

**BRIEF FOR THE LEGISLATIVE COUNCIL
CIVIL SERVICE PAY ADJUSTMENT 2001**

INTRODUCTION

At the meeting of the Executive Council on 5 June 2001, the Council ADVISED and the Chief Executive ORDERED that an offer of a pay adjustment of 4.99% for the directorate and the upper pay band and 2.38% for the middle band and the lower band, with effect from 1 April 2001, should be put to the Staff Sides of the four central consultative councils.

BACKGROUND AND ARGUMENT

Existing Policy and Methodology

2. The Government's policy on civil service pay adjustments is that the adjustment should be considered annually and that changes should be broadly in line with pay adjustments in the private sector. To this end, a survey of private sector pay trends is carried out annually. The results of the pay trend survey, after being discounted by the payroll costs of civil service increments, provide the basis for considering the size of the annual pay adjustment. A note on the pay trend survey methodology and the increment deduction formula is at ——— **Annex A**. Other factors taken into account include changes in the cost of living, the state of the economy, budgetary considerations, the Staff Sides' pay claims, and civil service morale.

2000-2001 Pay Trend Survey

3. The pay trend survey for 2000-2001 covered a total of 127 625 employees in 76 companies. Data was collected over the period from 2 April 2000 to 1 April 2001. The resulting pay trend indicators (PTIs) and net pay trend indicators (NPTIs) for the three non-directorate pay bands are as follows -

	2000-2001 Gross PTIs	Payroll cost of civil service increments	2000-2001 NPTIs
	(a)	(b)	(a-b)
Upper pay band (\$46,486 - \$92,700 p.m.)	6.15%	1.16%	4.99%
Middle pay band (\$15,160 - \$46,485 p.m.)	3.55%	1.17%	2.38%
Lower pay band (below \$15,160 p.m.)	2.95%	0.98%	1.97%

Cost of Living

4. The changes in the cost of living indices for the period 1 April 2000 to 31 March 2001, over the period from 1 April 1999 to 31 March 2000, are as follows¹ -

Consumer Price Index C [CPI(C)] (i.e. average monthly household expenditure of \$32,500 to \$65,999 at 1999/2000 prices)	-3.5%
Consumer Price Index B [CPI(B)] (i.e. average monthly household expenditure of \$18,500 to \$32,499 at 1999/2000 prices)	-3.0%
Consumer Price Index A [CPI(A)] (i.e. average monthly household expenditure of \$4,500 to \$18,499 at 2000 prices)	-2.4%

¹ As from the fourth quarter of 2000, the year-on-year rates of change in the consumer price indices are computed from the new 1999/2000 based CPI series. Before then, the rates of change are computed from the old 1994/95 based CPI series. Splicing has been applied to the indices to maintain continuity. This change of base for the CPIs is relevant to the reference period for the present pay adjustment exercise.

Composite CPI
(i.e. based on the expenditure pattern of all the above households taken together) -3.0%

State of the Economy

5. The Hong Kong economy picked up strongly in 2000. Externally, total exports of both goods and services grew markedly. This was due to the buoyant import absorption in the major markets, improved price competitiveness and productivity upgrading over the past two years. Internally, as employment and real income improved, consumer spending also increased further. The Gross Domestic Product (GDP) attained a double-digit growth at 10.5% in 2000, compared with the 3.1% growth in 1999, and this was the fastest growth recorded since 1987.

6. In the last few months of 2000, the economic environment had however turned less positive. The international oil price hike, the renewed setback and increased volatility in the US stock market, the plunge in the regional stock markets, and the subdued state of the property market locally all acted to weaken sentiment, and signs of slow-down in overall demand began to emerge. Since the beginning of 2001, growing concern about a slackening US economy and persistent sluggishness in the Japanese economy, and their ensuing impact on the global economy have dented sentiment further. The outlook for 2001 is for GDP to settle to a moderate growth path, after the sharp surge in 2000.

