Investigating civil service pay reforms and their impact on public governance in China, including the fight against corruption.

As agents of the state, civil servants play a central role in public governance and socioeconomic development. In developing countries, an effective civil service pay system may provide strong incentives for better public service and rein in corruption, whereas poor remuneration can fuel corruption and discontent among civil servants.

Grappling to develop a well-functioning pay regime has challenged the PRC since its birth. Over the past decade, reforms implemented in the civil service pay system have been closely associated with legitimacy change (from an economy-based approach to welfare-based one), income distribution and central-local relations. However, these reforms have sparked a heated debate over their legitimacy, effectiveness and direction. By examining the complexities of this situation and the tug-of-war over remuneration among different players, this pioneering study deepens our understanding of the internal tensions with which China’s reform process is fraught.

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GOVERNING CIVIL SERVICE PAY IN CHINA
Governance in Asia
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Most Asian countries have experienced radical social transformation in the past decades. Some have undergone democratization yet are still plagued by problems of political instability, official malfeasance and weak administration. Others have embraced market liberalization but are threatened by rampant rent seeking and business capture. Without exception, they all face the challenge of effective governance. This book series explores how Asian societies and markets are governed in the rapidly changing world and explores the problem of governance from an Asian perspective. It also encourages studies sensitive to the autochthony and hybridity of Asian history and development, which locate the issue of governance within specific meanings of rule and order, structures of political authority and mobilization of institutional resources distinctive to the Asian context. The series aims to publish timely and well-researched books that will have the cumulative effect of developing theories of governance pertinent to Asian realities.

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GOVERNING CIVIL SERVICE PAY IN CHINA

Alfred M. Wu
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A decade ago, when invited to sit and listen to a provincial party secretary talking to his senior management, I was surprised by his complaints about civil service remuneration in China. A normally authoritative and unemotional official who governed a coastal province with a GDP equal to that of Ireland, he stood there openly lamenting the actions of another local authority. By giving substantial pay raises to all of its civil servants, the Beijing Municipal Government was negatively affecting civil service remuneration in his own jurisdiction and all around the country. It is difficult on limited resources to strike a balance between catching up with developed neighbors through considerable public investments in infrastructure and adequately compensating civil servants and other wage earners. As an old-style senior cadre, he paid heed to the governing philosophy – economic development first, income (re)distribution second – hence for him low wages and low consumption should be the norm. However, the Beijing Municipal Government’s attempt to better compensate its civil servants created a pressure on other local governments to follow suit. If they took no action, the morale of their civil servants would be dampened but on the other hand conceding pay rises had great implications for local public finances.

Though veteran, senior cadres may not seem to enthusiastically pursue material rewards, ordinary wage earners in the public sector are unlikely to dismiss the importance of improved compensation for their lives. Pay rates are always an attractive topic in informal gatherings of civil servants. Civil service remuneration in China, much like in the West, serves to attract and retain talent as well as motivate in-service civil servants. Against a seemingly low-wage and low-consumption environment in China, in recent years the “red-collar” jobs of civil servants have been most sought after. Several surveys indicate that red-collar jobs – rather than white-collar jobs found in the private sector – are new
favorite goal of university graduates today. Many argue that this change in the job market is due to rising civil service salaries.

Despite the link between public sector pay in China and the underlying logic that unfolds in other areas of society, nonetheless the subject remains seriously underexplored. When I embarked on my journey to explore civil service pay in China, I found very little in the English-language literature investigating the topic in the Chinese context. Several questions begged to be asked. What is the level of Chinese civil service pay? How are reforms to civil service pay related to broader administrative reforms in China? More fundamentally, what is the relationship between the civil service pay regime and income distribution in the whole society? Furthermore, as corruption is a rising concern in this transition economy, what is the relationship between civil service remuneration and reduction of corruption in China?

As agents of the state, civil servants are fundamental to public governance and socioeconomic development; this is especially so in developing countries. Civil service pay generally lies at the forefront of civil service reforms. Administrative reforms in many countries suggest that the civil service pay reform is crucial to several essential reforms such as fiscal reforms and organizational restructuring.

