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Pay reform for the senior civil service

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About this report

This report has been produced by the Institute for Government and commissioned by the Office of Manpower Economics (OME). The OME is an independent organisation that provides impartial secretariat support to the independent public sector pay review bodies. The work described in this report was carried out under contract as part of the OME's research programme. The views and judgments expressed in this report are those of the Institute for Government and should not be attributed to the OME.

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November 2021

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Introduction

The civil service – including the senior civil service (SCS) – has experienced a decade of wage stagnation. The government now proposes to introduce what it is calling "capability-based pay" for senior civil servants so that they can receive increases to their base pay as they improve their skills, knowledge and experience. Work is ongoing to determine how this new system will operate.

The Office of Manpower Economics (OME) has commissioned this report from the Institute for Government, which examines:

- the major barriers to achieving the government's intended goals for the civil service (particularly reducing staff turnover)
- the consequences of capability-based pay for other aspects of the pay and reward system, and further reforms the government should introduce.

We found widespread support for capability-based pay in the interviews we conducted across multiple departments. Interviewees were optimistic about the new system and believed it could provide a more objective framework for measuring and talking about their capability than the current system for awarding performance bonuses. However, we also found problems that the government will need to tackle if capability-based pay is to succeed. Our findings are that:

- A capability-based pay system will not be viable unless the government can **guarantee sufficient funding** to support pay rises. Introducing capability-based pay without the guarantee of funding to pay salaries commensurate with assessed capability will damage morale and performance.
- Funding for capability-based increases needs to be considered separately from the headline civil service pay figure, so that the system can be **maintained even if the government re-imposes a pay freeze**.
- Capability-based pay alone is **unlikely to do much to reduce turnover**. While pay contributes to churn, there are many other relevant factors including, most importantly, promotion prospects.
- Capability-based pay needs to **accommodate specialists who stay in post** and become deep subject matter experts. Reforming pay arrangements is only one part of creating new career structures for these individuals.
- **End-of-year bonuses should be scrapped** when a capability-based pay system is implemented, as they are currently not being used as a strategic tool for driving improved performance, capability or motivation; **in-year awards should be retained**.

- Departments will need to **improve managers' ability to lead discussions about pay**, capability and performance ahead of the introduction of capability-based pay.

- There is an **overlap between the concepts of performance and capability.** This means that continuing to reward performance while basing pay progression on capability could in effect reward the same activity twice. This needs to be addressed before capability-based pay is introduced.

- The **Scottish and Welsh governments should, on balance, be granted the power to decide pay scales** for their own senior civil servants, as they already do for delegated grades.

This report focuses on base pay and one-off payments for high performance (hereafter 'bonuses'), but pensions remain an important part of overall SCS reward, being substantially more generous than in the private sector. In setting out the existing SCS pay structure, we also compare the benefits of defined contribution pensions available in the private sector to defined benefit pensions offered to senior civil servants. We find that pensions make up for nearly half of the deficit between SCS pay and private sector equivalents. Civil service pensions are generous – a typical 52-year-old SCS1 official on a salary of £78,500 has an annual pension contribution 'worth' £18,300 of additional salary compared to the equivalent private sector worker.

This means that, when taking pensions into account, a worker in the private sector would need to earn £96,800 to match the overall financial value of the SCS1 official's £78,500 salary plus pension. The typical private sector worker is in fact paid £118,300, so still does better than their civil servant equivalent, but by a smaller margin than would be assumed from their base pay.

This report confirms that the government, with advice from the Senior Salaries Review Body (SSRB), is right to keep SCS pay under review. That is particularly important as the civil service continues to experience a period of pay restraint, even as the recent Covid-related freeze is relaxed. Capability-based pay could be a valuable tool to sustain morale in the senior government workforce, and may offer some benefits of reduced churn.

But such a system will need to be properly funded. The government has estimated that introducing capability-based pay will cost around £45 million; to ensure the new system retains the funding it needs to succeed this amount (rising with inflation and adjusted to meet demand each year), this money must be formally ringfenced to realise any of the benefits the government hopes will follow.[1]

1. Current framework for SCS pay

The SCS has operated under pay restraint since the 2008 financial crisis. The government has offered only small increases to salary ranges since 2009 (including several years of pay freezes) and has eliminated automatic pay progression within each of those ranges. There are limited opportunities for senior civil servants to increase their base pay without seeking promotion. Using remuneration to attract and retain talent is a longstanding difficulty within the SCS, but has grown more acute since 2009 – at least until the Covid pandemic, which seems to have temporarily reduced some staff churn – as SCS pay diverged further from both private sector equivalents and the cost of living.

Senior civil servants have limited opportunities to increase their base pay without being promoted

The largest component of SCS pay is base pay, which is used to calculate pension entitlements and is separate from bonuses.

Table 1 **Pay bands as of 1 April 2020 (rates unchanged in 2021)**

SCS grade	Pay band	Minimum	Maximum	Median
Deputy director (SCS1)	1	£71,000	£117,800	£78,500
Deputy director	1A	£71,000	£128,900	£84,700
Director (SCS2)	2	£93,000	£162,500	£103,500
Director general (SCS3)	3	£120,000	£208,100	£138,600

Source: Practitioner guidance on the SCS Pay Award for 2020–21 and government evidence to the SSRB.

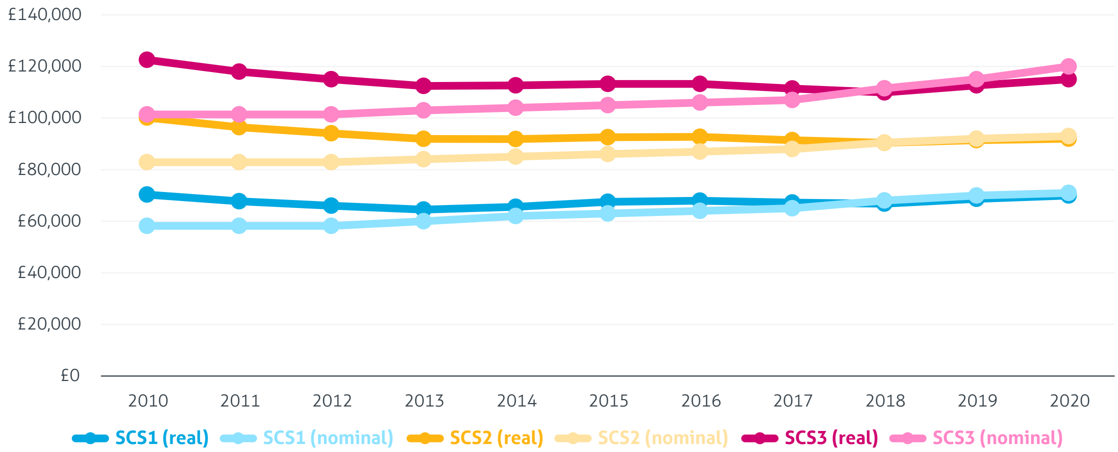
There are two main ways that staff can receive increases to their base pay without being promoted. First, each year the government decides whether (and by how much) to increase the pay ranges for each SCS level. Second, departments can also use a portion of their pay funding to increase base pay for selected staff. Most have targeted this towards staff who have achieved top performance ratings but are paid at the lower end of the range for their SCS level.