7. Labour market conditions improved further in 2000. The seasonally adjusted unemployment rate came down distinctly, from 6.3% in the fourth quarter of 1999 to 4.4% in the fourth quarter of 2000. The underemployment rate also fell. The distinct surplus in labour supply over labour demand prevalent in 1998 and 1999 narrowed considerably over the course of 2000, while vacancies rose markedly for most of the year. Labour earnings, having remained static in the first quarter of 2000, recorded a year-on-year increase of 2% in money terms in the ensuing three quarters. Likewise, labour wages, having shown no change in March 2000 from a year earlier, were higher by 1% in the remainder of the year. Yet after netting out the moderated decline in consumer prices, the increase in earnings and wages in real terms was somewhat smaller than the rise earlier in the year. The labour market eased slightly in the early part of 2001, along with the slow-down in overall economic activity. The seasonally adjusted unemployment rate edged up to 4.6% in February – April 2001. The underemployment rate nevertheless fell marginally further.

Budgetary Considerations

8. The provisional results for the past financial year ended 31 March 2001 show a deficit of \$7.8 billion for that year, which represents an improvement of \$3.6 billion over the revised deficit of \$11.4 billion announced in the 2001-02 Budget Speech. The improvement was due to revenue being \$2.2 billion better than expected, largely as a result of additional Profit Tax receipts, and expenditure being \$1.4 billion lower than forecast. For the current financial year ending 31 March 2002, the 2001-02 Budget forecasts a deficit of \$3.0 billion. A major assumption in the Budget is that we receive proceeds of \$15 billion from the sale of the second tranche of the MTR shares. Market conditions permitting, we plan to launch the sale within this financial year.

Staff Sides' Pay Claims

9. The pay claims from the Staff Sides are at **Annexes B to F**. Three of the four central consultative councils, namely the Police Force Council, Disciplined Services Consultative Council and Model Scale One Consultative Council have submitted pay claims which urge the Government to award a pay adjustment of no less than 4.99% across-the-board for all salary bands. Their submissions largely cover similar ground. They argue that the workload for civil servants at all ranks has increased as a result of Government initiatives such as the Enhanced Productivity Programme, Civil Service Reform and the measures to contain the size of the civil service. They also point out that civil service pay has been frozen for two years. For reason of staff morale, the Government should grant a pay adjustment of no less than 4.99% to all staff. Awarding a higher adjustment to the upper band and directorate will be divisive and will damage overall staff morale. The Model Scale One Council has stressed that 96% of their staff are already at the maximum of their pay scale and promotion opportunities for their grades are minimal. All the three councils have commented that the implementation of the Mandatory Provident Fund (MPF) Scheme in December 2000 has had an impact on the pay adjustment in the small and medium companies².

10. Two of the three members of the Senior Civil Service Council (the Senior Non-Expatriate Officers' Association and the Association of Expatriate Civil Servants of Hong Kong) have submitted pay claims which basically follow the NPTIs, i.e. the upper band and directorate should be awarded a pay adjustment of 4.99% and the middle band and lower band should be awarded a pay adjustment of 2.38%. The remaining member, Hong Kong Chinese Civil

² MPF is a fringe benefit which falls outside the purview of the pay trend survey.

Service Association (HKCCSA) has not submitted a specific pay claim but requested the Government to offer a reasonable upward pay adjustment taking into account all relevant factors.

2001 Pay Adjustment

(A) Outline

11. Having considered the above factors, we decide to put to Staff Sides the following pay offer which will take effect on 1 April 2001 –

	Net PTIs	Proposed Pay Adjustment
Directorate	N.A.	4.99%
Upper pay band	4.99%	4.99%
Middle pay band	2.38%	2.38%
Lower pay band	1.97%	2.38%

(B) Directorate

12. The adjustment for the directorate should follow that of the upper band, i.e. 4.99%. This has been the practice since 1990 and has been widely accepted.

