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Panel on Public Service
Meeting on 20 November 2006

Background Brief
on the development of an improved pay adjustment mechanism
for the civil service

Purpose

This paper sets out the background to the development of an improved civil service pay adjustment mechanism, and summarizes the major views and concerns raised by Members on related issues at meetings of the Legislative Council (LegCo), the Panel on Public Service (PS Panel), the Bills Committee on Public Officers Pay Adjustment Bill (POPA Bill) and the Bills Committee on Public Officers Pay Adjustments (2004/2005) Bill (POPA 2004/2005 Bill).

Existing pay policy and system

2. The existing civil service pay policy is to offer sufficient remuneration to attract, retain, and motivate staff of a suitable calibre to provide the public with an efficient and effective service. Such remuneration should be regarded as fair both by civil servants and by the public which they serve. Within these parameters, broad comparability with the private sector is an important factor in setting civil service pay.

3. The substance of the existing civil service pay policy could be traced back to the 1960s. The 1965 Salaries Commission¹ recommended that civil service pay should be based on the principle of fair comparison with the private sector. This was further recommended by the 1968 and 1971 Salaries Commissions and accepted by the Government. In 1974, the Government decided to conduct a private sector pay trend survey (PTS)² in order to ensure that civil service pay moved broadly in line with that

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In the 1950s and 1960s, the Government appointed a Salaries Commission every few years to review the general levels of civil service pay and the salaries and structures of individual grades.

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The PTS aims to assess the average pay movements of full-time employees of private sector companies participating in the survey over a 12-month period from 2 April of the previous year to 1 April of the current year.

of the private sector. A PTS was then conducted on an annual basis up to 2002. In determining civil service pay adjustment, the Government takes into account the results of PTS and other relevant factors, including the state of the economy of Hong Kong, budgetary considerations, changes to the cost of living, the staff sides' pay claims and civil service morale.

Civil service pay adjustments since 2001

2001 civil service pay adjustment

4. Given the economic downturn in the late 1990s and pay reduction in the private sector, the upward adjustment in civil service pay announced in mid 2001 aroused public concern about the possible erosion of broad comparability of civil service pay with the private sector. The views expressed by various sectors of the community sparked a public debate on whether civil service pay levels were reasonable.

2002 civil service pay adjustment

5. Having regard to the state of the economy and the stringent fiscal position, the Financial Secretary (FS), in the 2002-2003 Budget Speech delivered on 6 March 2002, stated that he aimed to restore fiscal balance step by step through reducing the growth of Government expenditure and modestly raising revenue. FS stated that for financial planning purposes, he had assumed in the Medium Range Forecast that civil service pay and the salary-related portions of subventions to the various organizations would be reduced by 4.75% with effect from 1 October 2002. He also stated that any decision on a civil service pay cut needed to go through the legislative process before implementation. The assumption on civil service pay reduction made by FS before the findings of the 2001-2002 PTS were available caused concern that the Administration had a pre-determined stance on the pay adjustment exercise. It also invited queries on the need to implement civil service pay reduction by legislation.

6. In late April 2002, the Administration announced the findings of the 2001-2002 PTS. The net pay trend indicators for the three non-directorate salary bands were: -4.42% for the upper salary band (\$47,591 - \$97,325 a month), -1.64% for the middle salary band (\$15,520 - \$47,590 a month), and -1.58% for the lower salary band (below \$15,520 a month). Having considered all relevant factors including the staff sides' views, the Chief Executive (CE) in Council decided on 28 May 2002 that civil service pay should be adjusted downward in accordance with the findings of the 2001-2002 PTS, and that the POPA Bill should be introduced into LegCo.