Until 2018, one other way senior civil servants could increase their base pay was to change jobs at the same SCS level and negotiate a higher salary, particularly where the role advertised a maximum salary higher than their current pay. This option has now been largely closed off to help control turnover. Currently, senior civil servants cannot increase their pay for moves at the same SCS level or receive a pay rise of more than 10% (or the minimum of the new grade if they are promoted) unless they obtain an exemption, for instance where the move is to a role with more responsibility. Interviews with civil servants suggested that this had been successful in reducing the number of pay increases on sideways moves, but we have not identified clear data to support this.

Increases to minimum pay at each level have been constrained in recent years

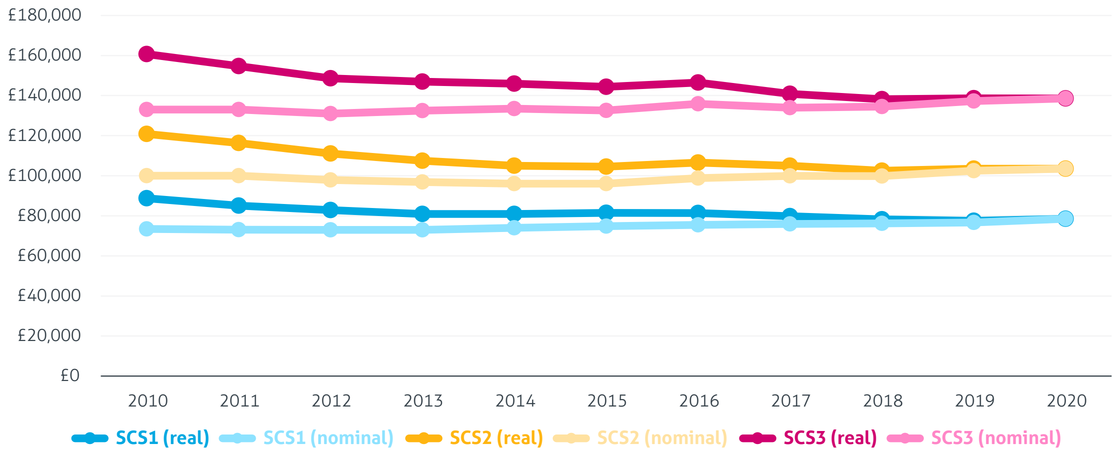
The government has frozen SCS pay for the year 2021/22 due to the pandemic. That comes on top of a decade of wage restraint due to the 2008 financial crisis and subsequent austerity programme. The real pay minimum did not increase for any of the SCS levels from 2009 to 2012, and the following years have seen little growth (Figure 1). The combination of small increases in minimum salaries and lack of pay progression for most senior civil servants over the last decade means that median salaries have fallen in real terms by 14–17% for each pay band since 2010 (Figure 2).

Figure 1 **Senior civil service minimum salary in real and nominal terms (2010–20)**



Source: Institute for Government analysis of Cabinet Office, Government Evidence to the Review Body on Senior Salaries on the Pay of the Senior Civil Service, 2021, p. 53. Notes: (1) Calculated using CPIH inflation, as used by ONS estimates, 2020. (2) Salary figures are calculated on a full-time equivalent basis, and are for those senior civil servants in scope for the SSRB pay award remit as at 1 April. (3) Figures are rounded to the nearest £100.

Figure 2 **Senior civil service median salary in real and nominal terms (2010–20)**

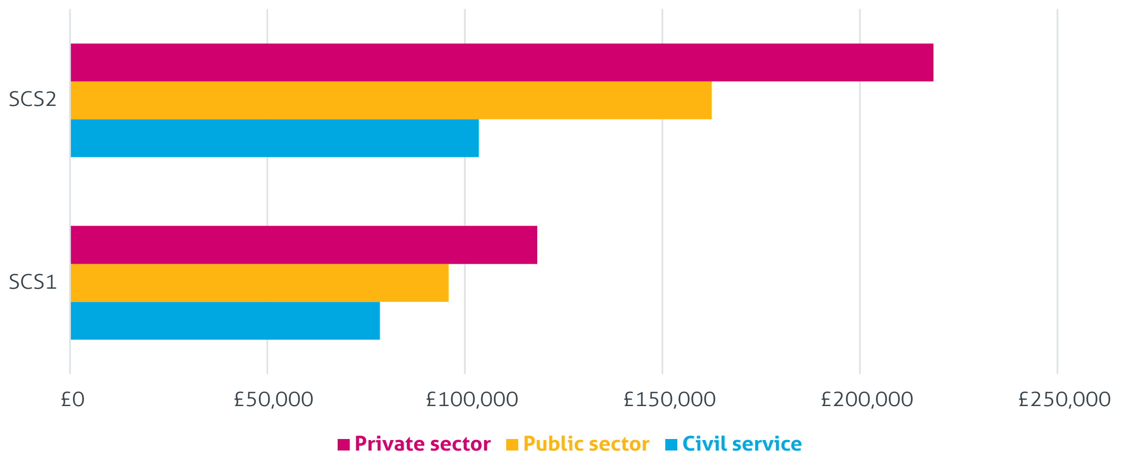


Source: Institute for Government analysis of Cabinet Office, Government Evidence to the Review Body on Senior Salaries on the Pay of the Senior Civil Service, 2021, p. 91. Notes: (1) Calculated using CPIH inflation, as used by ONS estimates, 2020. (2) Salary figures are calculated on a full-time equivalent basis, and are for those senior civil servants in scope for the SSRB pay award remit as at 1 April. (3) Figures are rounded to the nearest £100.

Senior civil service salaries are lower than those in the private and wider public sector

Senior civil servant base salaries are lower than those for senior jobs in the private and wider public sector. A director at SCS2 level is paid half of their private sector equivalent and, perhaps more surprisingly, only two thirds of their public sector counterparts (non-civil servants whose salary is also paid by the taxpayer, like directors of local councils or headteachers). This is because public bodies outside of central government – such as the NHS, the BBC and local authorities – have more freedom to set pay levels.