(C) Upper Band and Middle Band

13. The pay adjustment for the upper band and middle band should follow strictly their respective NPTIs, i.e. 4.99% and 2.38%. This arrangement accurately reflects the adjustment of the private sector on the civil service and has been accepted by the Staff Sides as well as the public. We see no reason to depart from this.

(D) Lower Band

14. The pay adjustment for the lower band should be brought up to that of the middle band, i.e. 2.38%. This is in accordance with the prevailing Government practice following a recommendation of the 1988 Committee of Inquiry – where the NPTI for the lower band is below that of the middle band, it should be brought up to the same level, unless there are overriding reasons for not doing so.

(E) Alternatives

15. We have considered alternative pay adjustment levels which would effectively mean a departure from our long-standing and well established practice of following the NPTIs for the upper band and middle band and bringing up the adjustment of the lower band to that of the middle band. We do not feel this is in the interest of the civil service nor the community at large. Civil service pay has been frozen for two years. We consider, on the ground of civil service morale, that it is appropriate to adjust salaries this year and feel that it is reasonable and acceptable for the civil service pay adjustment to follow the NPTIs.

16. We are aware of the argument that awarding a higher adjustment rate to the upper band and directorate than that of the middle and lower band will exacerbate the problem of wealth gap in the community. However, we do not consider it appropriate to award a uniform rate across-the-board at either the upper band NPTI rate (4.99%) as requested by some of the central staff councils or the middle band NPTI rate (2.38%) for all bands. Given that different levels of pay adjustment are awarded in the private sector to the upper, middle and lower band, and as we follow the private sector, it is already an inherent feature of the mechanism that pay adjustment rates will not be uniform among the civil service bands. On the other hand, in accordance with the established practice, we propose to bring up the adjustment of the lower band to that of the middle band rate. Further bringing up of the adjustment for the middle and lower band will have significant financial implication for the Government. It is also inappropriate to do so for the reason explained above.

17. Since the introduction of the pay trend survey system in 1974, there have been only four occasions in which the pay adjustment departed from the results of the pay trend survey (details at **Annex G**). On each occasion, a conscious decision was taken based on the budgetary or economic situation. The situation this year does not justify a departure from the NPTIs.

IMPLICATIONS ON THE SUBVENTED SECTOR

18. It has been the Government's policy to extend the pay adjustment to subvented organisations whose salary adjustments in line with those in the civil service have been accepted as a case for funding. Appointments in subvented organisations are matters between the respective subvented bodies as employers and their employees. The relationship between the Government and the subvented organisations is one of funding, rather than Government having a direct staff management function. If we increase civil service salaries this year, the same will apply in the subvented sector by virtue of the funding arrangement. We have and will continue to keep the subvented organisations informed of the results of the pay trend survey and the agreed pay offer through the respective Controlling Officers.

IMPLICATIONS ON STARTING SALARIES FOR RECRUITS

19. With effect from 1 April 2000, starting pay has been delinked from the annual pay trend adjustment. To ensure the entry pay is in line with the level in the private sector, a benchmark review will be conducted every three to four years, with an annual updating in the interim. Though the delinking mechanism commenced on 1 April 2000, neither entry pay levels nor civil service pay scales have changed as there was no pay adjustment in 2000 and the first annual updating exercise carried out in 2000 did not result in any change to the level of starting pay. Should our proposal for a pay adjustment this year be approved, the delinking mechanism will begin to operate in that the starting pay points will not be adjusted by this year's pay adjustment while the pecuniary value of other pay points for serving staff will go upward. This means that the starting salaries for recruits from 1 April 2001 onwards and those who have joined the Civil Service recently and have not yet attained their first increment increase will continue to be paid at the 1999/2000 pay level (the delinked/frozen scale for recruits) until such time as they reach their anniversary date for increment jump or when a formal benchmark review is conducted in 2002/03 or 2003/04 which leads to an adjustment to the starting pay/benchmarks. We have already invited the Standing Commission on Civil Service Salaries and Conditions of Service to undertake the second annual updating exercise for starting salaries. We will study the results before we decide whether to undertake an entry pay review in 2002/03 or 2003/04.