This book was written to scrutinize how, since the founding of the People’s Republic of China (PRC), the Chinese government has grappled with implementing a well-functioning pay regime. The investigation will not only explore human resource management in the Chinese government but also the politics of contemporary China. The latter is vital to a good understanding of civil service pay reforms in China. For one thing, these pay reforms have prompted ideological debates among heavyweights in the Chinese Communist Party (CCP), including Mao Zedong and Deng Xiaoping, over a long period. Mao Zedong preferred the remuneration system inherited from the guerrilla period before 1949; a cash-based remuneration system for state cadres was thus under attack on numerous occasions in the early period of the PRC. Ironically for a person promoting the market economy in China, for nearly five decades Deng Xiaoping advocated the rational low wage policy. In contrast, Premier Zhu Rongji, a reformist in Post-Mao China, enthusiastically espoused the policy of paying a good salary to reduce corruption.
Preface

The impact of increased civil service pay on public governance in China thus remains an open question.

Recent economic and political developments in China have complicated efforts to rationalize civil service remuneration in China. Not least, the central government has worked to legitimize its rule through enhancing social welfare and improving income redistribution in the country. Nevertheless, local governments pay more attention to GDP growth and revenue generation with substantial fiscal resources being used to boost growth. Therefore, some local governments, especially county governments, cannot even remunerate their employees to the extent stipulated by central policy.

Central–local relations have further confounded the situation. The Chinese government adopted an asymmetric decentralization system in 1994 with revenue collection being centralized and much expenditure decentralized. With expenditure being further decentralized recently, local governments are falling short of the fiscal resources they need. This is especially so for local authorities at the grassroots level, which need to improve public services and motivate civil servants through developing an appropriate remuneration regime. Therefore, though some local governments strive for a smart use of public money, most of them fail to manage their civil service remuneration very well.

This study will contribute to governance theory through elucidating the interactions among different players in setting Chinese civil service pay. Some assume that the Chinese civil service remuneration system is conducted under a top-down, command-and-control framework. This is true in part. Nevertheless, though it is made under the institutional structure of an authoritarian regime, civil service pay involves tug-of-wars among different players, for example local politicians, policymakers, civil servants, and the general public.

AUDIENCE

This book is aimed at scholars and in particular students of political science, sociology and economics. As the first attempt to systematically review the civil service pay system in China, the book should appeal to scholars who are curious about administrative reforms in China. In addition, recent developments in regime legitimacy, income distribution, and central–local relations in China will be investigated in the book.
Therefore it can be used for some courses related to China studies, such as intergovernmental relations within the PRC, public finances, political economy, and contemporary Chinese politics.

Likewise, some scholars or postgraduate students who are interested in civil service reforms or pay regime changes in developing countries or transition economies will find it valuable to consult this study; in the Chinese experience are found essential characteristics of remuneration issues affecting many other countries, especially transition countries wrestling with an effective incentive structure for their civil servants. Moreover, the complexities embedded in the Chinese case may enrich our understanding of civil service reforms worldwide.

Perhaps more importantly, this book will investigate the impact of civil service pay reforms on public governance in China, including the fight against corruption. Corruption is of increasing concern to the general public, public administrators, and academics in China. The Chinese government unequivocally uses good pay to reduce corruption. This book will offer an answer to whether salaries in the civil service affect corruption in a developing, transitional context.

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Preface

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Errors and omissions in this book remain my sole responsibility.
CHAPTER ONE

Introduction

This book is a study of civil service pay management and civil service reforms in China. The Chinese government is endeavoring to build a modern civil service system, to be instrumental in promoting state capacity and government legitimacy. The transition from a Communist administrative system to a market-based administrative system requires careful planning and implementation of civil service pay reforms. The Chinese experience in public sector remuneration attests to the complexities of motivating civil servants while taming self-serving bureaucrats in a transitional economy. Deciphering the dynamics and complexities of public sector remuneration reforms in China will not only contribute to a significant but under-explored research area but also will have significant implications for civil service reforms and income distribution in other developing countries.

