



P.01540

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PRIME MINISTER

Nationalised Industry Board Members' Pay
Paper by the Chancellor of the Exchequer
E(NI)(85)2

BACKGROUND

You announced on 7 July 1980 that the salaries of the Chairmen and Members of Nationalised Industry Boards would in future be determined by the Minister concerned rather than by the Top Salaries Review Board, and on 7 April 1981 you announced the principles by which Ministers would be guided. Salaries would be based on managerial and market considerations rather than on traditional comparisons and ranking, and would take into account the need to recruit and retain people of experience and ability, internal differentials within the board and with senior management, the performance of the industry, and the general economic climate. Chairmen and non-executive directors would make recommendations on the pay of full-time directors to the appropriate Minister.

2. The Sub-Committee reviewed pay arrangements in January 1984 (E(NI)(84)1st meeting.) It rejected proposals that full time board members should receive a salary in respect of their executive functions together with a fee in respect of Board Membership, with Ministers fixing only the latter element, preferring that the existing system should be retained but operated in a more robust and flexible way.

3. The Secretary of State for Energy suggested in a letter of 10 December 1984 (annexed to E(NI)(85)2) that the



system is not working well, and asked for a discussion. Other Ministers welcomed this suggestion. The Chancellor of the Exchequer has circulated his paper as a basis for that discussion.

MAIN ISSUE

4. The main issue is whether any improvements can be made in the system by which Ministers determine the pay of members of Nationalised Industry Boards.

5. The defects which have been identified are:

(i) Remuneration Committees (comprising the Chairman and non-executive directors) have tended to recommend large increases by reference to outside comparisons, paying insufficient attention to individual merit;

(ii) not much account has been taken of the success of industries in achieving Financial Targets or External Financing Limits (EFLs). 'Norm'-like increases have been usual;

(iii) there have been inordinate delays.

6. In practice nationalised industry board members received an average increase of 8 per cent in 1984, with most receiving between 5 and 10 per cent but with extremes of 0 and 25 per cent. Average earnings in the economy have been rising by 7½-8 per cent a year, but the pay of private sector board members has probably risen faster than this so that the gap between them and their public sector colleagues has widened.

Proposals for Reform

7. None of the objections summarised above call into question the fundamental basis of the existing arrangements. It is accepted that pay determination is a matter for Ministers and should be based on the criteria outlined in paragraph 1, and that remuneration committees should play a key part: changes therefore relate to the method of operation and the



and the guidelines which should be given to the remuneration committees.

8. The essential difficulty in dealing with Nationalised Industry Board Members' (NIBMs) pay is in reconciling conflicting objectives of Government. Ministers want the nationalised industries to show a determined commercial approach to the management and development of their businesses; in principle they want more of the commercial decisions to be left to the industries; they want private sector disciplines and practices in fixing remuneration of NIBMs to be applied through remuneration committees made up of the Chairman and some of the part time Board members; and they want the Boards to set good examples of restraint to their staffs and to a wider public.

9. At a time when - notwithstanding big reductions in marginal tax rates on high incomes - top management pay in the private sector (including industries recently privatised) has been rising substantially faster than earnings in the economy as a whole, and substantially faster than top management pay in the public sector, and when Ministers have accepted payment of 'market' salaries to attract desired new talent into nationalised industry Boards, it is perhaps not surprising that tensions have developed over NIBMs' pay. In weighing the balance between 'market' factors and the need for exemplary restraint, Ministers have generally attached more weight to the latter point, at least so far as existing NIBMs are concerned. The question now is whether there should be any change in that balance, in order to reduce the tensions.

10. The Chancellor and the Energy Secretary are agreed that explicit guidance should be given to remuneration committees to reduce their ambitions and that decisions on their proposals should be reached more expeditiously; they are further agreed on the need to give further emphasis



to merit and performance, to keep the general level of increases below 10 per cent, and to avoid major reviews of Board salary structures without the approval of the responsible Secretary of State. The Energy Secretary, however, proposes paying more attention to vertical relativities (so that staff will have an incentive to aim for promotion to the Boards), and allowing some element of 'catching up' over a period, while the Chancellor rejects both these considerations and proposes that overall NIBM pay increases should be lower on average than last year's 8 per cent.

11. The tensions are probably incapable of precise resolution: the political pressures affecting different industries are themselves different, and change over time; for reasons outside their control, some of the industries will find less difficulty than others in achieving any given financial target; and there is always likely to be difficulty, if a relatively larger increase is proposed for one individual, in making the invidious choice of one of his colleagues to receive only a minimal increase. It may be possible to reduce the scale of the problem in some industries by promoting existing staff members, or people from elsewhere in the public sector, rather than bringing in much more highly paid recruits from private industry. Nevertheless there would seem to be advantage in arranging for sponsor Ministers to give discreet instructions to their remuneration committees to proceed cautiously, and to avoid proposals for average NIBM pay increases in excess of about 8 per cent unless there is the strongest practical case for such increases which has previously been agreed with the responsible Minister.

HANDLING

12. You will wish to ask the Chancellor of the Exchequer to introduce his paper. All Ministers sponsoring nationalised industries but particularly the Secretary of State for Energy are likely to have views. The Secretary of State for Employment may have a view on the degree to which board pay settlements influence expectations generally.



CONCLUSIONS

13. You will wish to reach decision on whether the Government should

- ✓ (i) confirm the general approach to the determination to board pay set out in 1981;
- ✓ (ii) endorse the development of closer links between pay and performance and the introduction of performance related pay schemes;
- (iii) give new guidance to remuneration committees;
- (iv) aim to react to the committees' proposals within three months;
- (v) require the agreement of Ministers before major reviews of pay structures are undertaken;
- ? (vi) reject placing particular emphasis on vertical relativities;
- (vii) reject any element of general catching up with private sector board pay, or with TSRB increases;
- (viii) aim for an overall increase no higher than achieved last year.

PLG

P L GREGSON
Cabinet Office
15 May 1985

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MR TURNBULL

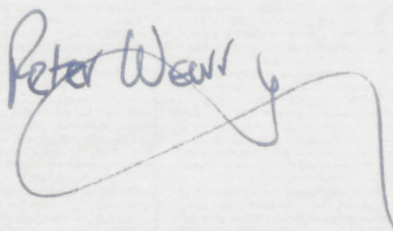
13 May 1985

NATIONALISED INDUSTRY BOARD MEMBERS PAY

Last year, Board pay increases averaged 8%. Nigel Lawson is certainly right to oppose general catching-up increases to TSRB levels, or that maintenance of vertical relativies within individual industries should be a significiant factor.

Performance-related pay schemes have now been introduced in British Steel, the Post Office and British Airports Authorities. Provided the criteria for such schemes include privatisation milestones as well as financial objectives, then this is the right way to go. It provides motivation to the individuals and justification for large salary increases where they occur. And of course if an industry fails to achieve its targets then salaries can actually decrease.

We support Nigel Lawson's proposals, in particular the emphasis on performance-related pay schemes.

A handwritten signature in blue ink, appearing to read 'Peter Warry', with a long, sweeping horizontal line extending to the right.

PETER WARRY

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