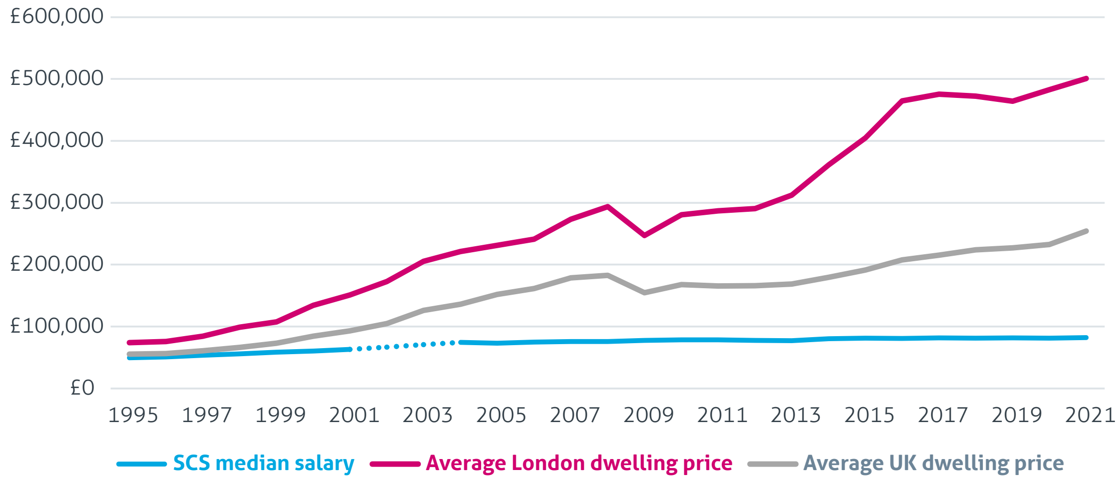
Figure 3 **Median base salary for senior civil service and public and private sector equivalents by grade**



Source: Institute for Government analysis of Cabinet Office, Government Evidence to the Review Body on Senior Salaries on the Pay of the Senior Civil Service, 2021, p.29. Notes: SCS figures are from April 2020, while private and public sector figures are from October 2020. Comparison figures are not available for the SCS3 level.

Civil service salaries have also not kept pace with some of the costs of living, especially in London. This is not, of course, unique to the civil service, but given that traditionally many of the more senior roles have been based in the capital, the risk is that talented potential candidates are disincentivised by the wide disparity between house prices and salary – an area where more generous pensions are of little help to civil servants early- and mid-career. This problem has worsened over time, and is a good reason for the government to prioritise its plans to move more senior jobs out of London.

Figure 4 **Senior civil service salary compared to average house prices (1995–2021)**



Source: Archived Civil Service Statistics, 1995–2001; Hay SCS Pay report, 2004; SSRB Government Evidence 2006, 2005–06; ONS Civil Service Statistics, 2007–18; Cabinet Office Civil Service Statistics, 2009–21; UK House Price Index, Average price by type of property, 1995–2021. Note: SCS salary data from 2002 to 2003 is missing due to lack of data availability.

Bonuses have not delivered meaningful pay increases

Senior civil servants have access to one-off payments based on performance, but these are relatively small compared to the bonuses offered to private sector equivalents and have not led to substantial pay increases overall.

Departments can, and almost always do, use up to 3.3% of their SCS pay budget to make payments to recognise high performance.[2] These payments can be made at the end of the annual performance review to those rated in the highest of the three performance bands (end-of-year awards) or on an ad-hoc basis during the year to recognise individual achievements (in-year awards and corporate recognition scheme awards). They do not count towards pension calculations.

End-of-year bonuses can reach £17,500 (with larger bonuses requiring the approval of the chief secretary to the Treasury), although most departments set maximums well below this amount. The median bonus for SCS2 is £9,600, which represents 9.3% of the SCS2 median salary. The percentage of the SCS who could receive these bonuses was previously limited to 25% but that cap was removed in 2019.[3]

In-year bonuses are used by departments to reward performance in a timelier manner and are capped at £5,000 per person, per year. Usually, only 20% of SCS members are eligible for in-year awards. But in 2019/20 and 2020/21, the cap was temporarily increased to 40% in recognition of the demands of Brexit and the pandemic.

The Cabinet Office also awards one-off bonuses of up to £1,000 under a cross-civil service corporate recognition scheme. These bonuses can be given to senior civil servants who have been nominated by permanent secretaries for their contribution to cross-departmental work. Up to 0.1% of the funding for SCS pay is available for this purpose.

Pay restraint has coincided with low pay satisfaction, but has not yet created recruitment difficulties for most civil service professions

Unsurprisingly, this period of pay restraint has coincided with senior civil servants self-reporting relatively low levels of pay satisfaction – albeit still above those in more junior 'delegated grades'.[*] In each of the years from 2013 to 2020, only a small minority of responding senior civil servants reported that they were satisfied with SCS pay arrangements (although figures trended upwards over the final two years of this period).[4]

But as the government itself has noted in its evidence to the SSRB, this has not yet led to the widespread loss of high-performing employees or difficulties with recruitment in most civil service professions – the groupings of policy, legal, commercial, finance, project management and other experts. The government reports that high performers in the SCS are less likely to resign than low performers,[5] and that it is satisfied with the level of competition for vacancies in the SCS.

We heard in interviews that, overall, the civil service is able to recruit and retain the talent it needs, though with greater difficulty in some professions where it faces direct competition from the private sector.[**]

There are several reasons why this might be the case. First, pay has a weaker impact on public sector employees' job decisions than it does on those in the private sector, with a public service motivation being a strong influence on the former. Second, across the workforce as a whole, the Institute for Employment Studies has found that people "seldom" resign because of the level of their pay.[6] Finally, the private sector has also experienced wage stagnation over the same period. In London, where the SCS is concentrated, the gap between public and private sector pay, while still favouring the private, had narrowed in the decade before the pandemic.[7]

Nonetheless, several interviewees expressed a concern that at some point in the future a lack of pay growth and pay progression would lead to difficulties with recruitment. For many, a pressing concern is that the increase in pay from Grade 6 to SCS1 is not commensurate with the increase in responsibility, and the overlap between the highest-paid Grade 6 civil servants and the bottom of the SCS1 pay band means that some deputy directors are being paid less than their direct reports.[***]

For example, while the pay band minimum for SCS1 in 2019/20 was £70,000, the maximum pay for Grade 6 civil servants was £72,000 in the Department for Business,

* On the standard civil service grade structure, delegated grades begin at administrative assistant (AA), the most junior grade, and end at Grade 6 (G6). Delegated grades are so called because individual departments have more autonomy over their pay and other conditions, which for the SCS are set centrally.

** For instance, the Data, Digital and Technology profession has the highest SCS resignation and turnover rates across all professions, and also has high rates of external recruitment (above 40% for the SCS): Cabinet Office, Government Evidence to the Review Body on Senior Salaries on the Pay of the Senior Civil Service, 2021, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/987458/Government_evidence_to_the_Senior_Salaries_Review_Body_on_the_pay_of_the_Senior_Civil_Service__February_2021_.pdf, p. 42.

*** Almost a quarter of Grade 6 civil servants earn over the SCS1 minimum: Cabinet Office, Government Evidence to the Review Body on Senior Salaries on the Pay of the Senior Civil Service, 2021, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/987458/Government_evidence_to_the_Senior_Salaries_Review_Body_on_the_pay_of_the_Senior_Civil_Service__February_2021_.pdf, p. 53.

