

## **LEGISLATIVE COUNCIL BRIEF**

### **DEVELOPMENT OF AN IMPROVED CIVIL SERVICE PAY ADJUSTMENT MECHANISM - IMPROVEMENTS TO THE ANNUAL PAY TREND SURVEY METHODOLOGY**

#### **INTRODUCTION**

At the meeting of the Executive Council on 13 March 2007, the Council ADVISED and the Chief Executive ORDERED that -

- (a) the methodology of the pay trend survey (PTS) should be improved according to the proposals set out in paragraphs 7 to 11 below; and
- (b) a PTS based on the improved methodology should be conducted for the period 2 April 2006 to 1 April 2007.

#### **JUSTIFICATIONS**

##### **(A) Annual pay adjustment mechanism and previous criticisms**

2. From 1974 to 2002, a PTS had been conducted each year to ascertain the average year-on-year movements in private sector pay. Having regard to the pay trend indicators (PTIs) derived from the PTS and other relevant considerations (namely, the state of the economy, the Government's fiscal position, changes in the cost of living, pay claims of the staff sides and civil service morale), the Chief Executive (CE)-in-Council then decided on the specific rates of adjustment for civil service pay.

3. The existing PTS methodology, as set out in Annex A, was developed over the years through discussions between the management and the staff sides. It has come under criticisms since the mid 1990s. The major criticisms include -

- (a) the survey field does not cover small and medium private companies with fewer than 100 employees, which are the mainstay of the Hong Kong economy;
- (b) the survey field does not reflect the distribution of the working population by economic sectors;
- (c) the methodology does not take into account the downsizing, restructuring or cost-saving measures by private companies, which would have implications on the pay adjustments for their staff; and
- (d) the deduction of the civil service annual cost of increments from the gross PTIs<sup>1</sup> does not adequately offset the value gained by civil servants through the earning of increments, a practice which is rare in private companies.

## **(B) Improvements to the PTS methodology**

4. Pursuant to the decisions of the CE-in-Council in February 2003, we have been developing an improved civil service pay adjustment mechanism consisting of (a) the conduct of a Pay Level Survey (PLS) on a periodic and regular basis as the principal means to ascertain whether civil service pay is broadly comparable with private sector pay; and (b) the conduct of a PTS each year under an improved methodology.

5. With the help of a consultant, we have just completed the first PLS, using 1 April 2006 as the reference date. We are in the process of consulting the staff sides on how the results should be applied to the civil service, and hope to complete the consultations shortly.

6. Concurrently, we have developed, after extensive consultation with the staff sides, an improved methodology for the PTS. The improvements, set out in paragraphs 7 to 11 below, would address the criticisms in paragraph 3(a) and (b) above. For the reasons explained in Annex B, we have not made further changes to the methodology to deal with the criticisms in paragraph 3(c) and (d) above.

B

<sup>1</sup> The salaries of most civil service ranks are governed by a range of pay points on the relevant civil service pay scales (there are currently 11 sets of civil service pay scales). Subject to satisfactory performance (conduct, diligence and efficiency), a civil servant progresses to the next higher pay point each year until he has reached the maximum pay point of his rank. As the PTS covers both basic pay and variable pay (including non-guaranteed bonuses) in the private sector, the annual payroll cost of civil service increments (calculated as a percentage of the total salary payments for the specific year) is deducted from the gross PTIs to arrive at the net PTIs.

### **(a) Inclusion of smaller companies in the PTS survey field**

7. The majority of private companies employ fewer than 100 staff.<sup>2</sup> The past practice of only including companies with at least 100 employees in a PTS is out of step with the company and employment profiles in Hong Kong. To improve the credibility of the PTS, smaller companies with 50 to 99 employees will also be included in future PTSs. This arrangement strikes a reasonable balance between the need to improve the representativeness of the surveyed companies on the one hand, and the staff sides' concern that small companies tend to be less stable and do not administer pay on a rational and systematic basis on the other hand.