7. The POPA Bill was introduced into LegCo on 5 June 2002. The Bill provided that the pay and allowances of public officers at different salary bands should be adjusted downward with effect from 1 October 2002 and specified the relevant rates of adjustment. A Bills Committee was formed to study the Bill. Having considered the

views of the Administration, Legal Adviser and the staff sides, some members of the Bills Committee were not convinced of the legislative approach to implement civil service pay reduction. In their view, the fact that the Administration pursued the legislative approach demonstrated that there was no sufficient legal basis for the Administration to reduce civil service pay. To rectify the situation once and for all, members requested the Administration to consider introducing a general enabling legislation on civil service pay adjustment mechanism, providing the legal framework for implementing upward and downward pay adjustments. Members considered this general enabling legislation more appropriate than the proposed one-off legislation to deal with the civil service pay reduction for 2002. While the Administration was prepared to give further thought to the suggestion, it considered that the proposed general enabling legislation and the Bill were not mutually exclusive. The Bill was subsequently passed in July 2002.

2003 civil service pay adjustment

8. Despite the civil service pay reduction with effect from 1 October 2002, the perceived pay disparity between the civil service and the private sector continued to be the focus of public attention. The 2003 civil service pay adjustment therefore remained a contentious issue. Given the pressing need to tackle the fiscal deficit problem, CE announced in his 2003 Policy Address the Government's target of cutting its operating expenditure by \$20 billion to \$200 billion by 2006-2007. To achieve this target, the Government sought, amongst other measures, to control its expenditure on civil service pay and personnel-related expenses.

9. On 21 February 2003, the then Secretary for the Civil Service reached a consensus with the staff side representatives on the 2003 civil service pay adjustment. Under the consensus, the pay pertaining to each pay point on the civil service pay scales would be restored to the level as it was, in dollar terms, on 30 June 1997. For all pay points at D3 and above or equivalent, the pay reduction would be effective from 1 January 2004. For all pay points below D3 or equivalent, the pay reduction would be implemented by two adjustments of broadly equal amount from 1 January 2004 and 1 January 2005 respectively. On 25 February 2003, the CE in Council decided that civil service pay should be reduced in accordance with the above consensus proposal and that the Administration should introduce legislation into LegCo as soon as possible to implement the pay reductions.

10. The POPA 2004-2005 Bill was introduced into LegCo on 21 May 2003. The Bill sought to implement the civil service pay reductions which were to take effect from 1 January 2004 and 1 January 2005 respectively, as mentioned in paragraph 9 above. A Bills Committee was formed to study the Bill. Some members of the Bills Committee reiterated their request that the Administration should introduce a general enabling legislation on civil service pay adjustment mechanism, providing the legal framework for implementing upward and downward pay adjustments. The Bill was subsequently passed in December 2003.

Review of pay policy and system

Objectives of the review

11. In response to calls for a review of the civil service pay levels and pay adjustment mechanism, the Administration announced on 18 December 2001 its decision to conduct a comprehensive review of the civil service pay policy and system with the assistance of the three advisory bodies on civil service salaries and conditions of service³. The objectives of the review were to identify means and ways to improve the civil service pay system having regard to best practices elsewhere, with a view to making it simpler and easier to administer, and building in more flexibility to facilitate better matching of jobs, talents and pay. The three advisory bodies subsequently set up the Task Force on Review of Civil Service Pay Policy and System (the Task Force) to take forward the review. The Administration indicated that pending the outcome of the review, the civil service pay adjustment for 2002 would be determined in accordance with the existing pay adjustment mechanism.

Recommendations of the Task Force

12. The review is conducted in two phases, with Phase One being an analytical study on recent developments and best practices in pay administration in other countries. On 25 April 2002, the Task Force published an Interim Report of the Phase One Study, which outlined the civil service pay policy and system in five selected countries, namely Australia, Canada, New Zealand, Singapore and the United Kingdom, for public consultation. At the LegCo meeting on 22 May 2002, a motion moved by Dr Hon LO Wing-lok “that this Council notes the Interim Report of the First Phase Review of Civil Service Pay Policy and System” was passed.

13. Taking account of overseas experience, the particular circumstances in Hong Kong as well as the feedback received during the consultation exercise on the Interim Report, the Task Force suggested in its Phase One Final Report published on 20 September 2002 the priority areas for more detailed study in the short, medium and long term, as follows:

- (a) *For the short term*, priority should be given to devising a practical framework and methodology for conducting a Pay Level Survey (PLS) and to reviewing the PTS methodology. Meanwhile, the Administration should consider the appropriate interim measures for the annual civil service pay adjustment exercise.