Energy and Industrial Strategy, £72,226 in Department for International Trade and £72,356 in Department for Transport.[8,9,10]

Some areas like digital and commercial also report more difficulties recruiting specialist talent, and data specialists are, like in the rest of the labour market, in high demand across the civil service. While low pay satisfaction might not yet be a recruitment and retention problem across the civil service as a whole, specialists in some areas – including deep policy specialists, for example on tax or environmental regulation – are attractive to the private sector and the best officials risk drifting away from public service.

Pivotal role allowances have not had a major impact on retention of key staff

In addition to performance pay, managers can also apply to temporarily increase staff members' pay through the pivotal role allowance (PRA). Departments can offer this allowance to encourage project leaders to stay for the duration of a project, or to people working in highly specialised roles. This allowance is capped at 0.5% of the total SCS pay bill.

The average PRA agreed during 2020 was £20,000, with individual sums ranging from £12,000 to £40,000. At this stage, the allowance is yet to have a major impact on the retention of key staff on major projects: only 137 have been agreed since they were introduced in 2013. It has mainly been used by the Project Delivery (25%), Policy (17%) and Finance (15%) professions.

Pensions remain one of the most important benefits offered to the SCS

Both base salary and total salary for all SCS pay levels lag behind their private and wider public sector equivalents. This disparity increases for higher SCS levels. Unlike some of their private sector equivalents, senior civil servants do not receive equity or private health care as part of their wider reward package. But one of the main benefits of the SCS reward package is the civil service pension, which makes up for a reasonable part – but by no means all – of the gap between the two.

SCS members can choose between defined benefit and defined contribution pension scheme arrangements. Defined benefit schemes offer a set income upon retirement while defined contribution schemes offer a pension amount based on contributions made into the pension scheme and the investment return on those contributions. People in equivalent private sector jobs are invariably offered a defined contribution pension; very few private sector defined benefit schemes remain open to new contributions. Virtually all (97%) civil servants earning more than £70,000 are members of a defined benefit scheme,[11] compared to only 8% of private sector employees as of 2019.[12]

On average, public sector pension schemes are much more generous than in the private sector.[13] A civil servant starting their career now at age 25 and retiring as a member of the SCS1 at age 68, having had a fairly typical career, would receive £63,400 (in today's prices) each year in retirement under the current 'alpha' (defined benefit) pension scheme, representing more than 80% of their final salary.[*] By comparison, we estimate that someone in the private sector with the same salary profile as the civil servant would receive on average £28,000 a year of pension income in retirement through a private sector defined contribution scheme.

This figure assumes that the private sector employee would make the same employee contribution as the civil servant but receive only the 8.3% of salary average employer contribution that is made by FTSE100 companies.[**,14]

To achieve an annuity income of £63,400 a year from a defined contribution pension, someone in the private sector would need to accumulate a pot worth around £1.75 million (in today's prices) by the time they retire.[***] Assuming the employee's contributions matched those made by civil servants in the alpha scheme, the private sector employer would need to contribute nearly 32% of salary each year into the defined contribution scheme. This is almost four times the current average contribution rate for FTSE100 employers, of 8.3%.[15]

This disparity in the generosity of pensions in part makes up for the fact that a private sector employee in a role equivalent to SCS1 is paid over 50% more than the civil servant. Someone on a SCS1 median salary of £78,500, leaving the civil service for the private sector at the age of 52, would need a salary of £96,800 to be equivalently well off (in terms of their total annual remuneration from pay and employer pension contributions) after doing so. However, that is still well below the equivalent average private sector salary of £118,300.[16]

The switch from a final salary to a career-average calculation of the defined benefit pension entitlements has reduced the incentive that the civil service pension scheme gives for senior civil servants with longer careers to remain in the sector. When pensions were calculated on a final salary basis, each additional year's service also had the benefit of increasing the value of previous years' pension accruals. That no longer applies, and so senior civil servants have less incentive to remain in the public sector – and suffer less of a pension-related penalty from taking time out of public service to work in the private sector.

* See separately published methodology for assumptions and calculations. This figure includes an adjustment to account for the tax charge that would be applied to this pension because it would exceed the lifetime pension contribution limit. However, the figure shown is gross of income tax that would be due on this income when it is received.

** This assumes that the private sector employee would purchase an index-linked annuity, with no survivor benefits, at the age of 68. While most defined contribution members do not currently buy annuities, this is the fairest comparison with the public sector benefit, which provides a guaranteed annual income that is linked to inflation. However, our calculation understates the difference in pension value between the public and private sectors for someone with a spouse because the alpha scheme offers a 37.5% survivor benefit.

*** This assumes that the private sector employee buys an annuity at the current best index-linked annuity rate for a 68-year-old, which was 4.01% as of 7 July 2021.

The equivalent figures to those above for more senior SCS2 and SCS3 civil servants are shown in the table below.

Table 2 Overall comparison of SCS and private sector remuneration

	SCS2	SCS3
Annual pension under alpha scheme*	£73,600	£90,200
Annual alpha scheme pension as percentage of final salary	71.1%	65.1%
Annual pension for someone with the same salary profile in a private sector defined contribution scheme	£32,900	£41,200
Private sector defined contribution pension pot needed to match alpha scheme annual pension**	£2.1m	£2.6m
Employer contribution needed in defined contribution scheme to obtain that pension pot	32.4%	35.6%
Salary needed for someone leaving the SCS at age 52 to be equivalently well off in the private sector	£128,500	£171,900

* These figures are net of the tax that would be owed due to breaching the pensions lifetime allowance.
** These figures are gross of the tax that would be owed because this pot exceeds the lifetime allowance.

2. Rewarding 'capability' through pay

The government has said it wants to incentivise civil servants to develop their capability and depth of expertise by staying in their jobs longer, reducing high levels of turnover and a loss of institutional knowledge. As one of the ways of addressing that, ministers and civil servants have set out plans to introduce what they call "capability-based pay" for the SCS, at a yet-to-be fixed point after the 2021/22 financial year.

Under the new system, senior civil servants' demonstrated capability against new professional and leadership standards will be rated and assigned to one of three levels: developing, competent and expert. Standards will generally be set by the civil service professions, though each will have the same pay scale. Ratings will be used to set individuals' base pay following periodic reviews, as well as on appointment, promotion and when they take on new roles. This system will offer meaningful pay increases for civil servants without requiring them to seek promotion, the first time pay progression will have been offered on a widespread basis since it was effectively scrapped from 2010 onwards.

More detail describing the government's model for capability-based pay is set out in its 2021 submission to the SSRB, and it is this definition that we adopt throughout this report.[17]

Based on the existing literature on capability-based pay systems and interviews with civil servants, this chapter explores some of the key implications of a transition to the new system. We examine the potential of capability-based pay to reduce turnover and current pay anomalies, its viability in the face of economic and fiscal pressures, and the capacity of managers in the SCS to implement capability and pay assessments, especially given the sometimes loose and unclear definition of what 'capability' actually means.