8. The following guidelines will be used for selection of smaller companies (i.e. those employing 50-99 staff) -

- (a) they have been operating in Hong Kong for a minimum period of around five years;
- (b) their employment size has not changed by more than 50% as compared with the previous year. The focus would be put on downward change, such that smaller companies whose employment size has reduced by more than 50% would be excluded from the PTS survey field. Smaller companies whose employment size has increased by more than 50% may, if considered appropriate, be included in the PTS survey field;
- (c) they have not been convicted of any charges under labour-related legislation<sup>3</sup> and should preferably have not been involved in labour disputes (even though the disputes have not resulted in convictions under labour-related legislation) in the past five years; and

<sup>2</sup> According to the statistics from the Census and Statistics Department (C&SD), around 70% of the employees in the private sector work in companies with fewer than 100 staff.

<sup>3</sup> There are at present more than 20 major labour-related ordinances. The majority of prosecutions against employers for non-compliance with the law are taken by the Labour Department pursuant to the Employment Ordinance (Cap.57), the Employees' Compensation Ordinance (Cap.282), the Occupational Safety and Health Ordinance (Cap.509) and the Factories and Industrial Undertakings Ordinance (Cap.59). The Mandatory Provident Fund Schemes Authority is responsible for taking action on any non-compliance with the Mandatory Provident Fund Schemes Ordinance (Cap.485).

(d) they administer pay for their staff on a rational and systematic basis.

9. In addition, regard would also be given to selecting private sector companies (which meet the relevant guidelines) in economic sectors under-represented in past PTSs. This would help to address the criticism in paragraph 3(b) above.

### **(b) Share of smaller companies in the PTS survey field**

10. We need to include a sufficient share of smaller companies in the survey field in order to enhance the representativeness of the PTS results. As a general guideline, around 25% of the PTS survey field should be taken up by smaller companies (i.e. those with an employment size of 50-99) and around 75% by larger companies (i.e. those employing 100 staff or more). This apportionment is based on the current distribution of the private sector employees by these two types of company size.<sup>4</sup> A deviation of around plus/minus 5 percentage points would be considered acceptable (i.e. smaller and larger companies accounting for 20%-30% and 70%-80% respectively of a PTS survey field). This flexibility is needed as the actual number of companies and the share between smaller and larger companies in a PTS will depend on how many smaller and larger companies agree to participate in the survey.

### **(c) Data consolidation methodology**

11. In the past, data collected in a PTS were consolidated using the weighted average approach, resulting in companies with large employment size dominating the survey results. Unless this approach is modified, the inclusion of smaller companies in a PTS would have totally insignificant impact on the survey results. To address this, a modified weighted average approach, as explained below, will be adopted to consolidate the data obtained from the surveyed companies and to work out the gross PTIs -

(a) the surveyed companies would be separated into two groups

<sup>4</sup> According to the statistics from C&SD, the distribution of employees by company size (excluding those employing less than 50 staff) in the private sector as at September 2006 was as follows:-

Company size	Total number of employees	Percentage (%)
50-99	247,364	24.57
100-499	317,689	31.55
500-999	111,344	11.06
≥ 1000	330,460	32.82
Total	1,006,857	100

by employment size, namely those employing less than 100 staff and those employing 100 or more staff;

- (b) a weighted average adjustment rate will be worked out for the companies in each group;
- (c) based on the distribution of private sector employees by company size (referred to in footnote 4 above), a gross-up factor of 0.25 will be applied to the weighted average adjustment rate for the group of companies with less than 100 staff and a gross-up factor of 0.75 will be applied to the weighted average adjustment rate for the other group. These two gross-up factors will remain unchanged irrespective of the actual number of surveyed companies in each of the two groups; and
- (d) the figures worked out under item (c) above will then be added up to give the gross PTIs.

