

## **CHAPTER 6**

### **PAY ADJUSTMENT SYSTEM AND MECHANISM**

(This chapter sets out the Consultant's findings, the consultation feedback and the Task Force's views in relation to the present pay adjustment system and mechanism)

#### **Introduction**

6.1 As discussed in Chapter 4, "broad comparability with the private sector" has been one of the basic principles of civil service pay for many years (see paragraphs 4.11 – 4.23). To help ensure that civil service pay moves broadly in line with movements in the private sector, annual pay trend surveys (PTSs) have been conducted since 1974. The results of the PTSs are used as reference, amongst other factors, in determining annual pay adjustments in the civil service.

6.2 While the system has worked well in the past, and has contributed to providing Hong Kong with a stable, clean and efficient civil service, we see the need to examine whether it can still meet changing expectations from all quarters in the face of the present socio-economic circumstances.

#### **Experience in Surveyed Countries**

6.3 The Consultant has pointed out that historically, all the five countries studied had a highly centralised, national level pay and wage determination for the civil service. These systems tended to rely heavily on formula-based approaches to pay determination, and were often based on formal pay comparability with the private sector.<sup>1</sup>

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<sup>1</sup> Consultant's Final Report, Page 29

6.4 With the trend of decentralisation of pay administration to individual departments and agencies (more so in Australia, New Zealand and the United Kingdom, but to a lesser degree in Canada and Singapore), all the surveyed countries have moved away from a central, formula-based approach to pay determination. Individual departments now have greater delegated responsibility for pay determination, with affordability, achievement of performance goals, and recruitment, retention and motivation of staff as key considerations. Collective and individually negotiated agreements, within centrally determined bargaining and budgetary parameters, are now a common feature, with pay trend surveys and pay level benchmarking with the private sector used to inform rather than dictate the pay adjustment process.

6.5 The Consultant has also observed that the role of the central agencies has changed with more emphasis on setting the overall policy framework and providing advice, rather than directly controlling detailed pay negotiations.<sup>2</sup>

### **The Hong Kong Experience So Far**

6.6 Details of the experience in Hong Kong in respect of the determination of civil service pay are set out in Chapter 2 of our Interim Report.<sup>3</sup> Relevant developments are summarised in the following paragraphs.

6.7 In Hong Kong, civil service pay adjustments are determined with reference to the results of the annual PTS aimed at assessing the average pay movements of employees of private sector companies over the preceding 12 months. The current survey methodology setting out, inter alia, the criteria for selection of companies is at Appendix X.

6.8 For the purpose of the survey, the non-directorate civil service is divided into three salary bands. Companies participating in the survey are requested to provide information about changes in basic salaries on account of cost of living, general prosperity and company

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<sup>2</sup> Task Force's Interim Report, Page 27

<sup>3</sup> Ibid, Pages 6-12 and 14-16

performance, general changes in market rates and in-scale increment as well as changes in cash payments (e.g. merit pay, bonus) other than those relating to fringe benefits for employees in those salary bands. The information is then collated and analysed, according to the agreed methodology, to produce gross pay trend indicators (PTIs) for the three salary bands.<sup>4</sup> Subject to the validation of the Pay Trend Survey Committee, the PTIs are submitted to the Administration as reference in determining the civil service pay adjustments.

6.9 Apart from the PTIs, the Administration also takes into account changes to the cost of living, the state of the economy, budgetary considerations, the staff sides' pay claims and civil service morale in determining pay adjustments.

6.10 We pointed out in Chapter 2 in our Interim Report that<sup>5</sup> two major tasks are involved in establishing comparability with private sector pay –

- (a) identifying comparable work in the private sector and assessing corresponding pay levels (*pay level assessment*); and
- (b) assessing general pay movements in the private sector to ensure that civil service pay moved broadly in line (*pay trend assessment*).

The PTS only tackles task (b). A pay level review or survey is required for task (a).