“Civil service pay”, in this book, refers mainly to the monetary salary and perquisites offered by the state to reward the outputs of civil servants. As agents of the state, civil servants are vital to both public governance and socioeconomic development (Olowu, 2010, p.633). According to the 2006 Civil Service Law of the People’s Republic of China (PRC), the Chinese civil service refers only to white-collar employees performing public duties (Wu, 2013). The scope of civil service has been expanded substantially over the past decade. In the early 1990s, “civil servants” referred only to those working in administrative units of the state. Nevertheless, according to the 2006 Civil Service Law, “civil servants” includes not only those working in administrative organizations but also party personnel such as those employed in the discipline inspection commission or the politics and law commission of the Chinese Communist Party (CCP) (See Chan & Li, 2007; Jing & Zhu, 2012). According to the figure provided by the State Administration of Civil Service, the number of civil servants totaled 7.089 million in 2012. Nevertheless, in reality, more people enjoy the status of civil servant. For
example, employees in mass organizations such as the Communist Youth League have been incorporated into the civil service establishment. Therefore, according to the National Bureau of Statistics, the number of civil servants should reach 14.676 million, accounting for 10 percent of the labor force in the country in 2011. Meanwhile, attention should also be paid to the size of fiscal dependents (or budgeted employees, *caizheng gongyang renkou*, a phrase which denotes those employed by the state and paid by its coffers. It is estimated that the number of fiscal dependents in China is approaching 40 million (see Ang, 2012; Wu & Lin, 2012). The size of fiscal dependents is of great financial significance to the government budget. As will be discussed later, remunerating fiscal dependents in China’s local government poses a great threat to local financial health.

With regard to the geographical distribution of civil servants, almost no literature has discussed the issue. According to the National Bureau of Statistics, the number of civil servants including quasi-civil servants came to 430,866 in Beijing, where the central government is located. The World Bank (2007) reports that the central government of the PRC employed only some 50,000 civil servants, most of them work in Beijing. Therefore, the Beijing Municipal Government and local governments below that level had roughly 380,000 civil servants, accounting for 5.55 percent of the labor force in the urban area of Beijing. The Shanghai and Tianjin Municipal Governments also had relatively few civil servants (194,011 and 140,831, respectively). Some coastal provinces such as Guangdong, Fujian, Jiangsu, and Zhejiang had a relatively small government. By contrast, some inland provinces such as Qinghai, Guizhou, and Gansu had a big government. Tibet (42.96 percent of total labor force) was the highest with regard to the share of civil servants in the total employment.

In developing countries, motivating civil servants appropriately lies at the forefront of civil service reform. An effective pay system may provide strong incentives for better public services and rein in corruption (Akerlof & Yellen, 1990; Rijceghem & Weder, 2001). A poor remuneration system instead generates discontent among civil servants and thus fuels corruption. Substantial successes and failures in civil service

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1. Yang and Wang (2013) find a significantly positive correlation between civil service pay and job satisfaction in China.
pay reforms over the past three decades have been observed in developing countries (Olowu, 2010; Robinson, 2007). Drawing on the history of administrative reforms in a number of developed economies, Bender and Elliott (2003) argue that though fiscal reforms and organizational restructuring often precede reforms in civil service pay, an ineffective pay system nonetheless will seriously erode the effectiveness of any administrative reforms.

Instituting a well-functioning pay regime has been a daunting task facing the Chinese government since the founding of the PRC. Over the past decade, both pay reforms and pay enhancements in the public sector have led to heated debate over the legitimacy, effectiveness, and direction of these reforms in China. English-language academic literature has shed little light, however, on these stimulating and far-reaching developments in remuneration reforms in China. Civil service pay reforms are closely associated with several important reform issues in China, namely legitimacy change (from an economy-based approach to a welfare-based one), income distribution, and central-local administrative and fiscal relations. Investigating the tug-of-war over remuneration among different actors (including non-state actors) will deepen our understanding of China’s economic and administrative reforms over the past several decades.