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The three advisory bodies are the Standing Commission on Civil Service Salaries and Conditions of Service, the Standing Committee on Disciplined Services Salaries and Conditions of Service, and the Standing Committee on Directorate Salaries and Conditions of Service.

- (b) *For the medium term*, an extensive and critical assessment of the staff appraisal system should be conducted to see what changes were needed to pave way for introducing elements of performance pay and flexible pay ranges to civil servants, preferably the directorate level initially. Consolidation of job-related allowances should also be adopted as a target, as part of a move towards a "clean wage" policy in the long run.
- (c) *For the long term*, decentralization of pay administration should be adopted as a target, after detailed studies were conducted to determine the scope of implementation at different stages and to see whether the challenges associated with each stage could be overcome. In addition, a "clean wage" policy with benefits incorporated into base pay should be adopted as a target.

Development of an improved civil service pay adjustment mechanism

14. When the PS Panel was briefed on 20 January 2003 on the outcome of the public consultation exercise on the Phase One Final Report of the Task Force, the Administration pointed out that it had received a total of 135 submissions during the consultation exercise. In view of the many complex issues involved, the Administration considered it appropriate to focus, in the first instance, on the suggested priority areas identified by the Task Force for detailed study in the short term. These included devising a practical framework and methodology for conducting a PLS and reviewing the PTS methodology, as well as considering the appropriate interim measures for the annual civil service pay adjustment exercise.

15. On 25 February 2003, in the context of the annual civil service pay adjustment exercise for 2003, the CE in Council decided that:

- (a) the Government should in consultation with staff develop, on the basis of the existing system, an improved civil service pay adjustment mechanism which should comprise the conduct of periodic PLSs to compare civil service pay levels with those in the private sector, the conduct of annual PLSs based on an improved methodology and an effective means for implementing both upward and downward pay adjustments. The Government should aim to complete this exercise, including the conduct of PLS, within 2004; and
- (b) no annual PTS should be conducted for 2002-2003 and 2003-2004. The 2004-2005 PTS would be carried out on the basis of an improved survey methodology to be drawn up.

16. In April 2003, the Civil Service Bureau (CSB) embarked on an exercise to develop an improved pay adjustment mechanism for long-term adoption in the service. To take forward the exercise, CSB set up the Steering Committee on Civil Service Pay Adjustment Mechanism (the Steering Committee) and the Consultative Group on Civil

Service Pay Adjustment Mechanism (the Consultative Group)⁴ to respectively provide professional and staff input to the exercise. CSB also engaged a consultant (Phase One Consultant) to provide technical assistance in drawing up a detailed and feasible methodology for PLS.

17. In November 2003, CSB issued a progress report to outline the relevant policy considerations, the proposed framework of the improved pay adjustment mechanism and the work plan for taking forward the exercise. When the PS Panel was briefed on the progress report at its meeting on 15 December 2003, members were informed by CSB that while the original intention was to complete the whole exercise in 2004, views had been expressed during the previous few months that adequate time should be allowed for detailed examination of the many complicated issues involved, in particular the detailed methodology of PLS and the application of the PLS results. To allow sufficient time for more extensive consultation and in view of the complexity of the issues involved, the Administration aimed to complete the whole exercise (including presentation of detailed proposals on the application of PLS results and the introduction of any necessary legislation for implementing both upward and downward pay adjustments) in the second quarter of 2005. The Administration planned to proceed with the field work of PLS in the fourth quarter of 2004.

18. When the PS Panel was briefed on the progress of PLS at its meeting on 21 June 2004, members were informed by CSB that during the period from December 2003 to June 2004, the Steering Committee and the Consultative Group respectively held seven and nine meetings/sessions to discuss various issues related to the exercise. In view of the latest progress of discussion in the Steering Committee and the Consultative Group, it was expected that the Phase One Consultant would submit his draft final report to CSB around end of June 2004.