Capability-based pay should not be implemented until the government can confirm it will fund pay rises

Departments will not realise the benefits of capability-based pay – and worse, risk undermining job satisfaction, motivation, performance and staff morale – if they do not follow through on promises to award staff pay rises commensurate with their assessed capability. In introducing such a system, departments are making a bargain with their staff, and evidence from behavioural science shows that a failure to meet expectations of pay increases can be perceived as a reduction in reward, with a resulting harm to staff morale.[18]

The difficulty for departments, however, is that they are restricted in how they can use their SCS pay budgets. This means there might be circumstances in which they cannot deliver on expectations of capability-based pay, particularly in a political, fiscal and economic climate when the government might want to contain spending on civil service wages. Pay awards for senior civil servants are decided by government ministers, following recommendations from the SSRB (for delegated grades, individual departments make decisions based on guidance issued by the Cabinet Office). Governments have often frozen public sector pay in response to fiscal or economic conditions: the chancellor, Rishi Sunak, decided not to offer pay rises to senior civil servants (and many other public sector workers) in 2021/22 "in the interest of fairness" and to ensure that public sector pay growth remained on a par with the private sector over the medium term.[19] Before this, pay had been frozen between 2009 and 2012.[20]

This means that government decisions could prevent departments from offering staff base pay that matches their demonstrated capability. Several interviewees expressed this concern to us – and the potential for pay restraint to undermine any incentive which capability-based pay gives to staff to remain in their jobs longer and boost their skills. To avoid this happening, funding for capability-based increases needs to be considered separately from the headline pay figure, meaning that the system could be maintained even if the government instituted a pay freeze. Future pay restraint should in practice only apply to the base pay of civil servants, preserving money – the equivalent of the £45m additional real-terms cost of the capability-based element of the system – to maintain capability progression.

Managers will need support to make contentious decisions about capability and pay

The switch to capability-based pay will be a major cultural change for the civil service and managers will need proper support to build the skills to make it work. Many human resources (HR) professionals we spoke to emphasised the size of the change involved in having managers make decisions about their direct reports' base pay – in terms of both the civil service cultural mindset and the skills managers need to assess capability and make decisions about pay.

In terms of skills, we were told frequently that civil service managers' ability – and appetite – to lead regular, high-quality, well-informed conversations about capability and performance is lacking in comparison with the private sector. HR professionals who had worked in both the private and public sectors argued that civil service managers tend to have a less developed understanding of these concepts than their private sector counterparts, who often work in environments with clearer employee objectives and outcomes that are more easily measured, and where performance plays a bigger role in setting pay.

We also heard that managers are often reluctant to have 'difficult' conversations involving messages that are uncomfortable to communicate, such as confronting poor performance or disappointing their direct reports' expectations about progression. Some said this reluctance could be reduced if a capability-based system produced a clear, objective framework to ground conversations.

But we also heard that much of the difficulty stems from having to make decisions about individuals at the margins of the various performance ratings – and about who does and does not get bonuses. Under a capability-based system, managers will still have to make difficult calls about where individuals fit within the pay structure (albeit with the support of a framework), and convey disappointing news to some of their direct reports. They will need the authority to do this, and it should be clear to managers across the civil service that they will be supported and endorsed by those in the most senior positions as they make those decisions.

The cultural transition will be helped if frameworks are simple, and if there is clear and effective communication from the Cabinet Office and within departments. As well as helping managers, this will also mean that staff better understand the process by which their pay is decided – an important factor in pay satisfaction.[21] The Cabinet Office has previously noted that satisfaction with the current system of performance pay has been undermined by a perceived lack of transparency and by lack of awareness of recent changes to the pay framework, for example the removal of 'forced distribution' (where a set proportion of staff are required to be given high and low performance ratings), and it should apply the lessons learnt from this work to the implementation of capability-based pay.

There must be a clear distinction between capability and performance

Our interviews also suggested that the Cabinet Office and HR teams managing the transition will need to work out a clearer distinction between capability and performance. On paper the two concepts are separate, and nearly all interviewees working in HR initially said that they felt clear about the difference. Most understood capability as being a prerequisite for performance, or the skills needed to be able to do a job; one described capability as the standards people work to in a consistent way – in other words, the quality of output rather than the outcomes achieved. But when we discussed its real-world application with interviewees, we encountered a lot of muddle and overlap. For instance, capability was frequently cited as being 'forward looking' while performance was a 'backward looking' measure – but, based on current plans, capability will be assessed with reference to how staff have done their jobs in the past.

The government's *Declaration on Government Reform*, issued in summer 2021, has the potential to cause further confusion on this issue. While it committed to the introduction of capability-based pay, it also promised to link rewards and bonuses to performance targets.[22] The Cabinet Office will need to issue clear guidance, including explicit instruction as to the difference between capability and performance, and how managers should assess them differently.

Another area where managers will need authority, endorsement and support will be handling the expectations of senior civil servants about their level of capability and the likelihood of pay rises. Much of the staff enthusiasm for a capability-based pay system we detected in interviews related to an expectation of pay increases and being able to avoid the difficult choices associated with current limits on performance bonuses. But the government has said – rightly – that senior civil servants should not expect to be rated as 'competent' until three to five years into their roles.

Several interviewees expressed a concern that newly promoted staff, used to receiving a top performance rating, or those who had been at their existing level for lengthy periods, might be demotivated if they find themselves rated as 'developing' or 'competent', rather than at the 'expert' target rate. As one interviewee put it, longstanding members of the SCS will "think they're already experts", but that this expectation would not always be borne out.

There is also a tension between roles and capability rating. Civil servants moving jobs within the same grade will expect to stay at the same rating of capability. But they will not be as 'capable' in their jobs if they move to new roles with a large knowledge or relationship component, where they do not (yet) have the expertise to carry out the job. The government will need to make it clear whether civil servants will be incentivised to stay in post to develop expertise, or whether their capability status can be ported across different jobs. The latter would put a big dent in the impact of capability-based pay, because the pay system would no longer be rewarding capability, but time served at a particular grade. Equally, capability-based pay should not become a way to reward time served rather than expertise possessed.

The evidence gathered in our research reinforces the importance of the Cabinet Office's current plan to use pilots and roll out the new system in stages. Before the new capability frameworks are used to set pay, the Cabinet Office should ask departments to use them as part of existing performance appraisals and in recruitment processes, to ensure they are well understood and so they can be refined before being used to make pay decisions. Existing evidence points to the importance of ensuring that a performance management system is effective before linking it to pay decisions,[23] which suggests the same is likely to apply to a system based on capability.

Capability-based pay is rarely used in other organisations to reduce turnover

In our research, we did not find evidence of capability-based pay being used in other organisations with the primary intention of reducing internal job moves. Instead, employers covered in the studies more often targeted improving their workforce's skills and rewarding success, making career paths clearer, and improving motivation and performance.[24] As such, our judgment is that the introduction of capability-based pay in the civil service, on its own, will not make much difference to turnover.

