

PART I

LETTER OF 27 NOVEMBER 1981 TO  
HIS EXCELLENCY THE GOVERNOR TENDERING ADVICE  
ON THE PROPOSED ARRANGEMENTS FOR  
THE GENERAL CIVIL SERVICE PAY ADJUSTMENT  
FOR 1982

27 November 1981.

His Excellency Sir Murray MacLehose, G.B.E., K.C.M.G., K.C.V.O.,  
Governor of Hong Kong.

Your Excellency,

General Pay Adjustment for the Civil Service :  
Proposed Arrangements for 1982

We are required by Clause I(c) of our Terms of Reference to advise Your Excellency whether overall reviews of the Master Pay Scale and other non-directorate pay scales, as opposed to reviews of the salary of individual grades, should continue to be based on surveys of pay trends in the private sector conducted by the Pay Investigation Unit and subject to the advice of the Senior Civil Service Council, or whether some other mechanism should be substituted. As this question is related to other aspects of pay determination for the civil service, we considered that it should be examined in the context of a general review of civil service pay policy. In our Second Report on Civil Service Pay (Report No. 5), which was completed in October 1980, we announced our intention of carrying out this review during our next programme of work.

The Review of Pay Policy

2. We began our review in November 1980 with a study of the origins and development of the present arrangements, and also the procedures adopted in a number of other countries. In November and December 1980 Mr. Vernon Morgan, at the time the Director of the United Kingdom Civil Service Pay Research Unit, visited Hong Kong in the capacity of consultant to the Commission and produced a helpful report containing a number of proposals for improvements to the present system of pay determination in the civil service. In February 1981 we issued a Consultative Document on the subject of pay policy which resulted in a wide range of views being expressed by the Administration, staff associations and individuals, and interested bodies in the private sector. By the end of June we had identified a number of defects in the existing arrangements and had reached broad agreement on the measures necessary to rectify the situation.

3. However, the 1981 civil service pay award, which was announced in late July and in which the Commission was not involved in any way, resulted in increases of 17 - 18% to the Master Pay Scale and other non-directorate scales. This caused considerable concern to the private sector and some Unofficial Members of the Legislative Council voiced their reservations about the present system. One criticism was that the award resulted in bodies receiving fixed subventions experiencing considerable budgetary difficulties, although we feel that this might be attributable as much to the system of allocating funds to these organisations as to the pay trend survey system. Some suggested that pay trend surveys might not provide a satisfactory basis for determining overall pay awards. All these comments reinforced our previous doubts about the validity of the methodology of the present pay trend survey system.

4. In the light of these new developments we intensified our investigation of the whole operation and methodology of the pay trend survey system, in order to reaffirm our view that the present system is basically satisfactory. We felt that it was also necessary to confirm our previous broad agreement on the measures necessary to rectify the situation which included the need to take proper account of the value of fringe benefits and to identify the various elements which account for private sector pay adjustments. In addition, we felt that the survey field should comprise a more representative sample of the economically active population of Hong Kong.

5. To assist us in this task, we engaged Wyatt Harris Graham (H.K.) Ltd., an international firm of employee benefit consultants, to recalculate the pay trend survey data obtained by the Pay Investigation Unit in 1979-80 and 1980-81, taking into account fringe benefits and also weighting the data from the fifty surveyed companies in order to reflect the major categories of employment in Hong Kong.

6. Although the results of the consultants' study indicate that the inclusion of fringe benefits in the pay trend survey in 1979-80 and 1980-81 and the reweighting by industrial classification of the existing survey data would have only a relatively small effect on the results of the survey, it does show that in most categories the value of fringe benefits in the civil service is considerably higher than that of those enjoyed by private sector employees earning the same basic salaries. This is mainly on account of the higher retirement benefits in the civil service as well as the provision of housing benefits to a greater proportion of the staff.

7. Our preliminary conclusions on the basis of the consultants' findings are that it is essential that future arrangements for determining the general levels of civil service pay should take into account the total package of pay and other benefits in both the civil service and the private sector. Moreover, it is fundamental to the validity of a pay trend survey system that in the civil service the basic levels of pay and benefits taken together are broadly comparable with those in the private sector; if this is not so, reliance on surveys of trends alone would not only perpetuate but could also exacerbate pay inequalities that may already exist. It will therefore be necessary to carry out surveys of the actual levels of pay and benefits of comparable jobs in the civil service and the private sector.

8. The problems involved in devising new arrangements to meet these requirements and to make other necessary improvements will involve a considerable amount of work and very careful consideration. We intend to accord priority in our programme of work to the study of these problems, but it will inevitably be some months before we are able to complete our deliberations and report our conclusions to Your Excellency.

#### Interim Proposals

9. Since our recommendations on the system to be used in the future will not be completed in time to enable them to be implemented for next year's overall civil service pay adjustment, we recognise the need to make recommendations on interim arrangements for 1982.