19. In November 2004, CSB issued a consultation paper to set out the Phase One Consultant's recommendation on the methodology of PLS as well as CSB's proposals on the application of the survey results to the civil service. When the PS Panel was briefed on the consultation paper at its meeting on 15 November 2004, members were informed by CSB that in considering the application of the survey results to serving officer who joined the Government before 1 July 1997, the Administration had taken into account the relevant provisions of the Basic Law⁵ as well as the following considerations:

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The Steering Committee comprises selected members drawn from the Standing Commission on Civil Service Salaries and Conditions of Service, the Standing Committee on Disciplined Services Salaries and Conditions of Service, and the Standing Committee on Directorate Salaries and Conditions of Service. The Consultative Group comprises staff representatives from the staff sides of the four central consultative councils and the four major service-wide staff unions.

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Those Basic Law provisions which expressly mention civil service pay and are thus of particular relevance are Article 100 and Article 103. Article 100 provides that "Public servants serving in all Hong Kong government departments ... before the establishment of the Hong Kong Special Administrative Region, may all remain in employment and retain their seniority with pay, allowances, benefits and conditions of service no less favourable than before". Article 103 provides that "... Hong Kong's previous system of employment ... and management

- (a) It is the current Administration's policy that during its term of office ending 30 June 2007, the pay of civil servants who were serving immediately before 1 July 1997 will not be reduced to below the levels as at 30 June 1997 in dollar terms; and
- (b) Following the civil service pay adjustment on 1 January 2005 in accordance with the Public Officers Pay Adjustments (2004/2005) Ordinance, the pay pertaining to each pay point on the civil service pay scales will be restored to the level it was at, in dollar terms, on 30 June 1997.

20. Members of the PS Panel were also informed that given the above considerations and taking account of the feedback from the staff side members of the Consultative Group, the Administration proposed that if the PLS findings revealed that the civil service pay levels exceeded the private sector pay levels, the Administration should freeze the pay of these officers at the prevailing level until it was caught up by the private sector pay level. But the disparity would be noted and taken into account in the subsequent annual civil service pay adjustment exercises before the next PLS.

21. The PS Panel was briefed on the outcome of the consultation at its meeting on 21 March 2005. On 22 March 2005, the CE in Council decided that:

- (a) a PLS should be conducted in 2005 using the methodology as recommended by the consultant engaged for the design of the survey methodology and further refined following the recent consultation; and
- (b) with the conduct of PLS in 2005, there should be no annual PTS for 2004-2005. The Administration would further consider the future of PTS under the improved civil service pay adjustment mechanism.

22. When the PS Panel was briefed on the progress of PLS at its meeting on 20 June 2005, members noted that CSB had appointed Watson Wyatt Hong Kong Limited (Watson Wyatt) to carry out the actual field work of the survey (Phase Two Consultant). The field work would comprise three key stages (preparatory stage, information gathering stage, and information consolidation stage) with the third stage expected to be completed in November 2005. Given that Watson Wyatt had been commissioned by the Hong Kong General Chamber of Commerce (HKGCC) in 2002-03 to conduct a survey with results that civil service pay was much higher than that in the private sector, some members were gravely concerned that the consultant might have formed a pre-determined stance on civil service pay level and therefore could not carry out the survey in a fair and impartial manner. Representatives of the Police Force Council (Staff Side) then attended the PS Panel meeting on 21 November 2005 expressing their objection to the appointment of Watson Wyatt by the Administration

as the Phase Two Consultant for PLS for the civil service. They considered that the involvement of Watson Wyatt in the HKGCC survey and its appointment as the Phase Two Consultant of PLS had resulted in a conflict of roles, which seriously undermined the impartiality of Watson Wyatt and confidence of the staff side and the public on the credibility of the findings of the upcoming PLS. Members of the PS Panel shared their concern and passed the following motion at the meeting on 21 November 2005:

“That this Panel urges the Civil Service Bureau to accept the general request of civil service organizations to replace Watson Wyatt Hong Kong Limited, the Phase Two Consultant for conducting the pay level survey for the civil service.”