6.11 In 1986, in response to staff request for an increase in pay, a consultant was commissioned to conduct a comprehensive pay level survey. The findings of the survey were, however, rejected by the staff sides. While discussion on this continued, there was further disagreement between the Administration and the staff sides over the size of the 1988

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<sup>4</sup> Ibid, Page 15

<sup>5</sup> Ibid, Page 6

pay adjustment. In the event, a Committee of Inquiry (the Burrett Committee) was appointed to examine, inter alia, the methodology and findings of the 1986 pay level survey and comment on their validity as a basis for making adjustments to civil service pay. The terms of reference of the Burrett Committee also included reviewing the methodology employed in the 1987-88 PTS.

6.12 In accordance with the recommendations of the Burrett Committee, the Administration has since 1988 adopted the formula to deduct the value of civil service increments at their payroll cost (expressed as a percentage of the total payroll cost for each salary band) from the gross PTIs to produce the net PTIs. In considering the civil service pay adjustments, the Administration also takes into account the Burrett Committee's recommendation that where the resulting PTI for the lower salary band is below that for the middle band, it should be brought up to the same level unless there are over-riding reasons for not doing so.

### **Results of Public Consultation**

6.13 The majority of the respondents in the civil service and some in the non-civil service sector agree that civil service pay should continue to adhere to the principle of broad comparability with the private sector. They generally believe that the current adjustment mechanism is fair, works well, and should not be replaced unless there is a better, proven alternative. The majority of these respondents, however, also support the idea of fine-tuning the present system, such as introducing more flexibility by separating the annual pay adjustment into two components – the first part being a basic pay adjustment applicable to all civil servants and the second part a discretionary portion awarded subject to performance. Others believe that more frequent and regular reviews could be conducted to ensure that the system is brought in line with the changing environment. It is also pointed out that if the present system is replaced, pay adjustment may have to be negotiated annually. This could be time-consuming, costly and counter-productive.

6.14 Some respondents in the civil service, on the other hand, argue that it is unfair to compare civil service and private sector jobs because in many cases, there are too few comparable jobs in the private

sector for objective comparison. In difficult times, private enterprises may cut service to reduce expenditure, but the level of service provided by the Government may not be varied in either good or bad times. Public demand for certain services, such as social welfare, may even be greater in bad times. It would therefore be unfair to compare civil service pay directly with that of the private sector.

6.15 A few press articles and some non-civil service organisations hold different views. They consider that civil service pay should not be directly linked to that of the private sector, one reason being that civil servants enjoy job security while employees in the private sector often do not. The present PTS is criticised for not taking into account the downsizing and cost-cutting measures initiated by private sector companies, which may have a bearing on salary adjustments in these companies. They point to flaws in the current formula, e.g. that the increment cost deducted from the gross PTI does not adequately offset the value civil servants actually gain through obtaining an increment (see paragraph 6.12 above and Appendix XI for background of the formula). They also consider the lack of pay level surveys as the cause of a widening pay disparity between the civil service and the private sector. They propose to include small and medium enterprises (with less than 100 employees) in the survey population to increase the representation of the pay trend surveys.

6.16 On the issue of whether fiscal constraints should be an over-riding factor in determining pay adjustments, most respondents in the civil service agree that it should be one factor, but not an over-riding factor. Views from respondents in the non-civil service sector, however, are rather diverse. Some think that fiscal constraints should be an over-riding factor, but some do not.

## **The Task Force's Views**

### *Pay Levels and Pay Trends*

6.17 Since the economic downturn in recent years, the pay adjustment mechanism has been under severe criticism, particularly as regards whether the method of comparing with the private sector is

reasonable and fair. The public is increasingly questioning whether the existing civil service pay adjustment mechanism is still compatible with the present socio-economic circumstances.

6.18 As we see it, the fundamental problem with the perceived pay disparity between the civil service and the private sector lies in the absence of a proper pay level comparison. In the 1989 Final Report of the Burrett Committee, it has been emphasised that there is an important link between pay level surveys and pay trend surveys. It is pointed out that –

*“...even the most unstructured system of civil service pay determination must have regard to outside pay levels if only as an aid to satisfying recruitment and retention needs. When, as in Hong Kong, the total remuneration ‘package’ is intended, as a matter of deliberate policy, to be broadly comparable with that of private sector employees, there has to be a structured methodology for establishing a correct comparison. This involves the conduct of pay level surveys. If annual pay adjustments are an accepted practice in both sectors and if annual checks on the continuing correctness of the pay level comparison are either impossible or impractical, then there has also to be a mechanism for updating civil service pay in between the periodic checks on pay levels.*