10. In view of the doubts about the methodology used in the present pay trend survey system, we have considered several alternative arrangements which might be applied in 1982. These include systems based on the use of consumer price indices and the gross domestic product per capita, and also the determination of an interim award on the basis of the general economic and financial situation without reference to pay trends in the private sector. All these alternatives appear to us to have shortcomings and we have therefore reached the conclusion that the only practicable arrangement is for the pay trend survey system, with such improvements as can be made in the time available, to be used again in 1982. We would stress that this recommendation should be regarded as a purely interim measure without prejudice to any recommendations which we may eventually make in respect of arrangements for the longer term.

Modifications to the Pay Trend Survey System

11. We have given careful consideration to a number of modifications to the present arrangements which we believe could be implemented in 1982, and which would meet most of the criticisms made. These are as follows :

(a) Timing

One of the major criticisms of the operation of the present pay trend survey system is that the announcement in July or August of a civil service pay adjustment effective from 1 April may unduly influence the next pay round in the private sector and also results in large retrospective payments. We share this concern and recommend that the exercise should be advanced as far as possible so as to minimise its impact on the next round of pay settlements in the private sector. While we consider that for practical reasons 1 April must still be used as the effective date of implementation of the salary adjustment for 1982, we propose that the cut-off date of the survey should be advanced to 31 January. The survey should therefore cover pay adjustments made by the surveyed companies during the period from 2 April 1981 to 31 January 1982. Companies normally included in the survey which have not announced and made any pay adjustment in this period should be excluded for the purpose of the 1982 survey. The processing of the survey results and the subsequent administrative procedures should also be streamlined so as to enable the adjustment to be decided and announced preferably before 1 April or at the latest during April 1982. We understand that this is possible.

We do not share the view which has been expressed that the effective date of the civil service salary adjustment should be changed to 1 January. The pay trend survey should reflect pay awards given in the private sector in the previous year. To advance the effective date of the civil service salary adjustment to 1 January would be unsatisfactory in that it would mean the exclusion of the considerable number of pay adjustments made by companies in the survey field in January of each year.

(b) Salary Bands

It has been represented to us that the present collection of survey data according to three salary bands is unsatisfactory, and we have received

suggestions for a variety of alternative arrangements. This question needs detailed consideration and we have not been able to reach a conclusion in the limited time available. We therefore recommend that the present system of three bands should be continued in 1982. We are nevertheless of the view that one unsatisfactory aspect of the present system of banding should be removed. At present survey information on the pay of private sector employees corresponding to Model Scale 1 and the bottom band of the Master Pay Scale and other related scales is collected separately despite the fact that the pay scales of the former fall entirely within the pay range of the latter. This has in the past produced different percentages for the two groups, which if implemented would have led to the disturbance of established relativities between them. We therefore recommend that for the purpose of the 1982 pay trend survey these two groups should be considered as one single pay band.

(c) Survey Field

It has been suggested to us that the fifty companies which make up the present survey field do not constitute an accurate cross-section of economic activity in Hong Kong or reflect the actual distribution of work force. We share this view and although we recognise that it would not be possible to change the survey field for 1982, we consider that an improvement could be achieved by different weighting arrangements. At present the data obtained from each company is weighted in accordance with the number of employees in that firm. We recommend that it should also be weighted so as to reflect the major categories of employment in Hong Kong, as classified by the Census and Statistics Department.

(d) Merit Payments and Pay Adjustments due to External and Internal Relativities

Pay adjustments in the private sector can be broadly broken down into six components reflecting the following factors :

- (i) cost of living;
- (ii) general prosperity and company performance;
- (iii) merit;
- (iv) internal relativities;

- (v) external relativities or adjustments due to changes in market rates;
- (vi) promotion and transfer.

Of these six components, only (i) and (ii) are relevant to the annual pay trend survey. Component (iii) is broadly analogous to the annual increments received by most civil servants, while (iv) and (v) can be taken to be the private sector equivalents of the adjustments made to individual grade pay scales as a result of this Commission's recommendations. Promotions and transfers are of course dealt with outside the annual pay adjustment in both the civil service and the private sector.

In order to recognise this situation, we recommend that the Pay Investigation Unit, when collecting data from the fifty companies, should make every effort to identify and report on the separate components of the pay increases awarded during the period covered by the survey. Consideration should be given to eliminating (iii) - (vi) from the increases before the percentages to be used as the basis for the civil service pay award are determined.

(e) Differences in the Value of Fringe Benefits between the Civil Service and the Private Sector

In accordance with the methodology at present used in the pay trend survey, the Pay Investigation Unit collects data in respect of movements in wages or salaries, including bonuses, within the companies forming the survey field. No proper account is taken of fringe benefits. This arrangement would be satisfactory if fringe benefits in the private sector and the civil service were broadly comparable. However, the figures produced by our consultants show that in relation to each of the pay bands, the value of fringe benefits in the civil service is substantially higher than the value in the private sector; indeed expressed as a percentage of basic salary civil service fringe benefits have at least twice the value of the corresponding benefits in the private sector.