23. CSB, in its written response issued to the PS Panel in mid-December 2005, pointed out that it had followed strictly the established procedures set out in the Stores and Procurement Regulations in the selection and appointment of the Phase Two Consultant. Moreover, it had consulted the staff side members on the criteria for assessing proposals from consulting firms. Under the principle of fairness and impartiality, these pre-determined assessment criteria could not, and should not, be altered subsequently against a particular consulting firm due to other considerations not previously specified in the assessment criteria. Watson Wyatt, which received the highest score after the assessment process, was appointed to undertake the Phase Two Consultancy. In view of some staff bodies' concerns, CSB had reviewed the consultant selection process and appointment procedures. Having consulted the Department of Justice, CSB was satisfied that there was no valid reason to overturn the decision to appoint Watson Wyatt as the Phase Two Consultant.

24. The PS Panel was updated at its meeting on 19 December 2005 on the progress of PLS. Members were advised that the Phase Two Consultant projected that the job inspection process, which involved 193 ranks in 61 civil service grades, should be completed in around the first quarter of 2006. The data collection, consolidation and analysis work would then be carried out in around the second quarter of 2006.

25. On 10 January 2006, the CE in Council decided that :

- (a) subsequent to the last pay adjustment effected on 1 January 2005, the next round of civil service pay adjustment exercise should be carried out in 2006 when the findings of the current PLS were available;
- (b) the CE in Council's approval should be sought on how the findings of the current PLS would be applied in the subsequent civil service pay adjustment exercise; and
- (c) with the PLS collecting private sector pay data as at 1 April 2006, there should be no annual PTS for 2005-2006. The Administration should further consider the future of PTS under the improved civil service pay adjustment mechanism.

26. The PS Panel was updated on the latest progress of PLS at its meeting on 19 June 2006. Responding to members' concern about the delay of the survey, CSB advised that given the scope and complexity of PLS, as well as the need to conduct staff consultation each step of the way before asking the consultant to move forward, the process so far had taken longer than initially expected. Nevertheless, the time spent on thorough staff consultation was necessary and worthwhile. CSB also pointed out that as annual PTSs had not been carried out in the past two years, the Administration had to make reference to the findings of PLS and consider how to apply them to the civil service in order to work out the proposed civil service pay adjustment, if any. PLS would capture the latest pay levels in the private sector as at 1 April 2006 instead of 1 April 2005 as originally planned. This would enable the survey findings to reflect the latest pay levels in the private sector after the recent economic recovery. According to the latest progress of the survey, CSB was confident that the Phase Two Consultant could complete the survey and report the findings to CSB by the end of 2006. The Administration would continue to endeavour to complete the remaining tasks of PLS in full speed, aiming to conclude the findings of the survey in late 2006 and reach a decision on the application of the survey results around mid 2007 after consulting staff side on the proposed application.

Relevant papers

27. A list of relevant papers is in the **Appendix**.

Council Business Division 1
Legislative Council Secretariat
16 November 2006

**Development of an improved pay adjustment mechanism
for the civil service**

**List of relevant papers
(Position as at 16 November 2006)**

Paper	LC Paper No.
Paper provided by the Administration on “Interim Report of the First-Phase Review of the Civil Service Pay Policy and System”	CB(1)1600/01-02(01) <i>(discussed at the PS Panel meetings held on 2 May and 17 June 2002)</i>
Minutes of PS Panel meeting held on 2 May 2002	CB(1)1954/01-02 <i>(Agenda Item I)</i>
Hansard of the Council meeting on 22 May 2002 (Motion moved by Dr Hon LO Wing-lok on the Interim Report of the First-phase Review of Civil Service Pay Policy and System)	--
Minutes of PS Panel meeting held on 17 June 2002	CB(1)2630/01-02 <i>(Agenda Item IV)</i>
Paper provided by the Administration on “Phase One Final Report of the Task Force on Review of Civil Service Pay Policy and System”	CB(1)66/02-03(02) <i>(discussed at the PS Panel meeting held on 23 October 2002)</i>
Minutes of PS Panel meeting held on 23 October 2002	CB(1)261/02-03 <i>(Agenda Item III)</i>