FINANCIAL IMPLICATIONS

20. The cost of the proposed pay adjustment to take effect on 1 April 2001 for the Civil Service and subvented organizations in terms of salary and allowances is estimated to be \$3,975 million in 2001/02, calculated as follows-

	\$ million
(a) Civil Service	1,860
(b) Subvented Organisations	
(i) deficiency grants	1,164
(ii) discretionary grants	945
(c) Auxiliaries	6
Total	3,975

ECONOMIC IMPLICATIONS

21. Government, just like any other employer, has to compete for the manpower and expertise it needs, through offering appropriate salaries and other terms of employment. The results of the 2000-01 pay trend survey, on which our pay adjustment proposal is based, reflect what was generally awarded by employers in the private sector to their employees in the preceding year when labour market conditions for most of the year were improving. Currently, civil servants make up about 6% of the total workforce, with their emoluments accounting for about 9% of the overall employment remuneration in the economy or about 5% of GDP. (If employees in the subvented organisations are also included, the proportion of employment in the civil service and the subvented organisations in total workforce is estimated at around 10%. The respective shares of their emoluments in overall employment remuneration and GDP are around 18% and 9% respectively.) While the actual significance of any civil service pay adjustment on the overall labour market should not be taken out of proportion, very often its psychological impact is likely to be pronounced.

PUBLICITY

22. The Secretary for the Civil Service has presented the pay offer to the Staff Sides of the four central consultative councils in the afternoon on 5 June 2001. A press release was issued on the same day.

Civil Service Bureau
June 2001

Civil Service Pay Adjustment 2001 : Annexes

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| Annex E | Joint-signed Letter from the Senior Non-Expatriate Officers' Association and the Association of Expatriate Civil Servants of Hong Kong |
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| Annex G | Departure from Pay Trend Survey |

**Methodology for Determining the
Civil Service Pay Adjustment**

Annual Pay Trend Survey

The system of annual pay trend surveys was introduced in 1974. The survey is conducted by the independent Pay Survey and Research Unit (PSRU) of the Standing Commission on Civil Service Salaries and Conditions of Service.

2. The PSRU collects data from 76 Hong Kong companies on the following criteria -

- (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 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 in another country;
 - (iv) if they form part of a group or consortium in Hong Kong, only be treated as separate companies where they have complete autonomy in setting and adjusting pay rates; and
 - (v) not use the government pay adjustment as the main factor in determining pay adjustments.

3. The pay trend survey covers the period from 2 April of the previous year to 1 April of the current year. It includes all full time employees who work

75% or more of the normal weekly working hours and whose basic salaries are equivalent to the three salary bands of the non-directorate staff in the civil service. Basic salary increases relating to changes in the cost of living, overall changes in market rates, general prosperity and company performance, merit payments and inscale increments are accounted for in the survey. Changes in payments additional to basic salary such as year end bonuses, whether permanent or temporary, are also included¹.

4. The survey produces three gross PTIs, each representing the weighted average pay increases for all surveyed employees within each salary band. The payroll costs of civil service increments are then deducted from the gross PTIs to produce net indicators which form the basis for a decision on the civil service pay adjustment.

5. In the 26 years since the pay trend survey was introduced, the Government has been able to follow broadly the PTIs on the majority of occasions. There have been four periods in which the pay adjustment departed from the results of the pay trend survey (the details are set out in **Annex G**).

Increment Deduction

6. Prior to 1989, merit payments were excluded from the annual pay trend survey. At the same time, no account was taken of the value of increments in the civil service. For many years, there had been pressure from civil servants for private sector merit pay to be included because such payments were awarded in some firms on a scale which made them difficult to distinguish from general pay increases. However, agreement could not be reached with the Staff Sides on how civil service increments should be treated.

