

**BRIEF FOR THE LEGISLATIVE COUNCIL
CIVIL SERVICE PAY ADJUSTMENT 2000**

INTRODUCTION

At the meeting of the Executive Council on 30 May 2000, the Council ADVISED and the Chief Executive ORDERED that civil service pay should be frozen in 2000-01.

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 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. Each pay adjustment is a separate annual exercise based on circumstances prevailing at the time.

1999-2000 Pay Trend Survey

3. The pay trend survey for 1999-2000 covered a total of 122 273 employees in 71 companies. Data was collected over the period 2 April 1999 to 1 April 2000. The resulting pay trend indicators (PTIs) for the three non-directorate pay bands are as follows -

	1999-2000 Gross PTIs	Payroll cost of civil service increments	1999-2000 Net PTIs
	(a)	(b)	(a-b)
Upper pay band (\$46,486 - \$92,700 p.m.)	0.87%	1.28%	-0.41%
Middle pay band (\$15,160 - \$46,485 p.m.)	-0.70%	1.27%	-1.97%
Lower pay band (below \$15,160 p.m.)	-0.62%	1.16%	-1.78%

Cost of Living

4. The decreases in the cost of living indices for the period 1 April 1999 to 31 March 2000, over the period from 1 April 1998 to 31 March 1999, are as follows -

Consumer Price Index C [CPI(C)] (i.e. average monthly household expenditure of \$34,000 to \$68,700 at 1999 prices)	-4.9%
Consumer Price Index B [CPI(B)] (i.e. average monthly household expenditure of \$18,000 to \$34,000 at 1999 prices)	-5.4%
Consumer Price Index A [CPI(A)] (i.e. average monthly household expenditure of \$4,500 to \$18,000 at 1999 prices)	-3.9%
Composite CPI (i.e. based on the expenditure pattern of all the above households taken together)	-4.8%

State of the Economy

5. The Hong Kong economy staged a sharp rebound over the course of 1999. The recovery was strongly export-led. The Gross Domestic Product (GDP), though still recording a 3.0% decline in real terms in the first quarter of 1999 over a year earlier, rebounded to a 1.1% rise in the second quarter, and accentuated further to increases of 4.4% in the third quarter and as much as 8.7% in the fourth quarter. For 1999 as a whole, GDP grew by 2.9% in real terms, in stark contrast to the 5.1% decline in 1998. The latest figure shows a further robust growth of 14.3% in real terms in the first quarter of 2000 over a year earlier.

6. The turnaround owed much to the remarkably flexible and adaptable attitudes of our workers and entrepreneurs. Rentals have come down markedly to ease business costs. Wages and salaries have also been moderating, moving into a year-on-year decline by the second quarter of 1999. Along with virtually zero imported inflation, these cost reductions increased our competitiveness and at the same time resulted in consumer prices falling by an average of 4% in 1999, the first annual decline since the Composite CPI series became available in 1982.

7. Local consumer spending was back on a growth track by the second quarter of 1999. It strengthened further in the third and fourth quarters, as local economic conditions progressively improved and the employment situation stabilised. For 1999 as a whole, consumer spending grew by 1.1% in real terms, reversing the 6.7% decline in 1998. The latest figure shows an 8.3% growth in real terms in the first quarter of 2000 over a year earlier. But overall investment spending continued to fall, by 17.6% in real terms in 1999, after a 6.4% decline in 1998. Encouragingly, this decline moderated considerably in the latter part of the year and has resumed positive growth, at 5.6% in real terms in the first quarter of 2000 over a year earlier.

8. The labour market remained slack in the early part of 1999, yet a steady improvement was observed thereafter. The seasonally adjusted unemployment rate fell from 6.2% in the first quarter of 1999 to 5.5% in the first quarter of 2000. The underemployment rate likewise edged lower, from 3.0% to 2.8% over the period.

