

**BRIEF FOR THE LEGISLATIVE COUNCIL
2002 CIVIL SERVICE PAY ADJUSTMENT**

INTRODUCTION

At the meeting of the Executive Council on 22 May 2002, the Council ADVISED and the Chief Executive ORDERED that –

- (a) an offer of a pay reduction of 4.42% for the directorate and the upper salary band, 1.64% for the middle salary band, and 1.58% for the lower salary band, with effect from 1 October 2002, should be put to the staff sides of the four central consultative councils;
- (b) agreement in principle should be given to the draft Public Officers Pay Adjustment Bill (the Bill) at Annex A;
- (c) a copy of the draft Bill should be provided to the staff sides of the central consultative councils for comment concurrently when making the pay offer;
- (d) the Council's approval of the Bill, with the rates of adjustment specified for the respective salary bands, should be sought if following consideration of the reaction of the staff sides to the pay offer it is eventually decided that civil service pay should be reduced; and
- (e) pending further consideration of the new arrangement for determining the pay and conditions of service for judicial officers, the pay reduction currently proposed for civil servants will not be applied to judges and judicial officers.

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. In deciding on the size of the annual adjustment, we take into account the following factors: the net pay trend indicators (PTIs) derived from an independent private sector pay trend survey, the state of the economy, budgetary considerations, changes in the cost of living, the staff sides' pay claims and civil service morale.

3. The private sector pay trend survey is carried out annually by the independent Pay Trend Survey Committee. The survey produces the gross PTIs, which represent the movements in private sector pay for different salary bands during the period from 2 April of the previous year to 1 April of the survey year. The payroll costs of civil service increments are then deducted from the gross PTIs (which take account of additional payments such as year-end bonuses) to produce the net PTIs. A note on the methodology of the annual pay trend survey is at Annex B.

2001-2002 Pay Trend Survey

4. The pay trend survey for 2001-2002 covered a total of 130 854 employees in 91 companies. Data was collected over the period from 2 April 2001 to 1 April 2002. The resulting gross PTIs and net PTIs for the three non-directorate salary bands are as follows -

	2001-2002 gross PTIs	Payroll cost of civil service increments	2001-2002 net PTIs
	(a)	(b)	(a-b)
Upper salary band (\$47,591 - \$97,325 a month)	-3.39%	1.03%	-4.42%
Middle salary band (\$15,520 - \$47,590 a month)	-0.60%	1.04%	-1.64%
Lower salary band (Below \$15,520 a month)	-0.79%	0.79%	-1.58%

Cost of Living

5. The changes in the cost of living indices for the period 1 April 2001 to 31 March 2002, over the period from 1 April 2000 to 31 March 2001, are as follows -

Consumer Price Index C [CPI(C)] (i.e. average monthly household expenditure of \$31,801 to \$64,600 at 2001 prices)	-1.7%
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Consumer Price Index B [CPI(B)] (i.e. average monthly household expenditure of \$18,101 to \$31,800 at 2001 prices)	-1.8%
Consumer Price Index A [CPI(A)] (i.e. average monthly household expenditure of \$4,400 to \$18,100 at 2001 prices)	-1.9%
Composite CPI (i.e. based on the expenditure patterns of all the above households taken together)	-1.8%

State of the Economy

6. The Hong Kong economy underwent a distinct downturn in 2001, and economic activity remained generally modest in the first quarter of 2002. Externally, total exports of goods were still distinctly slack in January and February, yet they picked up in March as the global and regional economic conditions improved. Exports of services continued to fare relatively better, with growth advancing on the back of a swift recovery in inbound tourism and sustained rise in offshore trade. Locally, domestic demand however remained sluggish. While consumer demand moderated further along with rising unemployment and wage restraint, investment spending continued to plummet.

7. The labour market, having eased visibly after mid-2001, slackened markedly further in the first quarter of 2002. This was due to a contraction in total employment amidst more extensive corporate downsizing and lay-offs, in tandem with the economic setback. Also relevant was a sustained increase in total labour force in line with the population growth. The seasonally adjusted unemployment rate surged to a new high of 7% in the first quarter of 2002. The underemployment rate also moved up to 3.2%.

8. Overall consumer prices, having been on a continuous downtrend since late 1998, fell further in the first quarter of 2002. While domestically generated cost pressure continued to subside, import prices softened more under the combined effect of a strong US dollar and generally subdued inflation in the major supplier economies. Also keeping prices down were the Government's rates relief and the concessions on certain public utility and transport charges. The Composite CPI fell by 2.6% in the first quarter of 2002 over a year earlier, after a 1.6% decrease in 2001.