7. The existing formula used to calculate increment deduction for the purpose of determining the annual civil service pay adjustment was recommended by the 1988 Committee of Inquiry following a dispute with the Staff Sides over the 1988 pay adjustment. Its recommendation to value civil service increments at payroll cost², rather than at the weighted average percentage value⁴, was largely a compromise solution. In making the recommendation, the

¹ Our calculation method reflects any increases in additional payments in the year of award, and likewise registers the cessation of such payments in the subsequent year. Any one-off special payment in a private sector company would not have a permanent effect on civil service salaries.

² The formula for calculating the payroll cost of increment is :

$$\frac{\text{Actual increase in salary payments during the year due to increments awarded}}{\text{Total salary payments during the year}} \times 100\%$$

⁴Weighted average = $\frac{\text{No. of staff} \times \% \text{ of increase}}{\text{Total No. of Staff}}$

Committee of Inquiry was conscious of the long-standing arguments between the Administration and the Staff Sides on whether, and if so how, civil service increments should be discounted if merit pay in the private sector were to be included in the pay trend survey. The Committee considered it reasonable not to offset the full value of civil service increments against the gross PTIs for the following reasons -

- (a) Merit pay and increments are conceptually different. The former is a reward for performance whereas the incremental scale considered as a whole is the rate for the job.
- (b) A large proportion of civil servants (63% as at 1.4.2001) do not receive increments. They would not accept any scheme which would significantly reduce the level of civil service pay adjustment to take account of increments which they do not enjoy.

Departure from Pay Trend Survey

Since introduction of the PTS in 1974, there have been four periods in which the pay adjustment departed significantly from the results of the pay trend survey. Details as follows –

Year	Salary Band	Pay Trend Indicator (%)	Average Civil Service Pay Adjustment (%)	Reasons
(1) 1974/75	MOD I	8.12	Nil	Oil crisis, high inflation
	\$600	8.36	Nil	
	\$2,500	7.92	Nil	
	\$8,000	9.26	Nil	
1975/76	MOD I	3.94	12.86	Compound the 1974/75 increase
	\$600	4.71	13.04	
	\$2,000 - \$4,000	4.42	12.99	
	\$7,000 - \$8,000	3.68	12.90	
(2) 1981/82	MOD 1/Lower	16.18	15.00/15.01	Inflation pressure
	Middle	15.57	14.95	
	Upper	15.65	14.96	
1982/83	MOD 1/Lower	8.80	5.52/5.53	Collapse of property market, projection of budget deficit
	Middle	7.88	4.74	
	Upper	7.24	4.48	
1983/84	MOD 1/Lower	9.86	11.21	Staff Sides' pay claims
	Middle	8.64	9.93	
	Upper	8.45	9.12	
(3) 1989/90	MOD 1/Lower	15.11	15.00	High inflation, need to curb government expenditure
	Middle	16.46	15.00	
	Upper	17.00	15.00	
1990/91	MOD 1/Lower	12.09	10.43	High inflation
	Middle	12.49	10.43	
	Upper	11.88	10.43	
1991/92	MOD 1/Lower	10.68	11.60	The adjustment for MB and LB is based on CPI(A), so as to restore the real value of their salaries.
	Middle	10.82	11.60	
	Upper	11.17	11.17	
(4) 1997/98	MOD 1/Lower	5.01%	5.01%	*Pay for D3 and above frozen.
	Middle	5.79%	5.79%	
	Upper*	6.03%	6.03%	
1998/99	Mod 1/Lower	-0.54%	Nil	FS announced in Budget that freeze would be the limit for the exercise.
	Middle	+0.84%	Nil	
	Upper	-0.13%	Nil	
1999/00	MOD 1/Lower	-1.78%	Nil	Pay freeze across-the-board.
	Middle	-1.97%	Nil	
	Upper	-0.41%	Nil	