The Chinese experience in civil service remuneration may have important implications for developing countries. Many developing economies lack sufficient fiscal resources to compensate civil servants appropriately. As a country like China gradually becomes well off (and equipped with a surging fiscal capacity), civil service remuneration still encounters many thorny problems. Debunking the myth of the ineffectiveness and inefficiency of the Chinese remuneration regime for public administration will provide lessons for other developing countries to ponder. Scholars with expertise in civil service reform and public governance in developed economies will gain a nuanced understanding of public sector pay in a developing and transition economy.

THE PRINCIPLES OF CHINESE PUBLIC SECTOR REMUNERATION

It is worth discussing the principles of Chinese public sector remuneration before investigating the implementation of civil service remunera-

2. But on the early remuneration regime in China see Chew (1990a, 1990b) and Cooke (2005).
There have been four civil service pay regimes in the history of the PRC. They were introduced in 1956, 1985, 1993, and 2006, respectively. Based on socialist ideology and Chinese tradition, four civil service pay principles were established in China. “Pay according to work performed”, as a remuneration principle of Marxist theory, requires that civil servants be compensated according to their performance and contribution. Political attitudes should not play an important role in pay determination. The principle actually removes the barrier to using civil service remuneration to motivate public workers as, over the long haul, proletarian enthusiasm rather than material reward used to be emphasized by the top Communist leadership in China. The second principle, “base pay coexisting with variable pay”, is tightly related to the first principle. It means that civil service pay should be separated into different functional components. The principle in effect permits a substantial pay difference between good performers and ordinary ones. Base pay correlates with seniority and position, whereas variable pay is associated with an employee’s job performance. Meanwhile, base pay guarantees the daily necessities and other spending of cadres’ families, with variable pay serving to improve the benefits for civil servants with good job performance.

The next civil service pay principle, that of pay parity, usually referred to as “equal pay for equal work” between male and female employees in the Western context, emphasizes the importance of equal pay for public workers regardless of government departments. This principle has substantial implications for pay and fiscal management in the Chinese public sector. First, payrolls borne by governments include compensation for non-civil service public workers such as teachers in the basic education sector; thus a small increase in civil service pay will lead to a large payroll increase, which has a significant impact on the fiscal burdens of the Chinese government. According to the Compulsory Education Law of the PRC, teachers, who make up the largest segment of the public sector, must be paid the same as civil servants. Civil service pay adjustments are consequently applied to teachers. Pegging teachers’ salaries to civil service pay led to great fiscal pressure on local governments when the central government launched several civil service pay rises from 1997 on. Second, the principle also hinders the decentralization of pay determination to government units or public service units (such as public...
schools). Viewed useful for motivating civil servants, decentralized pay setting allows grassroots managers, for example, government department heads at the county level, to remunerate civil servants differently according to the existing rules. As pay parity requires that civil servants and teachers with similar seniority and comparable position be paid the same, it is impossible to adjust civil service pay departmentally while maintaining pay parity between civil servants and teachers. Therefore, “equal pay for equal work” in the Chinese context will in reality make remuneration policies unable to be realized.

Last but not least, the principle of “pay setting rests with the executive branch” emphasizes a unique institutional arrangement for pay determinants in the Chinese public sector. Civil service pay in most countries is contingent on various bargains among civil servants, labour unions, and so on. However, an executive-led model for civil service pay was established soon after the founding of the PRC. The executive branch of the government, more specifically the Ministry of Personnel, is in charge of public sector remuneration. Disputes about this model abound, especially in recent years as People’s Congresses, China’s parliaments, have become increasingly assertive.³ In theory, People’s Congresses should have a final say over the government budget including civil service remuneration. In addition, despite the executive-led model, congresspersons and non-state actors still play some roles in shaping civil service remuneration.