9. With the adverse external environment carried over from last year likely to gradually turn better over the course of this year, the Hong Kong economy is expected to stage a modest pick-up in 2002. Yet certain downside risks still prevail, including a possible relapse in the US economy and hence in

the global economy externally and the still subdued sentiments amongst consumers and businesses locally. For 2002 as a whole, GDP is forecast for a small growth of 1% in real terms.

Budgetary Considerations

10. In his 2002 Budget Speech, the Financial Secretary has set three targets to be achieved by 2006-07, which are to restore balance in the Consolidated Account, to attain a balanced Operating Account and to reduce public expenditure to 20% of GDP or below. In pursuit of these targets, the Government will contain annual growth of government expenditure from 2003-04 to 2006-07 at an average of 1.5% in real terms, or 1% in money terms, lower than the forecast economic growth rate for the same period. The Financial Secretary has assumed, for financial planning purpose, a 4.75% reduction in civil service pay and a corresponding reduction in the salary-related portion of subventions to various organisations to take effect from 1 October 2002, which will provide savings on government expenditure of about \$3 billion in 2002-03 and about \$6 billion in a full year. With this assumption, the Financial Secretary estimated a consolidated deficit of \$65.6 billion and \$45.2 billion for 2001-02 and 2002-03 respectively. The Financial Secretary has stated that other measures to control growth in government expenditure include reviewing our priorities for the deployment of resources, streamlining organisation, simplifying procedures and utilising market forces. The Financial Secretary has also stated that the Government will continue to adopt the existing mechanism in considering this year's civil service annual pay adjustment.

Staff Sides' Pay Claims

11. The pay claims from the staff sides of three central consultative councils (namely the Senior Civil Service Council, the Model Scale One Staff Consultative Council and the Disciplined Services Consultative Council) are at Annexes C to E. All of them urge the Government to freeze civil service pay for all salary bands despite the negative net PTIs. Their submissions cover similar grounds. They argue that in addition to the net PTIs, the Government should also consider the other important factors under the existing pay adjustment mechanism such as the state of the economy and staff morale. They point out the civil service has in recent years been under considerable work pressure as a result of the increasing demand for more efficient public services and various Government initiatives to enhance performance (e.g. the Enhanced Productivity Programme, outsourcing and measures to contain the size of the civil service). A pay freeze in such circumstance would be preferable in order to maintain staff morale. They further opine that a reduction in civil service pay would have a negative impact on consumer spending, which in turn would not be conducive to the recovery of the economy. While noting the fiscal deficit, they suggest that the Government should tackle the problem through other means rather than a pay

reduction. The staff side of the Model Scale One Staff Consultative Council also points out that over 98% of the Model Scale One staff are already at the maximum pay point with a monthly salary ranging between \$8,825 and \$11,500. A pay reduction would seriously affect their standard of living. The staff side of the Police Force Council has not submitted any pay claim.

2002 Civil Service Pay Adjustment

12. Having considered carefully all the relevant factors under the established adjustment mechanism, the Chief Executive in Council decided that an offer of a pay reduction of 4.42% for the directorate and the upper salary band, 1.64% for the middle salary band and 1.58% for the lower band with effect from 1 October 2002 should be put to the staff sides of the four central consultative councils.

IMPLICATIONS ON JUDICIARY

13. In recognition of the independent status of the Judiciary and the fact that the pay and conditions of service of the judges and judicial officers are determined separately from the civil service, the Administration has been discussing with the Judiciary for some time the establishment of a new institutional structure and mechanism as well as the appropriate methodology for the determination and revision from time to time of the pay and conditions of service for judges and judicial officers. We understand that the Chief Justice intends to make a proposal in early 2003 to the Administration for consideration. The proposal will be based on a consultancy study which the Judiciary has commissioned on overseas practice and will be made after consultation with judges and judicial officers.

14. In view of the above considerations, the Chief Executive in Council has decided not to apply the proposed pay reduction to judges and judicial officers in the draft legislation¹ being considered. However, when the new institutional structure, mechanism and methodology are in place, an assessment will be made within that structure as to whether the pay reduction currently proposed for civil servants should also be applied to judges and judicial officers and if so, as from what date.

IMPLICATIONS ON THE SUBVENTED SECTOR

15. The annual civil service pay adjustment has an impact on government's funding to the subvented sector, in that some subvented organisations receive subventions which are price-adjusted on the basis of formulae including a factor of civil service pay adjustment. When civil service pay is increased, we price-adjust such subventions accordingly. If it is finally decided to reduce civil

¹ Please see paragraph 22 below.

service salary, we shall similarly reduce such subventions. This is, therefore, a matter of funding. In reducing subventions as a result of a reduction of civil service pay, we will not be requiring the subvented sector to make similar adjustments to the pay of their staff. The question of pay for subvented staff is generally a matter between the subvented organisations and their employees.