That said, pay reforms can be a tool for signalling to a workforce the type of skills and behaviours the employer values. This points to the potential for using capability frameworks to reward the acquisition of deep subject matter expertise or specialist skills. That seems a more promising objective for the new pay system, especially given that, as we argue above, re-weighting promotion decisions would have more influence on job switching.

It will take more than capability-based pay to reduce civil service staff turnover

Despite the limited evidence outlined above, the government has said that capability-based pay is in part designed to address excessive levels of staff turnover in the civil service, while also acknowledging that pay is only one lever for addressing this problem and that other interventions are required.

It is not possible to estimate from current data what the likely impact on turnover would be. To do so would require a more detailed understanding of why civil servants change jobs, before estimating how many of these decisions might be avoided or deferred. While departments conduct exit interviews with those senior civil servants who leave the civil service entirely and record their reasons for leaving, similar data is not collected for those who switch roles within or between departments. Lack of data on turnover within individual departments, including reasons for moves, is a particular problem.

However, evidence gathered from our interviews with civil servants suggests the link between current pay policies and turnover levels is relatively weak. While there are good reasons to implement capability-based pay, the cost and disruption of moving to a new system are unlikely to be offset by gains in terms of reduced turnover. When we asked about the reasons senior civil servants changed jobs, we heard frequently that:

- senior leaders in departments themselves – rather than individual postholders – are responsible for many internal moves, as they assign high achievers to new priority areas
- individuals seek to broaden their experience to improve their prospects of future promotion
- many roles have their own 'expiry dates' where seeking a new job minimally disrupts a department, for example at the end of a major project.

This suggests that excessive turnover would be better targeted through reforms to recruitment, for instance by weighting selection criteria in favour of depth of expertise. Some decisions to seek promotion would of course be driven by pay. But promotion will in most cases offer a far greater pay jump than year-on-year capability-based progression, meaning the number of people seeking internal promotion seems unlikely to be reduced substantially under the new system.

Our interviews highlighted the need for the government to be clearer about where the problem of excessive turnover lies, and in particular whether it is confined to particular types of civil servants and types of roles, or whether it is a problem across the board. Several interviewees suggested it is more the former. This demands a more targeted solution, as a blanket approach that ties pay rises to remaining in the same job could punish those for whom it is right to move on. For instance, interviews conducted for our research on civil service relocation indicated turnover is a much bigger problem in London than in locations with fewer government job opportunities.

Furthermore, not every type of job is best served by longer tenure. The intensity of some high-profile roles, like private office jobs, means that individuals can only sustain them for a relatively short time. For some (though far from all) project-based roles, we were told that two or three years might be an appropriate length of tenure, and that many roles have periods of higher and lower intensity that dictate when the incumbent is likely to want to move on. At the other end of the scale, policy specialists would benefit from more time in the same role, to develop expertise, understanding and relationships, while functional (digital, commercial, financial or other similar) specialists might stay in the same post for longer tenures but work on a variety of projects lasting just days, weeks or months during that time.

The government has taken steps to limit turnover resulting from the current lack of pay progression. In the past, some departments had allowed senior civil servants to increase their pay when they moved to another job at the same level. In the absence of any pay progression, this practice was blamed for civil servants moving jobs too quickly in search of a pay rise.[25] The government tried to remove this incentive in 2018 when it introduced a policy preventing pay rises on level transfer, with only limited exemptions. It is not possible to say, based on existing data, the degree to which this change has reduced turnover. We did hear that some individuals continued to 'game' the system to seek pay rises on a lateral move between departments, but that gaming would continue wherever there was inconsistency in pay arrangements between departments.

Departments will need to ensure pay reforms do not reinforce gender, ethnicity, disability or socio-economic pay inequalities

Past research has found that gender-role stereotyping is reinforced in the way that competencies are defined, with the result that women are consistently rated lower than men in terms of leadership ability.[26] Interviewees expressed similar concerns about the potential for men to negotiate higher capability assessments and pay than women of the same standard.

Similarly, civil servants from lower socio-economic backgrounds have reported more difficulty navigating key points of career progression, such as salary negotiations and promotion rounds, because of a perception about unwritten cultural rules.[27]

But if departments can ensure that pay negotiations do not undermine equity, itself a major long-term task to reform and change workplace culture, capability-based pay could improve the existing gender pay gap (3.7% for full-time and 16.5% for part-time civil servants at the SCS level).[28] Currently, people appointed to the SCS from outside the civil service, who are more likely to be men,[29] have greater capacity to negotiate higher starting salaries than those promoted from within, and there is no mechanism to close this gap after appointment. As capability-based pay is introduced, the government should closely monitor outcomes by these characteristics – also including ethnicity and disability – to inform future pay decisions.

3. Rewarding performance or capability

The introduction of capability-based pay raises the question of whether departments should continue to pay performance bonuses to senior civil servants in parallel, and if so, in what form. The government has acknowledged some of the criticisms of the current regime – such as lack of transparency in making awards and poor understanding of the system among staff – and is conducting a wider review of SCS performance management. As we note above, similar problems could affect the introduction of capability-based pay; the government should address them as a priority.

This chapter considers how well performance bonuses are being used currently, and their potential application alongside capability-based pay.

Most research suggests that bonuses have little impact on performance or motivation

Studies of a variety of workplaces suggest that the impact of bonuses on performance – where it exists – tends to be limited.[30] This was backed by a widespread view in our interviews that existing performance bonuses have not led to better overall performance in the civil service.

The evidence base for performance pay is thin, with data showing that cost-effectiveness is rare and often mixed in conclusions on the impact on performance.[31] Where evidence is more definitive, it suggests performance pay has only small positive effects, tends to incentivise or motivate a minority of employees and can crowd out intrinsic motivation.[32]

We did not find any studies quantifying the impact of bonuses in the UK civil service context, though some work has noted improvements in the delivery of public services like health and education.[33] That has been in contexts where performance and outcomes can be more easily measured than in much of the civil service, especially when the work relates to giving policy advice.

The use of bonuses is not based on a clear goal

Even though all departments use performance bonuses, which make up 3.3% of the total pay bill, we found little consensus among interviewees as to what awards of a few thousand pounds per person are designed to achieve. The typical reasons cited in the existing HR literature include motivating employees (thereby improving performance), holding employees accountable for performance and as a way of ushering in other corporate changes (such as a more effective appraisal process).[34,35]

But interviewees told us they feel there is little strategy underpinning the use of current mechanisms (particularly end-of-year awards) and that decisions about who should receive bonuses are more a negotiation or a 'horse-trading exercise' than a genuine reflection of staff performance. So much so that the system was described to us by one interviewee as "broken". We heard that decision makers tend to approach the process in terms of sorting out who will receive bonuses, rather than how to elicit better performance. In other cases, we heard that bonuses are seen as a way of compensating high performers stuck towards the bottom of their pay bands, rather than recognition of high performance per se.