**(C) Existing features of the PTS to be maintained**

12. Save for the improvements set out in paragraphs 7 to 11 above, the other existing features of the PTS methodology (as set out in Annex A) will be maintained, including -

- (a) the survey period (i.e. from 2 April of the previous year to 1 April of the current year);
- (b) other criteria for selection of participating companies (e.g. a company should not use government pay adjustments as the main factor in determining its pay adjustments);
- (c) the use of three salary bands<sup>5</sup> for the collection of data from surveyed companies;
- (d) the criteria for determining the types/components of pay adjustments to be included or excluded from the calculation of PTIs (e.g. fringe benefits, whether made in cash or in kind, are excluded from the calculation of PTIs); and

<sup>5</sup> The three salary bands are:

Lower band:	below Master Pay Scale (MPS) Point 10 or equivalent;
Middle band:	MPS Points 10-33 or equivalent
Upper band:	above MPS 33 to General Disciplined Services (Officer) Pay Scale Point 38 or equivalent

- (e) the deduction of the annual payroll cost of civil service increments from the gross PTIs to arrive at the net PTIs.

**(D) Other aspects relating to the PTS to be maintained**

13. The existing institutional arrangement for the conduct of PTS will be maintained, including –

- (a) the Pay Trend Survey Committee (PTSC) which is responsible for commissioning the PTS. The PTSC is chaired by a member of the Standing Commission on Civil Service Salaries and Conditions of Service (the Standing Commission), and comprises representatives from the Standing Commission, the Standing Committee on Disciplined Services Salaries and Conditions of Service (the Disciplined Services Committee), the staff sides of the four central consultative councils and the Administration;
- (b) the conduct of the PTS according to the agreed methodology by the Pay Survey and Research Unit (PSRU) of the Joint Secretariat for the Advisory Bodies on Civil Service and Judicial Salaries and Conditions of Service (JSSCS), reporting to the PTSC; and
- (c) the PTSC may propose changes to the PTS methodology for consideration by the Standing Commission, which will in turn tender its advice to the Administration.

14. In line with established policy and practice, upon completion of a PTS each year, the Administration will invite the staff sides of the four central consultative councils to submit their pay claims and then make a pay offer to them after the CE-in-Council has considered their pay claims and other relevant factors. The staff sides of the four central consultative councils will submit further views on the pay offer, and the Administration will make a final submission to the CE-in-Council for a decision on the specific rates of adjustment for civil service pay.

**(E) Conduct of the 2007 PTS and interface with the PLS**

15. The improved PTS methodology will be used for the conduct of the 2007 PTS, covering the period from 2 April 2006 to 1 April 2007. The net PTIs from this PTS will, together with other relevant factors, be submitted to the CE-in-Council for determining the adjustment rates for civil service pay with effect from 1 April 2007.

16. The adjustment rates for 2007-08 will be applied to the civil service pay scales prevailing on 1 April 2006. These scales will be determined having regard to the outcome of our consultations with the staff sides on how the PLS results should be applied to the civil service and the views of the advisory bodies on civil service salaries and conditions of service.

## **IMPLICATIONS**

17. The improved methodology is in conformity with the Basic Law, including the provisions concerning human rights. It also has no sustainability implications.

18. The financial implications could only be assessed after a decision is taken on any adjustment to civil service pay for 2007-08, and whether there will be any adjustment to the civil service pay scales as at 1 April 2006 having regard to CE-in-Council's decision on how the results of the PLS (with 1 April 2006 as the reference date) should be applied to the civil service. Following the past practice, the PTS will be conducted by the PSRU under the JSSCS.

19. As regards economic implications, currently the civil service makes up about 4% of the total workforce and civil service emoluments account for about 8% of the overall employment remuneration in the economy. The civil service and employees in subvented organizations together account for around 17% of the overall employment remuneration in the economy. A well-constituted civil service pay system that facilitates the matching of jobs, talents and pay is conducive to a robust and efficient civil service and sound deployment of manpower resources for the economy at large.

## **CONSULTATION**

20. The improved PTS methodology has been drawn up after extensive discussions with both the Steering Committee and the staff sides through the Consultative Group (CG) on Civil Service Pay Adjustment Mechanism<sup>6</sup>. It is supported by the staff sides. The Standing

<sup>6</sup> The Steering Committee and the Consultative Group on Civil Service Pay Adjustment Mechanism were set up in April 2003 to respectively provide professional and staff inputs to the task of developing an improved civil service pay adjustment mechanism. The Steering Committee comprises members drawn from the Standing Commission, the Disciplined Services Committee and the Standing Committee on Directorate Salaries and Conditions of Service. The Consultative Group comprises representatives from the staff sides of the four central consultative councils and the four major service-wide staff unions.