16. Separately, however, in line with the general subvention principle, subvented organisations will have to review whether the remuneration packages for subvented staff remain no better than those for comparable civil service grades after an adjustment of civil service pay. The Controlling Officers will be in close touch with the subvented organizations on the necessary follow-up action in these organizations as a result of the final decisions on the 2002 civil service pay adjustment and will render assistance as appropriate.

IMPLICATIONS ON STARTING SALARIES FOR CIVIL SERVICE RECRUITS

17. With effect from 1 April 2000, starting salaries have been delinked from the annual civil service pay adjustment. An appointee recruited in a particular year on the delinked starting salary will remain on that salary until he qualifies for an increment after which he will join the respective pay scale and move along the adjusted scale in subsequent years. As a result of this delinking arrangement, any adjustment to the civil service pay scales, whether positive or negative, will not apply to the starting salaries. Legal advice has confirmed that in the event of a general civil service pay reduction, it would not be in order to subject those public officers who are on the starting salaries to such a reduction. We should, however, point out that when these officers eventually join the adjusted pay scale, their pay level will thereupon reflect the effect of the pay reduction.

LEGAL IMPLICATIONS

Basic Law implications

18. The Department of Justice has advised that the constitutional protection given to public servants under Article 100 of the Basic Law apply only to those officers who were serving in Hong Kong immediately before the establishment of the HKSAR on 1 July 1997. These officers are entitled to remain in employment and retain their seniority with pay, allowances, benefits and conditions of service no less favourable than before. Article 103 of the Basic Law further provides, among other things, that Hong Kong's previous system of management for the public service, including special bodies for advising on their pay and conditions of service, shall be maintained. Specifically on pay, legal advice is that it would clearly be consistent with the relevant provisions of the Basic Law if the revised pay levels of these officers are determined after

considering the usual relevant factors under the existing mechanism for the annual civil service pay adjustment, and are either at or above the level in cash terms at 30 June 1997.

19. As regards Article 160(2) of the Basic Law, the legal advice is that this provision ensures that rights enjoyed immediately prior to 1 July 1997 are not affected by the change of sovereignty. It does not prevent subsequent amendments to those contractual arrangements, provided those amendments do not contravene other provisions in the Basic Law. While, therefore, it is arguable that the provision would protect the salaries contractually payable on 30 June 1997, it would not protect any subsequent addition to an officer's salary and would not inhibit a statutory reduction back to the levels as at 30 June 1997.

Contractual implications

20. The employment arrangements for a civil servant are governed by the provisions set out in a letter of appointment and the Memorandum on Conditions of Service (MOCS) attached to the letter. The standard MOCS applicable to civil servants provides that the Government reserves the right to alter any of the officer's terms of appointment, and/or conditions of service set out in the MOCS or letter of appointment, should the Government at any time consider this to be necessary. However, this variation clause in most MOCS now in force does not expressly reserve the right to reduce the salaries of civil servants. There is therefore a risk that a decision to reduce civil service pay without legislation would be subject to a successful legal challenge.

21. To overcome the above-mentioned legal difficulties, legal advice is that we should seek the enactment of legislation to provide for an express reduction of civil service pay and to provide that each officer's contract shall be modified to the extent of the statutory variation. This approach will ensure that subject to the passage of the legislation by the Legislative Council, the policy decision to reduce civil service pay made in accordance with the established pay adjustment mechanism will be implemented with certainty.

LEGISLATION TO IMPLEMENT THE 2002 CIVIL SERVICE PAY ADJUSTMENT

22. In the light of the legal advice, we propose that in the event of a policy decision this year to reduce civil service pay, we should introduce legislation to clearly provide for the specified rates of adjustment for different salary bands with effect from a specified date. Consistent with our objective to facilitate the smooth implementation of a pay reduction, if finally decided, the proposed legislation should provide for the following –

- (A) categories of officers intended to be subject to the pay reduction;
- (B) allowances intended to be subject to the pay reduction;
- (C) rates of reduction for different categories of affected officers and allowances;
- (D) implementation date of the pay reduction; and
- (E) exemptions from the Bill as appropriate.

The draft Bill, entitled the Public Officers Pay Adjustment Bill, is at Annex A.