Paper	LC Paper No.
Paper provided by the Administration on “Public Consultation on the Phase One Final Report of the Task Force on Review of Civil Service Pay Policy and System”	CB(1)721/02-03(04) <i>(discussed at the PS Panel meeting held on 20 January 2003)</i>
Minutes of PS Panel meeting held on 20 January 2003	CB(1)878/02-03 <i>(Agenda Item IV)</i>
Paper provided by the Administration on “Progress on the Development of an Improved Civil Service Pay Adjustment Mechanism”	CB(1)450/03-04(02) <i>(discussed at the PS Panel meeting held on 15 December 2003)</i>
Minutes of PS Panel meeting held on 15 December 2003	CB(1)771/03-04 <i>(Agenda Item IV)</i>
Paper provided by the Administration on “Progress on the Development of an Improved Pay Adjustment Mechanism for the Civil Service”	CB(1)2118/03-04(03) <i>(discussed at the PS Panel meeting held on 21 June 2004)</i>
Minutes of PS Panel meeting held on 21 June 2004	CB(1)2466/03-04 <i>(Agenda Item III)</i>
Paper provided by the Administration on “Development of an Improved Pay Adjustment Mechanism for the Civil Service: A Consultation Paper on the Proposals on the Methodology of the Pay Level Survey and the Application of the Survey Results”	CB(1)178/04-05(03) <i>(discussed at the PS Panel meeting held on 15 November 2004)</i>
Minutes of PS Panel meeting held on 15 November 2004	CB(1)482/04-05 <i>(Agenda Item IV)</i>

Paper	LC Paper No.
Paper provided by the Administration on “Outcome of the Consultation on the Proposals for the Pay Level Survey and the Way Forward”	CB(1)900/04-05(13) <i>(discussed at the PS Panel meeting held on 21 March 2005)</i>
Minutes of PS Panel meeting held on 21 March 2005	CB(1)1247/04-05 <i>(Agenda Item III)</i>
LegCo Brief on “Development of an Improved Civil Service Pay Adjustment Mechanism: Conduct of a Pay Level Survey”	CB(1)1163/04-05(01) <i>(File Ref: CSB CR/PG/085-001/46)</i>
Paper provided by the Administration on “Progress Update on the Development of an Improved Pay Adjustment Mechanism for the Civil Service”	CB(1)1767/04-05(01) <i>(discussed at the PS Panel meeting held on 20 June 2005)</i>
Minutes of PS Panel meeting held on 20 June 2005	CB(1)2191/04-05 <i>(Agenda Item III)</i>
Paper on the CSB website on “Consultancy on the Conduct of a Pay Level Survey for the Civil Service – Supplementary information”	--
Submission dated 2 September 2005 from the Police Force Council (PFC) Staff Associations	CB(1)2295/04-05(01)
Administration’s written response dated 17 September 2005 to the submission from the PFC Staff Associations	CB(1)2295/04-05(02)

Paper	LC Paper No.
Second submission dated 29 September 2005 from PFC Staff Associations	CB(1)104/05-06(01)
Administration's written response dated 19 October 2005	CB(1)104/05-06(02)
Third submission dated 26 October 2005 from PFC Staff Associations	CB(1)295/05-06(05)
Fourth Submission dated 14 November 2005 from PFC (Staff Side)	CB(1)295/05-06(06)
Minutes of PS Panel meeting held on 21 November 2005	CB(1)674/05-06 <i>(Agenda Item V)</i>
Paper provided by the Administration on "Development of an improved pay adjustment mechanism for the civil service: Progress update on the pay level survey"	CB(1)507/05-06(03) <i>(discussed at the PS Panel meeting held on 19 December 2005)</i>
Minutes of PS Panel meeting held on 19 December 2005	CB(1)965/05-06 <i>(Agenda Item III)</i>
Paper provided by the Administration on "Development of an improved pay adjustment mechanism for the civil service: Progress update on the pay level survey"	CB(1)1746/05-06(04) <i>(discussed at the PS Panel meeting held on 19 June 2006)</i>
Minutes of PS Panel meeting held on 19 June 2006	CB(1)2257/05-06 <i>(Agenda Item IV)</i>