Though the above principles are not flawless, a well-functioning civil service pay regime could be established if those principles were upheld. However, policy makers in China often destroyed the principles’ equilibrium, when new remuneration regimes unfortunately led sometimes to even worse situations, which required quick fixes. For example, pay decentralization in the 1980s and 1990s paved the way for widespread pay disparities among civil servants even in the same locality. Excessive civil service pay gaps in the 1990s confirmed that the pay parity principle was being violated. In response to growing public concern over large pay disparities and deteriorating income distribution, the central government introduced a new equal pay policy in 2006 – the latest pay policy in China, which requires the strict implementation of equal pay

³ On a latest evaluation of the role of people’s congresses in Chinese local politics, see Wu (2014).
for equal work. In addition, decoupling pay from performance, which is caused by the strict implementation of the equal pay policy, runs counter to the fundamental socialist principle of “pay according to work performed”. The principle of the combination of base pay and variable pay is consequently violated as variable pay has disappeared. This new equal pay policy has been associated with a rise in “egalitarianism” in China. Though the principles are in place, generally, their beneficial implementation remains an open question.

THE DYNAMICS AND COMPLEXITIES OF CIVIL SERVICE REMUNERATION IN CHINA

During the Mao era, there were fundamental problems with regard to civil service remuneration. For example, the government’s shortages of fiscal resources led to the reality of remuneration dysfunction. The linkage between the pay issue and fiscal management was largely overlooked. When pay packages were formulated, policy-makers had no clear plans for aligning them with the budget or positioning them appropriately within the current fiscal system. For example, the within-grade salary increase mechanism, a common international practice, was introduced in the 1956 pay system. However, there was not enough revenue to accommodate regular payments. As a result, only four within-grade increases were implemented from 1957 through 1978 in a limited number of government institutions. Shi and Wu (1993) thus argue that not even a single advance in nationwide pay increases was accomplished in nearly 20 years.

Coordination between civil service pay management and fiscal management has appeared to improve since the late 1990s. The Ministry of Personnel, responsible for civil service remuneration, and the Ministry of Finance, empowered to appropriate public money, started to work together on some issues related to civil service remuneration. Nevertheless, civil service remuneration again encountered serious problems from the late 1990s. When inequality in the fiscal capacity of various local governments grew dramatically, civil servants’ pay was not based on their performance but on their employers’ financial capacity. Pay disparities in the public sector were huge even in the same city. Civil servants working in resource-poor departments were unhappy since well-paid civil servants might not work hard at all but still enjoy the
largesse of their departments, which tapped into rich public resources. As income distribution was a politically crucial issue in China at large, the central government intervened to narrow the pay gap among civil servants through reforming the civil service pay regime.

Thus the equal pay policy was introduced by the central government in 2006. It recentralized remuneration power by placing tight restrictions on pay schemes developed by local governments. Though in theory the principle of “base pay coexisting with variable pay” seems to be upheld, in practice variable pay has disappeared. Civil servants with similar seniority and comparable position earn the same pay without reference to workload and performance (Chou, 2008). The equal pay policy thus provides great disincentives toward motivating civil servants. This demotivation is further compounded by the poor implementation of civil service remuneration at the grassroots level (as shown in Chapter 4). When rank-and-file members of the civil service cannot receive their promised remuneration, public officials may seek bribes to compensate for their real or perceived losses. The implications of this poor implementation of civil service remuneration for corruption control are worrisome. Although numerous experiences in the history of China suggest that low pay leads to rampant corruption, the present Chinese government seems unable to avoid this problem.

The Chinese government is well aware of the importance of civil service pay and civil service remuneration reforms. Reforms of civil servant pay in China nonetheless have borne little fruit. Problems in civil service remuneration reflect the difficulties and complexities of aligning an appropriate pay regime with ever-changing socio-economic circumstances in a transitional country. On the other hand, dysfunctions of civil service remuneration are a result of uncoordinated interaction between the central and local governments and among the bureaucracy. Public sector pay principles in China permit a decentralized and performance-oriented remuneration system, despite some inherent counterforces. Nevertheless, a combination of unbridled local governments attempting to maximize their benefits, and an assertive, powerful central government has recently led to the replacement of a relatively promising pay regime, though not without loopholes, with a rigid, less effective, centralized pay system.
Governing Civil Service Pay in China

THE RETREAT FROM DECENTRALIZATION AND PERFORMANCE-BASED PAY

The Chinese remuneration regime has recently moved in an opposite direction to international trends. Changing from a decentralized pay system to a centralized one is a case in point. Civil servants around the world have to cope with escalating complex tasks in a fast-changing world; in response, many countries have decentralized pay setting to local governments and government units in order to improve government performance.