We found there was more clarity about the purpose of in-year bonuses, with explicit recognition of their role in rewarding staff going 'above and beyond' on a specific piece of work, closer to the time that work was performed rather than at the end of the year.

Performance bonuses are not motivating civil servants to perform better

The sense that managers are not using bonuses strategically was matched by a widespread view that those payments are not motivating better performance from senior civil servants. This is partly because of the way they are being used, but also because bonuses have limited potential to incentivise better performance – specifically in a civil service context.

One reason for this is the relatively small size of public sector bonuses. Past research suggests that the minimum threshold for a pay increase to be noticed by workers is around 7–10%.[36] Civil service bonuses tend to be far smaller than this, as a relatively small component of total pay and reward. At the SCS2 level, only three of 16 departments offered end-of-year bonuses of 11% or more of the median SCS2 salary in 2020/21.[37] With that median at £103,500, an 11% bonus would be £11,385 – we were told in interviews that civil servants in some professions could potentially receive bonuses of up to £50,000 if they worked in the private sector. Any civil servants inclined to be motivated by bonuses were thought by interviewees unlikely to be incentivised by those on offer.

Existing proposals for capability-based pay uplifts would not, in most cases, meet the 7–10% threshold. A deputy director who moved from the proposed developing target rate to the competent target rate at the speed expected by the Cabinet Office would expect capability-related pay increases of £3,500 a year (around 5%). This suggests that, in the absence of further efforts from the Cabinet Office and departments, capability-based pay might similarly fail to have a motivational impact on the SCS workforce.

In the public sector specifically, most evidence suggests that job content, career development prospects, 'public service motivation' and employees' belief in the value of their work are more important than financial incentives in motivating behaviour.[38,39] This was corroborated by civil service HR professionals we interviewed, who argued that if civil servants were motivated by performance bonuses (or total pay), they would go elsewhere, and by data from SCS exit surveys that shows that people tend to leave the civil service for career development opportunities, rather than pay.[40] We heard in some interviews that the status of being recognised as a 'high performer' was more important than the bonus itself.

Capability-based pay combined with performance bonuses could reward the same activity twice over

There is an overlap between the concepts of performance and capability. This means that continuing to reward performance while basing pay progression on capability could in effect reward the same activity twice.

The existing literature on performance and capability does not draw a neat line between the two concepts, and many pay systems described as being capability- or competence-based are in fact a combination of performance and competence.[41] As noted in the previous chapter, this blurring was evident when we discussed the two concepts with HR managers, as well as in the government's own claim that one of the principles of its proposed capability-based pay system is to "provide greater reward for high performers".[42] While interviewees gave logical conceptual definitions, when the practical application of capability-based pay was discussed, we encountered considerable overlap. We were also told that there is a correlation between performance and capability, with high performers starting to demonstrate the markers of capability earlier than their peers.

We question the utility of measuring and paying for capability twice – once on its own terms and indirectly by assessing performance – and running two similar but separate processes will also be a considerable time imposition on managers, HR professionals and members of moderation committees.

There is a stronger case for retaining in-year bonuses, which are tied to specific achievements as opposed to an assessment of whole-of-year performance and tend not to involve lengthy moderation processes. Interviewees consistently pointed to the distinct value of 'in the moment' recognition of achievement and 'above and beyond' commitment.

Performance bonuses are widely perceived to lack transparency and fairness

The government itself has noted persistent complaints about the lack of transparency and objectivity in the current system of performance management and bonuses. We heard similar complaints in our interviews. This opens the system to perceptions of unfairness, which behavioural science research suggests is a very strong factor in workers' response to a pay system,[43] and which is more likely to drive dissatisfaction with a pay system than the level of pay itself.[44]

The problem of objectivity stems in part from the difficulty of measuring output and outcomes in many public sector roles, and of finding suitable indicators which tie outcomes to a civil servant's performance. In many cases, outcomes manifest over the long term do not correlate neatly with 12-month performance assessment cycles. Equally, it can be difficult to isolate an individual's contribution to a wider team effort.

This leaves space for subjective managerial judgment that employees may see as unfair or inaccurate. Our interviews with HR professionals in the civil service suggests that the current process is unfair and is widely perceived to be so. As noted above, several thought that the conversation focused on who 'deserved' a bonus rather than as a rounded examination of performance, and as a 'locked door' process lacking in transparency. These interviewees argued that the current system was not being used to improve performance, motivation or capability, but was merely a process for distributing bonuses. We also heard that the final rating assigned to an individual frequently depends as much on their visibility and the power of their backers as their actual performance.

Far from driving better performance, a bonus system that is perceived to be unfair can actively undermine it. Even though civil servants have reported low satisfaction with their pay in recent years, existing research suggests that perceptions of pay fairness are far more important for employee commitment than pay satisfaction.[45] A transparent and objective process is not the only aspect of fairness – it is as much about rewarding individuals in proportion to their contribution as it is about the probity of the process by which those rewards are decided, so failing to reward high performance can also be counterproductive.[46] Feelings of unfairness can also arise where workers think they are performing better than others but receive the same reward. Fairness of process is particularly important in the public sector context, where research suggests that workers feel less strongly than those in the private sector that they want their pay to directly reflect their performance.[47]

We sometimes heard that there is less concern about transparency and fairness when it comes to in-year bonuses. One HR director told us that the statistics for in-year payments more closely reflected the diversity of their department than end-of-year bonuses, and speculated that this was because high-profile, full-time staff tended to be front of mind for managers reflecting on the previous 12 months, whereas in-year payments were made as a reaction to specific pieces of work during the year.

More work is needed to design bonuses that suit staff with specialist skills

While we did not find strong or consistent views among interviewees as to whether performance pay was particularly effective for certain groups of civil servants, these dynamics warrant further exploration and will need to be taken into account in any future reforms.

Performance pay may be more useful in professions where bonuses are standard among private sector competitors. The Government Commercial Organisation (GCO) offers terms and conditions more akin to those found in the private sector. For instance, SCS employees on GCO terms can receive up to 20% of their salary as non-consolidated bonuses, an offer that has helped attract and retain experienced commercial specialists.

However, this relationship should not be assumed without further evidence. Some studies suggest that even in these types of professions, there is a meaningful difference between the motivations of those who choose to work for public sector employers and those in the private sector.[48] More than half of senior civil servants employed by the GCO still choose standard SCS pay and employment conditions (58% of those eligible).

Other studies still have concluded that performance pay can improve the recruitment and retention of high performers in particular,[49] although these did not focus on the public sector and data from exit surveys suggests that high performers are less likely than low performers to resign from the civil service altogether.[50]

4. SCS pay in the Scottish and Welsh administrations

As employees of the UK Home Civil Service, pay bands and headline pay increases for senior civil servants working for the Scottish and Welsh governments are decided by the UK government. Their equivalents working in the Northern Ireland executive are employed by the Northern Ireland Civil Service (NICS), which determines their pay. We do not cover the NICS in this report and subsequent uses of 'devolved administrations' refer only to the Scottish and Welsh governments.

