheme;
- (2) experience in the private sector suggests that a range-based scheme is more appropriate, realistic and feasible than a performance bonus scheme at senior management levels.

The proposals are as follows:

PERFORMANCE-RELATED PAY RANGE FOR GRADE 3

9. I propose that we should introduce from 1 April 1984 a performance-related pay range for Grade 3. The range would have five points. The first point, at (say) 95 per cent of the normal rate, would be a probationary point for the first year of service of those newly appointed to the grade. The second point would be the "normal" rate for the grade. The third, fourth and fifth points would be (say) 105, 110 and 115 per cent of the normal rate. These points would be awardable according to individual performance. This would be judged by the Head of Department, usually the Permanent Secretary, in consultation with the Deputy Secretaries. A maximum of 25 per cent of the Grade 3 postholders could be in receipt of exceptional performance increments. These increments would be withdrawable in the event of a serious decline in performance, but subject to that the broad intention would be that an increment once rewarded should be retained, and should be pensionable. The Top Salaries Review Body would be asked to recommend what the normal rate and the range of increments should be.

10. This scheme is described in more detail in an annex to this paper. I recommend that it should be introduced from 1 April 1984 for Grade 3 (Under Secretary), and that we should also make it clear that, subject to experience with that grade, it would be extended to Grade 4 (the new consolidated grade between Assistant and Under Secretary) Grade 5 (Assistant Secretary) and Grade 6 (Senior Principal) from 1 April 1985. It might then or subsequently be extended to the Principal grade; but this will need to be considered in the context of other proposals for the extension of unified grading to that level, and for the time being I make no recommendations in that regard.

11. Such a scheme would:

- (1) be a clear signal of our determination to reward effectiveness and get value for money;
- (2) help to deliver better performance;
- (3) be aimed at the grades which are, increasingly, the levels at which operations objectives are defined under MINIS-type systems; and at the grades which are most able to influence managerial action and attitudes in the Civil Service.

JOB WEIGHTING FOR GRADES 1 AND 2

12. There are at present three "grades" of Permanent Secretary:

Grade 0	Secretary of the Cabinet)	
	Permanent Secretary to the Treasury)	£48,000
	Permanent Under Secretary of State)	
	Foreign and Commonwealth Office)	
Grade 1	Permanent Secretaries in charge of Departments)	£42,750
Grade 1A	Other (or "Second") Permanent Secretaries)	£39,500

This lumps together all Permanent Secretaries in charge of Departments, whatever the weight of their policy and management responsibilities. There is clearly a large difference between the job weight for (for example) the Permanent Secretary to the Ministry of Defence, with responsibility for the management of more than 200,000 staff, and that of (for example) the Department of Energy, with about 1,200 staff, and a correspondingly clear case for some difference between the two in job weighting and remuneration. On the other hand, it is questionable whether we should look for too complicated or sophisticated a set of weightings; apart from everything else, that would be taken to imply a pecking order of Departments which could fetter the Prime Minister's discretion in recommending Ministerial appointments.

13. If the Cabinet decides in principle in favour of job weighting for Permanent Secretaries, I recommend that in this experimental stage we should confine ourselves to two levels at Grade 1, reflecting a broad assessment of differences in weight of a combination of policy and management responsibilities:

Grade 1(1) Permanent Secretaries to the Ministry of Defence
 Home Office
 Scottish Office
 Department of the Environment
 Department of Trade and Industry
 Department of Health and Social Security

Grade 1(2) Other Permanent Secretaries in charge of Departments

The Top Salaries Review Body could be asked to recommend appropriate salary rates in its present review, to come into effect from 1 April 1984.

14. At Grade 2 (Deputy Secretary) level, the weight of the load tends to be reflected in the number of posts at the level in the Department: the Ministry of Defence (for example) has 17 Grade 2 posts, while the Department of Energy has only 3. I am not convinced that job weighting of individual posts varies so markedly as to justify differences of remuneration. I recommend that this should be subject to further examination.

PERFORMANCE BONUS SCHEME

15. The Megaw Report recommended that at grade levels up to that of Senior Executive Officer a limited number of pensionable bonuses should be available each year on evidence of consistently outstanding performance. I recommend that we should now accept this recommendation in principle, and announce that we propose to discuss with the unions the forms which a system of non-pensionable performance bonuses might take, with a view to introducing a scheme on an experimental basis from 1 April 1985. This will have the advantage of demonstrating our intention to introduce performance-related pay arrangements right through the Civil Service, not just at higher levels; and will give us the opportunity of discovering whether arrangements can be devised which are reasonably acceptable to the staff (and therefore likely to achieve our objectives) and can be introduced at a reasonable cost.