First, the public sector, in competing with the private sector for recruiting and retaining talent, requires a decentralized pay setting. While the private sector worldwide has increasingly utilized decentralized remuneration to improve the productivity and competitiveness of its grassroots regional units, so governments have replicated successful experiences in the private sector by introducing flexible and decentralized pay.

Second, macroeconomic pressures render the decentralization of pay setting desirable. Many governments worldwide have started to implement cost containment programs in response to the growth of public spending since the 1980s. Since public sector remuneration claims the largest share of a government’s budget, so governments must reform civil service remuneration in order to have better and cheaper public services. Decentralizing public sector remuneration to line managers has proved to be one of the most effective and intelligent solutions to ease macroeconomic pressures.

Third, and more technically, decentralization can overcome the weaknesses of public sector pay structure. For example, the “double imbalance” is common in many countries, wherein experienced and skilled public workers are compensated with relatively low pay compared with those in the private sector, while the least skilled workers are paid relatively high wages (Katz & Krueger, 1993). Through empowering line managers and grassroots regional governments, decentralized pay setting can achieve a better pay structure, wherein the double imbalance can be mitigated to some extent and be instrumental in recruiting talent.

Some countries, such as the United Kingdom, with a tradition of centralized pay setting have turned to decentralized pay setting since the 1990s (Bender & Elliott, 2003). Many other developed countries have
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seen a similar development in civil service pay management (Rexed, Moll, Manning & Allain, 2007). Decentralization in pay setting in China reaped some benefits in the late 1980s and 1990s. As local governments did not need to wait for central remuneration policies to effect change, they could adjust both the pay structure and the pay rate to both local costs of living and remuneration increases in the private sector. Though decentralized pay setting facilitated favoritism and even corruption, it made talent recruitment easier and government services more adaptive and responsive. Since the late 1990s, however, the central government of China has become increasingly assertive in restricting local autonomy. Widespread overpayments in some rich areas and serious pay disparities among civil servants have justified the central government’s taking back of remuneration power. In addition to recentralizing pay setting, the central government is further prohibiting local governments from innovating in the management of civil service remuneration. But this prohibition may not prove to be a smart solution.

Parallel to decentralized pay setting, performance-based pay in the public sector has also suffered a great setback in China in recent years. Though linking pay to performance is not without controversy, many countries in recent decades have introduced some forms of performance-based pay in the public sector. Empirical evidence suggests that performance-based rewards improve employees’ job performance, thereby enhancing the role of public sector remuneration in motivating public workers. Drawing on international practices, performance-related pay in China emerged in the public sector in the mid-1980s and expanded later on. Originally, the ratio of performance-based pay to total pay was slight, as public managers attempted to restore work discipline after the Chinese had experienced decades of turmoil. Performance-related pay became a high-powered incentive over time. As suggested by the principal-agent theory, high-powered incentives can be effectively employed to align the agent’s interests with the principal’s. In China, local governments, in order to get things done, rewarded civil servants with performance-based pay double that of the base salary.4

4. Local governments in China, more often than not, offered civil servants performance pay as much as 100 percent of their base pay. By contrast, performance-linked pay claims less than 20 percent of the total pay in many OECD countries (OECD, 2005).
Local leaders also utilized performance-based pay to strengthen patron–client ties. Favoritism was pervasive in China’s local government. In many cases, performance pay schemes were employed to enhance all employees’ extra benefits in addition to base salaries. Similar to the outcome experienced in developed economies, performance-related pay led to competition – sometimes overcompetition – among colleagues in the Chinese public sector. As performance-based pay was more handsome than the base salary, performance-based pay in China led to more serious negative consequences than in the West.

In response to the negative effects of pay for performance, many countries have tried various remedies to mitigate this negative side of linking performance to pay. The Chinese government did not take similar action but instead simply put a halt to performance-related pay in the public sector. As will be discussed in Chapter 6, this withdrawal of pay for performance by the central government had various causes, such as an “egalitarian” culture and public sentiment towards local budget maximizers.

