



Ref. A084/2143

PRIME MINISTER

Performance-related Pay

(C(84) 20)

INTRODUCTION

You discussed merit pay with the Chancellor of the Exchequer and the Minister of State, Privy Council Office, together with Sir Robin Ibbs and me on 23 July. Lord Gowrie was invited to circulate proposals to the Cabinet for an experimental merit bonus scheme to be applied as soon as possible to the grades of Principal up to Grade 3 (Under Secretary).

2. Lord Gowrie's paper raises three main issues for decision by the Cabinet:-

- (i) whether in principle merit pay should be introduced into the Civil Service, initially through a limited experimental bonus scheme;
- (ii) if so, what grading levels should be covered in the initial experiment;
- (iii) how should the costs of the bonuses be financed.

Subject to the Cabinet's conclusions on the broad principles and coverage of merit pay experiments, the paper proposes that officials should be instructed to prepare detailed proposals for implementing and operating schemes.

MAIN ISSUES

Should merit pay be introduced at all?

3. The case for merit pay has partly to do with its role in sharpening the managerial awareness and personal accountability of Civil Service managers. In the nature of much Civil Service work, managers do not necessarily experience the personal consequences of success or failure as can occur in the private sector and it would be in accordance with the change of management style which developments such as the FMI are seeking

to foster if, through the operation of merit or performance-related pay, staff had a greater personal stake in the achievement of objectives and results. In part, the case for merit pay has to do with the sharp diminution in promotion prospects which is a consequence of the rundown in numbers, but which may damage the motivation of talented staff who see their own career prospects in somewhat bleak terms compared with their predecessors. Merit pay offers a means of recognising good people which could to some extent compensate for the reduced availability of promotion as a reward.

4. Some members of the Cabinet may question whether a system of merit pay would produce benefits in terms of increased motivation and effectiveness commensurate with the financial costs. It would mean a major change in the culture and climate of the Civil Service, and there is room for more than one view about whether the introduction of differential rewards and the resulting greater sense of personal competition would enhance the performance both of those performing well (whose motivation might already be high) as well as those performing more moderately; and about whether this effect would outweigh the possible damage to the spirit of co-operation between officials which remains important if Ministers are to be properly and effectively served. Permanent Secretaries, who have been consulted informally in the course of the preparation of this paper, mostly agreed that the time had come to try merit pay in the public service, but were concerned about the risk of divisiveness.

5. It is the experience of all employers that the introduction of merit pay involves a significant addition to the pay bill, typically in the range of 2-5 per cent. The effectiveness and benefits of this expenditure cannot be demonstrated objectively; but the fact that the private sector, and some parts of the public sector (and public services in other countries), do operate such arrangements suggest that there is a link between motivation and financial reward. There is not any good reason to think that such a link would not exist in the Civil Service.

6. The judgment must necessarily be a subjective one, and it seems unlikely that it will be elucidated by further study. If the Cabinet takes the view that merit pay can be afforded and should be pursued, then it may agree that the start should necessarily be limited and experimental as Lord Gowrie proposes, both so that the complex questions of practicability can be explored and in order to manage the cost implications. In agreeing to an experimental scheme in principle it will be important that the Cabinet should recognise:-

- (a) that there would be no commitment to continuing the arrangements after the three-year experimental period if the experiments are not successful;
- (b) but that there will be a strong presumption in favour of continuing and extending the arrangements ultimately to the whole of the Civil Service if the experiments are successful.

7. The Chancellor of the Exchequer may have reservations about (b) above because of the financial commitment it may imply. But there would be little point in embarking on experiments at all if the Cabinet were not prepared to agree now to accept the implication (and intention) that the experiments should lead to permanent and more comprehensive arrangements. It would be particularly damaging to staff motivation if Ministers were to decide not to go ahead after a successful experiment.

8. Other points are:-

(a) The Chancellor of the Exchequer places great importance on the proposition that the award of bonuses should be confidential to the individual. Outside practice varies. The Chancellor can be supported in this.

(b) It will be important that Ministers should take no part in the processes of deciding who receives bonuses.

(c) Although there should be an early announcement, if the Cabinet decides to go ahead with what is proposed, it is important that nothing should be said publicly while the present Civil Service pay negotiations are still in train. Any suggestion that extra money is available for this sort

of purpose would lead to immediate demands that it should be spread across the staff as a whole. The timing of the announcement must therefore be reserved to yourself, the Chancellor and Lord Gowrie in the light of other developments.

- (d) Although the sums of money involved are small, there may be questions about how the money is to be found, given that it will lie outside "the existing overall provisions for Civil Service pay". This is a matter for detailed discussion between the Treasury and Departments, and it would be profitless for the Cabinet to pursue it further now.

Financing

9. Since the initial experiments will apply to only a small minority of civil servants (the grades from Principal to Grade 3 (Under Secretary) represent some 3 per cent of the total Civil Service) it is particularly important that the cost is not seen to be at the expense of the provision made for the pay of the majority who will be outside its scope. In the longer term the financing of merit pay covering the whole Civil Service would clearly need to be taken into account in determining total provision for pay.

Implementation

10. A number of detailed questions remain to be settled about the operation of merit bonus arrangements. These include such matters as the detailed criteria for the award of bonuses, the administrative and operating procedures, the size and number of bonus payments within the financial provision, the budgetary control mechanisms, the treatment of staff who are on loan from their own Department or who are posted during the assessment period etc. The Cabinet does not need to decide such matters now. They need further study by officials; on some of them the Civil Service unions ought to be given an opportunity to express their views. Once the Cabinet has decided the broad parameters of the experimental schemes, this detailed work can be put in hand within the framework so established.



CONCLUSIONS AND NEXT STEPS

11. The Cabinet needs to decide whether it accepts the recommendations in paragraph 13a.-c. of C(84) 20, that is:-

- (a) an experimental programme of confidential merit bonuses covering the grades from Principal up to Grade 3 (Under Secretary) starting if possible on 1 April 1985; to run for a period of three years; at a cost of £4 million a year financed separately from general pay provision; all subject to review in the light of experience with the experiments;
- (b) agreement to indicate in an announcement a willingness to discuss with the Civil Service unions the possibility to further experiments at lower grading levels, without commitment as to method, timing or finance, but on the understanding that any such schemes could be authorised to begin within the three-year period.

12. If the Cabinet endorses these proposals, they may agree with the recommendations at paragraph 13d. and e. of C(84) 20, which commissions further work by officials on the practical and operational arrangements. Thereafter the sequence of events would be for an announcement to be made of broad intention as to the size and scope of initial experiments; for officials to be authorised to consult the unions as part of the process of formulating detailed proposals; and for these proposals to be submitted to Ministers this autumn, so that the experiments can start from 1 April 1985. Lord Gowrie might be invited to agree terms and timing of an announcement with the Chancellor and clear it with you.

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Approved by
ROBERT ARMSTRONG
and signed in his absence.

[Handwritten signature]
25 July 1984