(A) Categories of officers intended to be subject to the pay reduction

Civil servants

23. Generally speaking, civil servants are remunerated according to the pay scales of their respective grade and rank. There are currently 11 sets of civil service pay scales (such as the Master Pay Scale (MPS), the Directorate Pay Scale (DPS), the Police Pay Scale (PPS), the General Disciplined Services (Rank & File) Pay Scales (GDS(R)), etc.). These pay scales are subject to annual adjustment. There are also a small number of officers who are on personal salaries² and whose pay is adjusted in line with the annual civil service adjustment. We propose that the proposed legislation should cover all civil servants whose pay is –

- (a) determined in accordance with or by reference to, directly or indirectly, a point on the civil service pay scales;
- (b) adjusted in accordance with or by reference to, directly or indirectly, adjustments to the civil service pay scales; or
- (c) determined and adjusted as mentioned in (a) and (b) respectively.

Officers in the Independent Commission Against Corruption (ICAC)

24. ICAC officers are not civil servants and are mostly remunerated according to the ICAC Pay Scale. This pay scale is adjusted annually in line with adjustment to the civil service pay scales. We propose that the proposed legislation should cover ICAC officers whose pay is –

² Some of these civil servants are seconded to the publicly-funded organisations and are promoted or transferred to a rank/grade where there is no corresponding rank/grade in the civil service. There are also civil servants who have opted to retain the pay scales in their old rank/grade which have now become obsolete.

- (a) determined in accordance with or by reference to, directly or indirectly, a point on the said public service pay scale;
- (b) adjusted in accordance with or by reference to, directly or indirectly, adjustments to the said public service pay scale; or
- (c) determined and adjusted as mentioned in (a) and (b) respectively.

Public officers³ who are not civil servants or ICAC officers

25. In addition to civil service appointments and ICAC officers, the Government makes various non-civil service appointments to bureaux and departments on different terms of employment. Examples of these appointments are members of the auxiliary services, undergraduate/graduate trainees in the Department of Justice and works departments, and temporary teachers.

26. We propose that in addition to civil servants and ICAC officers, the proposed legislation should also apply to other public officers whose pay is –

- (a) determined in accordance with or by reference to, directly or indirectly, a point on the civil service pay scales or the public service pay scale;
- (b) adjusted in accordance with or by reference to, directly or indirectly, adjustments to the civil service pay scales or the public service pay scale; or
- (c) determined and adjusted as mentioned in (a) and (b) respectively.

Director of Audit

27. Under section 4(A) of the Audit Ordinance (Cap.122), the Chief Executive may, from time to time, increase the rate of salary of the Director of Audit by order published in the Gazette. The practice has been that following the annual civil service pay adjustment exercise, we seek the Chief Executive's approval to revise the salary of the Director of Audit in accordance with an established formula based on certain pay points on the Directorate Pay Scale. Legal advice is that given section 4(A) of the Audit Ordinance, it is necessary for a reduction of the salary of the Director of Audit, if finally decided, to be implemented by statute.

(B) Allowances intended to be subject to the pay reduction

³ Under the Interpretation and General Clauses Ordinance (Cap.1), a public officer means any person holding an office of emolument under the Government, whether such office be permanent or temporary.

28. In the civil service, duty-related allowances are paid for the performance of additional duties which are not otherwise compensated by regular pay. Duty-related allowances are also paid to certain public officers. These allowances are determined and adjusted in different ways. We propose that in the event of a civil service pay reduction, the following types of allowance should be similarly adjusted –

- (a) allowances which are determined in accordance with or by reference to, directly or indirectly, a point on the civil service pay scales or the public service pay scales (e.g. Hardship Allowance (Dangerous Duties) is set at 9.3% of MPS 1);
- (b) allowances which are adjusted in accordance with or by reference to, directly or indirectly, adjustments to the civil service pay scales or the public service pay scales (e.g. Consolidated Overtime Allowance for domestic staff in official residences is adjusted annually in line with the lower salary band of the civil service); or
- (c) allowances which are determined and adjusted as mentioned in (a) and (b) respectively.

29. Where the allowance rates are determined by reference to an individual officer's substantive salary (e.g. Acting-up Allowance is the difference in pay between the minimum of the acting office and the substantive pay of the officer), the allowance payable will be adjusted automatically following the adjustment to the relevant civil service/public service pay scale.

(C) Rates of reduction for different categories of affected officers

30. We propose to specify in a schedule to the Bill the specific rates of reduction for different categories of public officers.

(D) Implementation date of the pay reduction

31. We propose to implement the civil service pay reduction, if finally decided, from 1 October 2002. We consider it reasonable to allow time for affected staff to make appropriate financial arrangements before the reduction takes effect.