Commission also supports the improved methodology. We have also informed the Disciplined Services Committee and the Standing Committee on Directorate Salaries and Conditions of Service (the Directorate Committee) of the improved methodology, even though the matter falls outside their terms of reference.

### **PUBLICITY**

21. We will inform the advisory bodies on civil service salaries and conditions of service, heads of departments, the staff sides of the four central consultative councils, the four major service-wide staff unions and all civil servants of the CE-in-Council's decision. A press release will be issued and a spokesman will be available to answer media enquiries.

### **SUBJECT OFFICER**

22. Enquiries on this brief should be addressed to Mr. Chris Sun, Principal Assistant Secretary for the Civil Service (tel: 2810 3112).

Civil Service Bureau  
13 March 2007



## **A Note on the Pay Trend Survey**

### **Introduction**

A private sector Pay Trend Survey (PTS) has been carried out annually (until suspended since 2003) to ascertain the average year-on-year movements in private sector pay. Fringe benefits, whether made in cash or in kind, do not fall within the ambit of the survey.

### **Survey Period**

2. The survey covers the period from 2<sup>nd</sup> April of the previous year to 1<sup>st</sup> April of the current year.

### **Survey Field**

3. The criteria used in the selection of companies for inclusion in the survey are as follows:

- (a) the distribution of companies by major economic sectors in the survey field should reflect closely the overall distribution of Hong Kong's economically active population;
- (b) individual companies in the survey field should:
  - (i) be regarded as typical employers in their respective fields normally employing 100 employees or more;
  - (ii) be generally known as steady and good employers conducting wage and salary administration on a rational and systematic basis;
  - (iii) determine pay on the basis of factors and considerations applying to Hong Kong, rather than factors applying outside Hong Kong;
  - (iv) only be treated as separate companies where they have complete autonomy in setting and

adjusting pay rates if they form part of a group or consortium in Hong Kong.; and

- (v) not use the government pay adjustment as the main factor in determining pay adjustments.

### **Salary Bands**

4. Three salary bands are used for the collection of survey information. They are:

Lower band : below Master Pay Scale (MPS) Point 10 or equivalent

Middle band : MPS Points 10-33 or equivalent

Upper band : above MPS Point 33 to General Disciplined Services (Officer) Pay Scale (GDS(O)) Point 38 or equivalent.

### **Employees Covered**

5. The survey covers all employees in the participating companies with the exception of :

- (a) employees whose basic salaries are above the dollar amount of GDS(O) Point 38 or equivalent;
- (b) craft and technician apprentices;
- (c) part-time employees who are certified by the company concerned to work less than 75% of the normal weekly working hours in that company;
- (d) employees remunerated at piece-rates;
- (e) all imported labour; and
- (f) employees whose pay is determined on the basis of factors and considerations other than those applying to Hong Kong.

## **Components of Pay Adjustment**

6. Salary adjustments awarded to employees on account of the following factors are included in the calculation of the pay trend indicators (PTIs):

- (a) cost of living;
- (b) general prosperity and company performance;
- (c) general changes in market rates; and
- (d) inscale increment and merit.

7. Changes in payments additional to basic salary such as year-end bonuses are also included.

8. Salary adjustments attributed to external and internal relativities are identified and reported for reference. They are excluded from the calculation of the PTIs. (Note: Adjustments due to external relativities refer to those given to a specific group of employees in a company as a result of salaries paid by other companies for a similar job.)

## **Calculation Criteria**

9. The following criteria are used for the calculation of the PTIs:

- (1) All companies participating in the survey are included in the calculations provided that:
  - (a) they can furnish and confirm data on adjustments of salary and additional payments for not less than 75% of their total employees by a specified date;
  - (b) where appropriate, they can furnish, either separately or in an aggregate form, data on adjustments relevant to the calculation of the PTIs (i.e. the factors listed in paragraph 6 above); and
  - (c) their economic activities, company size or

salary structure have not changed to such an extent that it is no longer appropriate for the data provided by them to be compared with the data provided in the previous year.