The governments in Scotland and Wales do have the power to make decisions about other aspects of SCS pay and reward, such as the award of bonuses. Previous SSRB reports, and government evidence to the board, have highlighted growing divergence between arrangements for senior civil servants in those administrations and in the UK government.[51,52] For instance, the Scottish and Welsh governments have banned performance pay for their SCS cohorts,[53] with those funds in Scotland being used to offer limited pay progression.[54] Scotland has also set hard limits on pay increases for some senior civil servants: in 2020/21, it limited pay rises for those earning more than £80,000 to £2,000.

Current arrangements limit the devolved administrations' ability to manage their own workforces

Though the two devolved administrations we look at already determine some aspects of SCS pay and reward, locking devolved senior civil servants into UK government base rates of pay hampers their ability to devise an overall pay and reward package that best meets their needs.

Changes to pay structures are often used as a tool to achieve wider outcomes for an organisation or workforce, for instance as a way to usher in changes to performance management or to improve staff retention, as the UK government has indicated it hopes for from capability-based pay. But its goals on this front will not necessarily align with those of its Scottish and Welsh counterparts. For instance, we heard that turnover in Wales tended to be "unhealthily low", in contrast to UK central government, which hopes to incentivise senior civil servants to stay longer in post.

While interviewees were positive about a capability-based pay system, there are legitimate reasons that a government might want base pay determined by factors other than just capability – for instance, a small number of interviewees within UK government departments argued that a component of pay should be determined by performance.

There is a strong case that the devolved administrations should be given the autonomy to decide on the pay scales that make most sense, given their fiscal positions and their goals for their SCS cohorts. Our interviews suggested that HR professionals in Scotland and Wales felt more constrained, and more frustrated, than their counterparts working for the UK government.

Freedom to set pay for delegated grades but not the SCS leads to inconsistencies and perverse incentives

One argument frequently advanced in favour of capability-based pay – both by the government in evidence to the SSRB and in interviews conducted for this research – was the need to resolve the situation of Grade 6 civil servants at the top of their pay band being paid more than their SCS1 managers. But a UK-wide approach to setting SCS pay rates will not necessarily resolve this problem in Scotland and Wales, which are responsible for setting their own rates for the delegated grades.

Splitting responsibility for delegated and SCS pay and performance decisions in the devolved administrations risks perverse outcomes for the SCS in Scotland and Wales, and that problem will increase as arrangements for delegated grades increasingly depart from those of delegated grades in the UK government.

As a general principle, pay and performance policies for the SCS should not be set in isolation from those of the delegated grades. As the SSRB and the government have previously noted, the small gap between the top of the Grade 6 pay range and the bottom of the SCS1 pay range disincentivises Grade 6 civil servants from seeking promotion, which is exacerbated in the devolved administrations where pay progression means more Grade 6 officers are at the top of their pay bands than in the UK government. Interviewees from Wales described this as a "huge frustration", causing "massive problems".

The UK government should review the case for continuing to set SCS pay in Scotland and Wales

In light of these factors, the UK government should work with the Scottish and Welsh governments to review whether future SCS pay scales should continue to be set centrally by the UK government. Devolving these decisions to the Scottish and Welsh governments would also be consistent with their increasing fiscal autonomy.

There are some benefits of continuing central control. Diverging SCS pay rates could make it harder for the lower-paying civil service to attract staff in locations where both devolved and UK government departments have a presence. It would mean the UK and devolved governments competing for top talent in, say, Edinburgh, but with the UK government civil service offer constrained by UK pay policy. (The same could, of course, happen the other way around, although that has not so far tended to be the case.) This pressure will become more acute as the UK government implements its commitment to shift 22,000 civil servants and 50% of the SCS out of London, including to locations in Scotland and Wales.

But our research suggests that there would be more benefit to devolving pay than retaining UK-level control. Scottish and Welsh administrations must currently choose between implementing the pay and reward arrangements for delegated grades they think will best deliver their desired outcomes, and making arrangements for the delegated grades compatible with those for the SCS.

More generally, we heard from several interviewees working in the UK government about the importance of considering pay and performance arrangements in a holistic way to minimise the capacity for 'gaming' behaviours. We were also told that these behaviours had been in part motivated by the absence of other means of securing pay progression, and that they might be reduced with a move to capability-based progression. However, this could continue to be a concern in the devolved administrations, where we heard that departments have at times had to use other methods like ad-hoc bonuses to attract and retain the skills and expertise needed, while also complying with pay rules set in Whitehall.

Conclusion and recommendations

Civil service pay will continue to be politically contentious, and there will always be strong pressure on ministers to limit increases. In some ways that is as it should be – scrutiny of the pay awarded to ministers, civil and other public servants is to be welcomed, and governments rightly focus on spending money efficiently. But too much parsimony ultimately damages the capacity of the government and undermines the effectiveness of the civil service. It is therefore encouraging that ministers and senior civil servants are pursuing reforms to the structure and award of civil service pay.

However, the government should not assume that a capability-based pay system will solve the problem of specialist skills shortages or excessive turnover in parts of the civil service. To make any reforms to SCS pay a success, we offer the following recommendations.

- High levels of staff churn is a substantial problem within the SCS, especially within the policy profession. While pay does contribute to this, the incentives for civil servants to move jobs regularly to gain the experience they perceive to be necessary for promotion is a bigger factor. **Addressing these incentives will do more to reduce turnover than reform to how the SCS is paid.**

- The introduction of capability-based pay must also **accommodate specialists who stay in post** and become deep subject matter experts. Reforming pay arrangements is only one part of creating new career structures for these individuals.

- A new pay system for the SCS should not be implemented until the **government is able to offer pay rises** properly commensurate with assessed capability. The **additional annual cost of capability-based pay should be protected with a ringfence**. Failing to match capability assessments with requisite pay levels will undermine confidence in the system and its ability to motivate staff to improve their capability.

- When capability-based pay progression is introduced, the government should **scrap end-of-year awards**. There is little agreement about their purpose and little confidence in the robustness of assessments. There is also likely to be an overlap in the achievements and behaviour rewarded. **In-year awards should be retained** as a tool for the timely reward of outstanding performance and contribution.

- The **Cabinet Office must focus on improving the ability of senior civil servants to lead discussions about pay, capability and performance** ahead of the introduction of capability-based pay. This should include making clear the distinction between assessing capability and assessing performance, and *why* the government has chosen to reward the former.

- The UK government, in partnership with the Welsh and Scottish governments, should **seriously consider ending the centralised model for setting SCS pay across the UK civil service**. This should assess the potential benefits of separate decision-making processes for base pay for senior civil servants in each of the nations of the UK.

The government is right to examine civil service pay as part of its reform programme, set out in the *Declaration on Government Reform* in summer 2021.[55] The introduction of capability-based pay will be an important milestone in the civil service's reform effort, which should not be undermined by a lack of funding from the Treasury. But as this report illustrates, ministers and civil servants should not load more expectations on this particular reform than it can achieve in reality.

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