(E) Exemptions from the Bill as appropriate

32. We propose that public officers who are remunerated on starting salaries which are delinked from the annual civil service pay adjustment as well as judges and judicial officers should not be subject to the pay reduction. The proposed Bill will provide for such exemptions.

THE BILL

33. The key provisions of the draft Bill at Annex A are set out below –
- (a) Clause 2 defines the terms used in the Bill.
 - (b) Clause 3 reduces the pay pertaining to a point on the civil service pay scales by the relevant percentage specified in Schedule 3 to the Bill.
 - (c) Clause 4 reduces the pay pertaining to a point on the ICAC Pay Scale by the relevant percentage specified in Schedule 3 to the Bill.
 - (d) Clause 5 reduces the pay of public officers who are not civil servants or relevant public officers but whose pay is determined or adjusted in accordance with or by reference to a civil service pay scale or a public services pay scale by the relevant percentage specified in Schedule 3 to the Bill.
 - (e) Clause 6 reduces the rate of salary payable to the Director of Audit by a specified percentage.
 - (f) Clause 7 reduces the allowances payable to public officers where the allowance rate is determined or adjusted in accordance with or by reference to a civil service pay scale or a public service pay scale.
 - (g) Clause 8 makes it clear that the Bill does not operate to prohibit or affect any adjustments made after 1 October 2002 to the pay or the amounts of allowances payable to public officers.
 - (h) Clause 9 modifies the contracts of employment of public officers to expressly authorize the adjustments made by the Bill and makes it clear that the reductions in pay and allowances effected by the Bill do not give rise to any claim for compensation, damages or other remedies.
 - (i) Clause 10 and Schedule 4 provide that the pay of certain public officers and allowances will not be affected by the Bill.
 - (j) Clause 11 empowers the Chief Executive in Council to amend Schedule 4.

LEGISLATIVE TIMETABLE

34. It is our intention to obtain the Legislative Council's approval of this year's civil service pay adjustment, if decided, within the current legislative session. We shall seek the Chief Executive in Council's decision on the size of this year's pay adjustment in the light of the comments received from the staff sides on the pay offer. If the recommendation is to reduce civil service pay, we shall seek the Chief Executive in Council's approval of the Bill, with the recommended rates of pay reduction specified, for introduction of the Bill into the Legislative Council.

FINANCIAL AND STAFFING IMPLICATIONS

35. The estimated full-year savings arising from proposed pay adjustment in terms of salary and allowances is estimated to be \$3,102 million.

	\$ million
(a) Civil Service	1,488
(b) Subvented Organisations	1,609
(c) Auxiliaries	5
Total	3,102

The estimated savings in 2002-03 will be \$1,551 million.

36. There are no staffing implications.

BASIC LAW IMPLICATIONS

37. The Department of Justice has advised that the Bill is consistent with the Basic Law.

HUMAN RIGHTS IMPLICATIONS

38. The Department of Justice has advised that the Bill has no human rights implications.

BINDING EFFECT OF THE LEGISLATION

39. The Bill does not contain any express binding effect provision, but it will bind the SARG by necessary implication.

ECONOMIC IMPLICATIONS

40. The results of the 2001-02 Pay Trend Survey reflect that employers in the private sector had generally reduced the pay of their employees in the preceding year. However, a general civil service pay reduction, though broadly following the trend in private sector pay adjustment in the preceding year, might still have some impact, if only psychological, on the labour market. Currently, the civil service makes up about 5% of the total workforce and civil service emoluments account for about 10% of the overall employment remuneration in the economy. Taking account of the subvented sector, the civil service and employees in subvented organisations together account for about 10% of the total workforce and their emoluments account for about 20% of the overall employment remuneration in the economy.

PUBLICITY

41. The Secretary for the Civil Service will present the proposed pay adjustment to the staff sides in the afternoon on 22 May 2002 and invite them to submit comments by 24 May 2002. The Secretary for the Civil Service will hold a press conference on 22 May 2002 to explain the Administration's considerations when deciding the pay offer and the justifications for a legislative approach in the event of a civil service pay reduction. A press release will be issued on the same day. A spokesman will be available to answer media enquiries.

SUBJECT OFFICER

42. Enquiries on this brief should be addressed to Miss Angelina Fung, Principal Assistant Secretary for the Civil Service (tel: 2810 3112) or Miss Gloria Lo, Assistant Secretary for the Civil Service (tel: 2810 3259).

Civil Service Bureau
22 May 2002