Budgetary Considerations

9. Based on the provisional outturn, we have a budget surplus of \$9.9 billion for 1999-2000. This dramatic improvement in our fiscal position came about mainly because of a "windfall" from investment earnings on our fiscal reserves invested with the Exchange Fund. This in turn was due to the

surge in the Hang Seng Index by 70% during 1999 that boosted the value of the portfolio of Hong Kong stocks acquired by the Exchange Fund in 1998. For 2000-01, even taking into account the estimated one-off proceeds of \$15 billion from the partial privatisation of the MTRC, the Financial Secretary is forecasting a budget deficit of \$6.2 billion. More importantly, we are forecasting a situation of recurrent expenditure, the bulk of which is spent on payroll, exceeding considerably recurrent revenue throughout the medium term. The Financial Secretary has announced the setting up of a Task Force to review whether the successive operating deficits reflect a structural or cyclical problem in our public finances.

Staff Sides' Pay Claims

10. Three of the four central consultative councils and two of the three members of the Senior Civil Service Council have submitted pay claims which urge the Government to freeze civil service pay despite the NPTIs for all salary bands. Their submissions largely cover similar grounds. They argued that apart from the indicators, other important factors should be considered, notably staff morale and the budgetary situation. Given the increasing demand for more efficient services and various Government initiatives such as the Enhanced Productivity Programme, the Civil Service Reform and the measures to contain the size of the civil service, any move further than a pay freeze is unacceptable and will damage morale. In addition, given the surplus of \$9.9 billion this year, it is not necessary to reduce pay. The Model Scale 1 Staff Consultative Council also pointed out that the 1998-99 NPTI for the middle band of +0.84% had not been given to them last year and over 90% of their staff have already reached the maximum point.

11. The Hong Kong Chinese Civil Service Association (HKCCSA) has submitted a claim for a 1.61% pay increase across the board. They argued that consideration should be given to the accumulated shortfalls in pay adjustment during the period from 1989-90 to 1998-99, which amount to 3.58% for the middle band and 3.32% for the upper band. Taking into account the NPTIs for 1999-2000, the accumulated shortfalls comes to 1.61% for the middle band and 2.91% for the upper band. The HKCCSA's submission is not consistent with the established pay policy in that each pay adjustment exercise is taken as a separate and independent exercise based on circumstances prevailing at the time. We do not consider that they have any valid basis to seek to recover any perceived shortfalls arising from previous pay adjustments. Accordingly, we reject this pay claim.

2000 Pay Adjustment

12. Having considered carefully all the relevant factors, including the indicators, changes in the cost of living, the state of the economy, budgetary considerations, the Staff Sides' pay claims and civil service morale, we consider civil service pay should be frozen in 2000-01.

IMPLICATIONS ON THE SUBVENTED SECTOR

13. 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 implications for the Government and the subvented organisations are of funding, rather than staff/management relationships.

14. The decision to freeze civil service salaries this year will apply in the subvented sector by virtue of the funding arrangement. We have kept the employers of the subvented organisations informed of the decision through the respective Controlling Officers.

LEGAL IMPLICATIONS

15. Legal advice is that the Government could not unilaterally impose a reduction in pay upon its employees without their consent, notwithstanding that the reduction would be in accordance with the Pay Trend Survey. We see no prospect that we could reach agreement with the Staff Sides on this.

FINANCIAL IMPLICATIONS

16. The decision to freeze civil service pay will have no financial implication.

17. Had we implemented the reduction this year, the savings arising from a reduction for the civil service and subvented organisations in terms of salary and allowances is estimated to be \$1,760 million.

ECONOMIC IMPLICATIONS

18. 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 pay trend survey for 1999-2000 reflected that the pay adjustment awarded by employers in the private sector to

their employees in the preceding year were either nil or marginally downward. Currently, civil servants make up about 6% of the total workforce, with their emoluments accounting for about 10% 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 will be around 20% and 10%). While the actual significance of any civil service pay adjustment or otherwise on the overall labour market should not be taken out of proportion, its psychological impact could be much greater under the present circumstances.

PUBLICITY

19. The Secretary for the Civil Service has presented the decision to the Staff Sides of the four central consultative councils and subvented organisations. We have explained to them that there will be a freeze this year.

20. A press release was issued on the same day.

SUBJECT OFFICER

21. Enquiries concerning this brief should be addressed to Cecilia Yen, Principal Assistant Secretary for the Civil Service (Special Duties) (Tel.: 2810 3113).

Civil Service Bureau
May 2000

**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 71 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.

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.