16. Performance bonuses could be expressed as a proportion of salary or as absolute amounts. These amounts, and the numbers of staff eligible to receive them, would depend on how much we were prepared to afford. There would have to be criteria for eligibility, and arrangements for deciding who of those eligible

should receive bonuses. All these questions will require further detailed work and discussion with the Civil Service unions. At this stage I seek no more than a decision in principle to introduce a system of performance bonuses at these levels from 1 April 1985, and to discuss details of such a system with the Civil Service unions. I will discuss with the Chancellor of the Exchequer the amount of money which we can afford to provide for this.

CONCLUSIONS AND RECOMMENDATIONS

17. We need to act now to reinforce the pressure for an improved style and greater professionalism of management in the Civil Service, and for better value for money, by introducing arrangements to link pay to performance.

18. I invite the Cabinet:

(1) to approve the introduction of a performance-related pay range for Grade 3 (Under Secretaries) from 1 April 1984, with the prospect of extension to Grade 4 (the grade between Assistant and Under Secretary) Grade 5 (Assistant Secretaries) and Grade 6 (Senior Principals) from 1 April 1985

(paragraphs 9 to 11);

(2) to consider the introduction of a simple system of job weighting for Permanent Secretaries in charge of Departments (paragraph 13);

(3) to agree in principle to the introduction of a system of performance bonuses for grades up to and including Senior Executive Officer from 1 April 1985, the details to be discussed with the Civil Service unions.

19. If the Cabinet decide accordingly, I recommend that the schemes should all be regarded as experimental and as a single package. This will enable us more readily to counter criticisms from the media and elsewhere that, despite the managerial advantages, we are favouring senior civil servants. I further recommend that the Head of the Home Civil Service should be instructed to audit their effectiveness and to report further so that the Cabinet can in due course consider whether to introduce definitive schemes of performance-related pay and, if so, what form these schemes should take.

ANNEXPerformance Pay Scale for Grade 3 (Under Secretary)

<u>Present Pay</u>	<u>Proposed Performance Scale</u>	
£	£	
27,500 (flat)	26,125	95%
	27,500 normal performance point	100%
	28,875 performance 1 increment	105%
	30,250 performance 2 increment	110%
	31,625 performance 3 increment	115%

Those newly promoted would expect normally to advance to the equivalent of the present flat rate after one year, though management would have the right to defer the move to the end of the second year if performance was not up to standard. This probationary starting point is not an essential feature of the proposal; but it has a certain logic as reflecting the learning curve on first appointment to the grade, and would help to reduce the cost of the scheme. Beyond the "normal" rate, a maximum of 25 per cent of the staff could be in receipt of exceptional performance increments at any one time (15 per cent on merit 1; 5 per cent on merit 2; 5 per cent on merit 3). Arrangements will need to be devised to apply these budgetary limits in Departments where there are very few Grade 3 posts. The Top Salaries Review Body would need to decide how the performance pay scale should be taken into account in advising on pay levels for the grade.

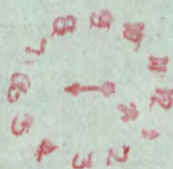
2. Decisions would be taken by the Permanent Secretary of the Department, in consultation with Deputy Secretaries, within whatever budgetary limits were set.

3. The broad intent, following the private sector, would be that exceptional performance increments would be retained from

year to year (and thus be pensionable if held during the last three years of service before retirement). Their retention would be subject to positive annual affirmation. The additional increments would be intended to mark outstanding performance, and their award and retention would be on the explicit understanding that they would be retained only as long as the standard of outstanding performance is kept up. In practice an ebb and flow of awards would be expected.

4. There would be no formal machinery for appeal. Decisions would be conveyed to each individual personally by the Permanent Secretary. As in the private sector, and elsewhere in the Civil Service where pay scales operate, salaries of individuals would not be published.

5. Common guidelines might be appropriate to assist senior managers in their assessments, and the maintenance of a reasonable degree of consistency across the Service. The Head of the Home Civil Service would audit the scheme to ensure that awards are correctly made, and to monitor the effectiveness of the scheme.



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