There is a considerable difference between the total private sector and civil service pay packages and this may lead to the pay trend survey figures being inflated in so far as their applica-

tion to the civil service is concerned. This is because in determining a pay award, a private sector company may take account of increases in living costs for its employees which do not affect civil servants to the same extent. For example, a company which does not provide housing benefits may take account of rising rents in its pay award; through the pay trend survey system this element of the pay award is then passed on to those more senior civil servants who are already receiving housing benefits in the form of quarters or private tenancy allowances. We regard this as a major defect in the existing pay trend survey arrangements.

As a general principle, we consider that comparability between civil service and the private sector should have regard to total pay packages. Although we accept that it would not be practicable to introduce major changes in the pay trend survey system for 1982, we feel that it is essential that some account should be taken of the differences between the total private sector and civil service pay packages. The question is therefore how this can be done within the context of the 1982 pay trend survey arrangements.

To take an example, our consultants' figures show that in 1981 for employees in the middle band of the Master Pay Scale the value of fringe benefits expressed as a percentage of basic salary is 15.5% in the private sector as against 32.1% in the civil service. While we do not suggest at this stage that this differential should be eliminated or even reduced, we consider that steps should be taken to prevent any further widening of the gap, as could occur if the pay trend survey figures were applied without adjustment.

One possible method of achieving this would be to apply the following formula to the figures resulting from the 1982 pay trend survey :

$$\begin{array}{rcl}
 \text{Indicated} & & \text{Total private} \\
 \text{percentage} & & \text{sector pay} \\
 \text{change in} & & \text{package} \\
 \text{private} & \times & \text{-----} = \\
 \text{sector pay} & & \text{Total civil} \\
 & & \text{service pay} \\
 & & \text{package} \\
 & & \text{Indicated} \\
 & & \text{percentage} \\
 & & \text{change in} \\
 & & \text{civil service} \\
 & & \text{pay}
 \end{array}$$

Using our consultants' figures for employees in the middle pay band and supposing, for example, that the 1982 pay trend survey indicates a



percentage increase in private sector pay of 15%, the effect of this formula would be as follows :

$$15\% \times \frac{115.5}{132.1} = 13.1\%$$

Thus the indicated increase for civil servants in this band would be 13.1% as against 15% in the private sector; i.e. the pay trend survey figures would be reduced by 0.126% for each one percentage point of the private sector increase.

The effect of using this formula to adjust the pay trend survey figures would be to maintain but not to increase the existing differentials. The formula assumes a common salary base for the private sector and civil service. We are well aware that it will be argued that in making this assumption we are not necessarily comparing like with like in that private sector pay levels for comparable jobs may be higher than those in the civil service to compensate for the lower level of fringe benefits. However, in so far as pay levels are concerned, evidence which we have received in connection with another review which we are undertaking establishes that, at least in so far as starting pay is concerned, civil service salaries compare very favourably with those in the private sector. Moreover, we would point out that the present pay trend survey system itself does not compare like with like but merely assesses movements in pay at particular salary levels as a basis for adjusting civil service salaries at those same levels.

We are also aware that our consultants' calculations of the value of fringe benefits are based on assumptions which could be challenged; the consultants would be the first to acknowledge this. The consultants have applied the same set of assumptions to both the civil service and the private sector and have therefore treated fringe benefits consistently on both sides. The use of different assumptions, provided that they were applied consistently, could change the absolute values, but would not unduly distort the relativities, nor change the general conclusion that benefits have a higher value in the civil service than in the private sector. Furthermore, a relatively large margin of error in the figures for fringe benefits would have only a limited effect on the results deriving from the application of the proposed formula.

We appreciate that this is not the only or necessarily the best method of taking account of the differences in total private sector and civil service pay packages within the context of the 1982 pay trend survey. The important element of our recommendation is that in 1982, the gap between the value of fringe benefits in the civil service and those in the private sector should not be allowed to widen further. We would therefore see no objection to some better means of achieving the same objective being used. We also propose to give further consideration to this problem as we pursue our study of civil service pay policy.

(f) Method of dealing with Late Adjustments

At present, when a pay adjustment effective from a date within the survey period is announced too late to be included in the current year's survey, the company concerned is recorded as having given no increase during the period, but the number of its employees is taken into account in weighting the survey results. This has the effect of depressing the current year's results but when these late adjustments are taken into account in the adjustment for the following year, they produce an exaggerated effect, as happened this year. We recommend that for the 1982 survey, companies which have not yet announced pay adjustments by the cut-off date should be excluded from the overall weighting of the survey results to give a more accurate reflection of the level of pay adjustment among the surveyed companies.

Conclusion

12. We therefore recommend that the 1982 overall civil service pay adjustment should be made on the basis of a pay trend survey, incorporating the various improvements proposed in the preceding paragraph. The resulting pay award should follow as closely as possible the results of the survey, subject only to the need to preserve rational incremental scales.

13. We intend to continue our study of the whole system of civil service pay adjustments and we shall give due regard in our deliberations to the effect of the interim improvements

to the pay trend survey system recommended in this letter, if they are adopted for the 1982 exercise. We shall submit our final report on these matters to Your Excellency in due course.

We have the honour to be  
Your Excellency's obedient servants,

S.Y. Chung  
Chairman

S.L. Chen

Gallant Y.T. Ho

Grace Ho

Gordon M. Macwhinnie

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