*Conceptually therefore a pay trend survey is an adjunct to a pay level survey, a subsidiary mechanism for preventing civil service pay levels from falling too far out of line with those of the private sector in the intervals between pay level surveys. ... By contrast, a pay trend survey says nothing about the correctness of civil service pay levels. Indeed the pay increases resulting from pay trend surveys may arouse public comment which actually diverts attention from the far more important question of the correctness of the pay levels to which such increases are applied. Moreover, pay trend surveys are of their nature only approximate reflections of what has been happening in the private sector. They lead to*

*arguments over the types of outside pay increase to be included in the calculation of the pay trend indicators and how they should be weighted. Any errors arising from their broadbrush nature can produce excessive or inadequate adjustments to civil service pay which are cumulative and compounding in their effect year by year.*

*From the above reasons, we believe strongly that pay level surveys should be regarded as the foundation of the pay system and that the role of pay trend surveys, though still essential, should be reduced. It follows that pay level surveys should be conducted regularly and frequently. It will also then follow that the built-in inaccuracies of even the best possible pay trend methodology will matter less than they do at present. If rough justice for one party or the other cannot be avoided, it is more tolerable if the results are corrected quickly.”<sup>6</sup>*

Regarding frequency, the Burrett Committee has recommended that *“the aim should be to mount a pay level survey at intervals of about every three years.”<sup>7</sup>*

6.19 We fully agree that pay level surveys should be the foundation of the pay determination mechanism while pay trend surveys play a complementary role to ensure that the civil service pay is updated in between the periodic checks on pay levels. The comparison with the private sector may be distorted if reliance is placed solely on the PTSs, which reflect only broadbrush changes in the pay of surveyed companies, in the absence of regular pay level surveys. Any disparity may be compounded in effect year by year.

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<sup>6</sup> Committee of Inquiry into the 1988 Civil Service Pay Adjustment and Related Matters (Burrett Committee), Final Report, Paras 5.3 – 5.6

<sup>7</sup> Ibid, Para 5.38

## *Pay Level Surveys*

6.20 Despite its important role in checking the appropriateness of pay levels, however, we note that a *comprehensive* pay level survey has not been conducted *successfully* (i.e. with results accepted by all parties concerned) for a very long time. The pay level survey conducted in 1986 was comprehensive, but the results and conclusions made were not accepted by the staff sides. The civil service starting salaries reviews conducted in 1979, 1989 and 1999 were limited in scope in that only benchmarks of salaries for entry-level jobs were established<sup>8</sup>. Hence, the question of whether civil service pay levels are comparable with those in the private sector has, in effect, been left unanswered for many years.

6.21 Given the large number of civil service grades and ranks, and the complexity in determining the actual pay level of different jobs, we appreciate that it is very difficult to find sufficient comparable jobs in the private sector to effectively carry out a comprehensive pay level comparison, and for the outcome of such a survey to be accepted by all concerned. We consider that it is necessary to examine this subject as a matter of priority so that a practical framework and methodology of pay level survey can be established and applied as soon as possible to provide much needed data to establish some form of comparability of civil service pay level with the private sector.

## *Pay Trend Surveys*

6.22 Although we believe that the root of the present controversy over civil service pay lies in the absence of a pay level survey, we agree that there are a number of issues which must be addressed in respect of the existing PTS system, as has been pointed out by some of the respondents during consultation. To start with, the “broad comparison” principle is historically premised on a comparison with big companies with 100 employees or more. The established practice is that comparison should only be drawn with employers that are generally known as steady and good employers who conduct wage and salary administration on a

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<sup>8</sup> The starting salaries reviews in 1979 and 1989 were conducted as part of the overall salary structure reviews.



rational and systematic basis. As such, PTSs only collect data from large and reputable firms with 100 employees or more. To some extent, data so collected may be biased as the majority of the working population in Hong Kong work for small and medium sized enterprises with less than 100 employees. Unlike large firms, these enterprises are believed to be more volatile. To exclude them in the PTS could render the survey results less representative.

