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to Redwood

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a MASTER SET

10 DOWNING STREET

From the Private Secretary

19 March, 1984.

Dear Paul,

Merit Pay

The Prime Minister held a meeting on 16 March to consider Lord Gowrie's minute to her of 2 March about merit pay in the civil service. Also before the meeting were the Chancellor of the Exchequer's letter of 9 March, and Lord Gowrie's reply of 14 March. Those present, in addition to your Minister, were the Chancellor of the Exchequer, Sir Robin Ibbs, Sir Robert Armstrong, Sir Peter Middleton, and Mr. Redwood.

Introducing his paper, Lord Gowrie said that the time had come to choose between proceeding with a pilot scheme of merit pay in the civil service, or abandoning the idea altogether. The Megaw Committee had favoured merit pay in principle, and its introduction would complement the Financial Management Initiative (FMI) in laying greater emphasis on the responsibilities of line management. He proposed a pilot scheme of merit pay for Under Secretaries. This was a key grade in securing implementation of the FMI. Eventually, about 25% of those in the grade might receive some element of merit pay. He had also proposed that new entrants to the grade should start at a salary point below the present level, to which they would progress automatically after a year. But he would be prepared to drop this element of the scheme if it did not find favour with colleagues.

Your Minister envisaged that the principle of merit pay would be extended below the Under Secretary grade, to Assistant Secretaries and Senior Principals, if the pilot scheme was successful. Extension to the Principal grade was desirable, but should await resolution of outstanding issues on unified grading. Below Principal, a system of merit bonuses was proposed, again on an experimental basis.

The Chancellor said that he would be in favour of the experimental introduction of a genuine scheme of merit pay. He doubted, however, whether your Minister's proposals achieved that objective. The scheme for Under Secretaries was too closely based on salary scales: as a result, there would be a tendency for people to drift towards the top of the scale regardless of merit, since it would be difficult to withdraw a merit increment once given. He would much prefer a scheme based on annually assessed bonuses, analogous with the "primes" payable to the best French civil servants.

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He was not, however, suggesting such an ambitious scheme for the UK. It would be right to start on a modest scale, and he was prepared to make available £4 million for a worth-while bonus scheme for Under Secretaries, Assistant Secretaries and - he hoped - Principals.

In discussion it was argued that merit pay for individuals should be clearly linked with the achievement of their personal objectives as specified under the FMI. This combination could produce a new but entirely healthy emphasis on "face to face" management. There was a psychological difference between merit pay based on scales and merit pay based on bonuses. Bonuses could be more clearly linked to performance; they could be paid in the first year and would have to be earned each year; and they need not be repeated for those who did not maintain their level of performance. On the other hand it was argued that a scale system might have advantages at the most senior grades, where objective measures of performance were particularly hard to find.

It was noted that a merit pay scheme based on departments could not readily take into account differences between them in the average quality of staff. However, at least for grades below Under Secretary, a centrally administered scheme had to be ruled out because of the numbers involved.

Summing up this part of the discussion, the Prime Minister said that the meeting supported the principle of merit pay, which could be especially valuable at a time when promotion was difficult for talented younger staff. The Minister of State, Privy Council Office, should discuss with the Chancellor of the Exchequer revisions to his proposals to take account of the points made in discussion. The pilot scheme should preferably be based on annual or twice-yearly bonuses, which would be paid as a lump sum rather than as part of monthly pay. The scheme should be applied as soon as possible to Assistant Secretaries, Senior Principals and Principles, as well as Under Secretaries. It was for consideration whether the scheme should allow for a single level of bonus, or for discretionary amounts. Only when the revised scheme had been approved by the full Cabinet should there be consultations with the trade union side, which would also need to cover the extension of merit pay below Principal. The Minister of State, Privy Council Office, should therefore prepare a revised draft Cabinet Paper in consultation with the Treasury as soon as possible.

The meeting also considered briefly your Minister's proposals on job weighting for Permanent Secretaries. No decision was reached on the principle of whether such a system should be introduced, but your Minister was invited to consider, in consultation with the Treasury, two possible

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amendments to the classification included in paragraph 13 of his draft Cabinet paper. The first would be to weight the job of Permanent Secretary to the Ministry of Defence as Grade O, leaving all other Departments as they are now. The second would be to shorten the list of Departments in Grade 1(i), for example by omitting the Scottish Office and the Department of Trade and Industry. The Prime Minister said that she would consider the issues further in the light of your Minister's conclusions on these two points.

I am sending a copy of this letter to John Kerr (HM Treasury), and to Sir Robin Ibbs, Sir Peter Middleton, and Sir Robert Armstrong.

Yours ever,

David

(DAVID BARCLAY)

Paul Cann, Esq.,
Office of the Minister for the Arts.

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