- (2) Only data on salary adjustments and additional payments relating to the survey period and additional payments for the 12 months before the survey period reported belatedly are included in the calculation of the PTIs.
- (3) Data on salary and additional payments for company employees in a particular band are included in the calculation of the PTIs only if by a specified date the company has announced adjustments for not less than 75% of the employees in that band relevant to the survey period.
- (4) Adjustments attributable to external and internal relativities are excluded from the calculation of the PTIs.
- (5) Changes in bonus are taken into account and one month's bonus is taken as equal to 8.33% of the annual basic salary.
- (6) Changes in payments and monthly allowance reported in dollar terms are converted into annual percentage terms by relating them to the appropriate salary rates.
- (7) Where a range of percentage adjustments to a particular salary band is reported, the average figure is used.

### **Survey Results**

10. A PTS produces three gross PTIs, each representing the weighted average pay adjustment for all surveyed employees within each salary band. These PTIs are submitted to the Administration which then deducts from the indicators the respective payroll cost of civil service increments to produce the net PTIs. The net PTIs and other relevant factors are taken into consideration by the CE-in-Council when deciding on the adjustment rates for civil service pay for the year.

**Other Criticisms Against the Existing  
Pay Trend Survey Methodology**

Not factoring in downsizing etc. in the private sector (ref. paragraph 3(c) of the paper)

There have been criticisms that the pay trend survey (PTS) does not take into account the impact of downsizing, restructuring or cost-saving measures in private sector companies on their pay adjustments, and that this has caused a disproportionate rise in civil service pay over the years as compared with private sector pay.

2. In theory, we may request companies participating in a PTS to provide information on the downsizing, restructuring and cost-saving measures introduced for the period covered by the PTS, and to give an assessment of the impact of these measures on the pay adjustment decided for their staff. On the basis of such information, we may then consider how the information provided should be reflected in the calculation of the pay trend indicators (PTIs). In practice, companies are unlikely to entertain such request, partly because of the resources involved in putting together such information and partly because of potential commercial sensitivity. Indeed, we risk discouraging companies from agreeing to participate in a PTS if we insist on the provision of such information, and the consequential danger of further undermining the representativeness of the PTS survey field. Such information, even if it were provided by participating companies, may be highly qualitative and its interpretation difficult to ascertain.

3. Moreover, over the past few years, the civil service has also gone through downsizing and restructuring. There are inherent and practical difficulties in arriving at a fair comparison between the downsizing in the civil service and that in the participating companies in a PTS.

4. Having regard to the above, we do not consider it prudent to modify the PTS methodology to reflect the downsizing and other cost-saving measures that may have affected the pay adjustment of participating companies in a PTS. We further consider that the conduct of pay level surveys at periodic and regular intervals (as entailed under the improved civil service pay adjustment mechanism) and the consequential adjustments to civil service pay, as justified, would go a long way to ensuring that civil service pay does not outstrip private sector pay.

Deduction for civil service increments inadequate (ref. paragraph 3(d) of the paper)

5. There have been criticisms that the present arrangement for the deduction of the total payroll cost of increments of the civil service from the gross PTIs to give the net PTIs does not adequately offset the value gained by civil servants through the earning of annual increments, which is rare in the private sector. This deduction arrangement has been adopted since 1989, upon the recommendation of the Committee of Inquiry, to cater for the inclusion of merit pay in the private sector in the PTS.

6. We accept the provision of an annual increment is not a common feature in the private sector. However, it is an integral part of the civil service pay system. We consider the current arrangement, under which the actual total payroll cost of increments is deducted from the gross PTIs to give the net PTIs, fair and appropriate, and should continue to be adhered to. In addition, we note that the majority of serving civil servants (around 80% in overall terms and 99% for low ranking staff remunerated on the Model Scale 1 Pay Scale) have already reached their maximum pay points and are not eligible to earn annual increments.