6.23 However, whether or not we include more smaller companies in the survey field, the ultimate question lies in the appropriate benchmarking sample for the pay adjustment survey. Consideration must be given to the representativeness of the economic sectors in general, the fulfilment of the criteria of a “good and steady” employer by companies in the sample, and the practical difficulty concerning participation.

6.24 Apart from comments on company size, the sample of surveyed companies is also subject to criticism for not being able to reflect accurately the territory-wide distribution of the economic population. Due to difficulty in finding companies to participate in the PTS in the past, and the need to maintain continuity in the survey sample, the survey population is heavily biased towards utility companies. This has led to allegations that the PTS results do not reflect accurately the general picture of pay adjustment, taking into account the economic population of all sectors as a whole. To address this inadequacy, the Pay Trend Survey Committee has, in recent years, included new companies from other economic sectors to the survey field, such as the “Wholesale, Retail and Import/Export” and the “Community, Social and Personal Service” sectors, with a view to securing a distribution that is more proportional to that of the territory as a whole. Nevertheless, progress made so far is slow due to the difficulty of finding and adding large number of surveyed companies in the under-represented sectors and the sheer size of the utility companies which are not easy to counter-balance over a short period of time.

6.25 Another common criticism is that the PTS does not take adequate account of the possibility that employees in a company may have received a pay increase only after the company has been downsized

or restructured. In the private sector, pay increase is a result of higher productivity in terms of output or value-added per employee, but in the civil service, productivity is difficult to measure and has not been a determinant of pay adjustment.

6.26 Under the existing pay-scale system, civil servants who have not reached the maximum points of their pay scales receive an annual increment in addition to the salary adjustment made in April each year. About 40% of the civil servants are in this group. Such practice is rare in the private sector and is therefore perceived as a kind of double adjustment. Although an increment deduction is applied to the gross PTIs every year, some critics argue that the value deducted does not adequately offset the value of increments, i.e. for those who have not reached the maximum points of their pay scales. (See also Appendix XI.)

6.27 Following the recommendation of the Burrett Committee in 1989, the Administration has established the practice that where the resulting PTI for the lower salary band is below that for the middle band, it is brought up to the same level unless there are over-riding reasons for not doing so. With changes in the distribution of the labour force and the socio-economic environment over the past ten years leading to an oversupply of labour and smaller increases in salaries at the lower end, the deliberate policy decision in the past may have aggravated the pay level imbalance between this group of civil servants and their private sector counterparts.

6.28 The fact that Hong Kong has experienced sustained economic growth from the 1970s to 1990s means that affordability, a factor for pay consideration at least on paper, had never been a prominent issue. Hence, the pay adjustment system in practice has become more or less a formula-based mechanism, which has the benefit of being straightforward and avoiding much argument with the staff sides. Whether this can continue is a matter that deserves serious consideration by the Administration given the current prolonged economic downturn.

6.29 In the past, pay increases for the civil service are applied across the board, without any regard to performance. Pay had only been

upwardly flexible and the reduction this year is only achieved by the introduction of highly controversial legislation. It is often a defence for objecting to pay cuts in the civil service that private sector bonuses in good years are not captured in the annual PTSs. Hence, it would be unfair for the civil service to follow private sector companies in cutting pay during bad times. This defence appears to be based on a misinterpretation of the PTS, as changes in bonuses are captured in the calculation of the PTIs.

6.30 To some extent, the responding stakeholders acknowledge that there are inadequacies in the existing pay adjustment system and some fine-tuning is required. We suggest that the existing PTS should be modernised to cope with the changing expectations from various stakeholders. The Administration should consider whether and what interim operational measures should be adopted, including whether or not the annual PTS in its current form should continue to be conducted in the interim period, pending an overall review of the pay adjustment system.

### **Further Consideration**

6.31 In the light of the Consultant's findings, we also suggest that, in Phase Two, a closer look should be taken as to whether the growing overseas trend of moving away from formula-based approaches in pay determination has any useful application to Hong Kong. Without going into details at this stage, we would point out that, in studying this issue, regard must be given to the contextual differences between Hong Kong and the countries surveyed.