The retreat from international good practices in remuneration has its root causes in a rapidly changing society, but as a geographically huge country China has many good reasons to adopt a decentralized pay regime with some forms of performance-based rewards. Especially since the Chinese government is attempting to develop a well-functioning civil service system and to improve public services, decentralized pay setting and a well-regulated performance-based pay scheme must be reintroduced. Otherwise, the Chinese central government’s overreaction to the risks of pay decentralization and performance-related pay will thwart civil service reforms, which are desperately needed in China.

LEGITIMACY CHANGE AND INCOME DISTRIBUTION

Civil service pay reforms are related to broader issues in China, namely legitimacy change and income distribution. Legitimacy deficit has plagued the PRC government since its birth in 1949; therefore one of the top priorities for the Chinese leadership has long been to bolster citizens’ confidence in the current regime (Gilley & Holbig, 2009; Schubert, 2008). Both “the scientific development concept” and “the harmonious society”, coined by the Hu Jintao-Wen Jiabao regime in recent years, reflect the central leadership’s concerns and attempts to
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justify the CCP’s rule. In addition to these rhetorical claims, one of the most significant legitimacy claims in recent years has been a move from an economy-based legitimacy model to a welfare-based one. It means that direct benefits to people are more important than GDP growth in assuring that people support the regime. Thus, income distribution must gradually override GDP growth and related economic indicators in performance evaluation among the Chinese bureaucracy. According to White (1986) and Zhao (2009), communist countries tend to rely on socioeconomic performance (eudaemonic legitimacy) to justify their rule. In the case of China, the government has relied more on an economy-based legitimacy since the advent of economic reform in the late 1970s.

Successful economic performance does of course bring great benefits to both the Chinese government and ordinary people. However, economy-based performance legitimacy suffers from serious weaknesses, as noted by Chen (1997). For one thing, uneven regional development and an enlarged income gap, accompanied by phenomenal GDP growth, make many people not better off but economically desperate.

Against this backdrop, achieving social justice has become a popular demand in China. Government statements and leaders’ speeches have thus undergone remarkable changes over the past two decades. Wong (2009) argues that “[I]t marks a major ideological and policy shift from the single-minded pursuit of economic growth and efficiency to an emphasis on social development, social stability and social justice” (p.2). This shift also reflects the central government’s need to preempt social unrest in China.

The new legitimacy model, emphasizing the importance of social spending such as education for ordinary people, also pays attention to welfare enhancement in the public sector. As long as civil service salary increments are well regulated, welfare enhancement for civil servants is an indispensable part of the new development model blessed by the Chinese leadership.

This adjustment in the pattern of public finance started to occur in the late 1990s, mirroring the change in the legitimacy approach. In 1998, the central government called for a change from “infrastructure finance” (jianshe caizheng) to “people’s livelihood-centered finance” (gonggong caizheng) (Zhou, 2007, p. 47). The former emphasizes the importance of financing public infrastructure, while the latter pays special attention
to welfare provision. The difference between the two is fundamental. Infrastructure finance, a legacy from the planned economy, highlights the developmental role of government with economic growth being prioritized. People’s livelihood-centered finance is in line with the market economy wherein the main role of government is to provide public goods and welfare benefits to the general public. The transition from infrastructure finance to people’s livelihood-centered finance indicates a departure from the planned economy wherein the government attempted to promote public investment and suppress consumption. The new direction is nevertheless debatable. Some argue that people’s livelihood-centered finance refers to an emphasis on public spending on welfare programs such as education and health care, which benefit the general public. Nevertheless, the Chinese government decided to increase public sector remuneration in the first place. Of course, this policy would benefit public employees in the basic education sector as well.

A State Council document in 2002 laid down further details for the shift in public spending priorities. Local governments had to give top priority to the following expenditures: remuneration for the public sector, pensions for retired personnel, and basic allowances for state-owned enterprises’ laid-off workers [emphasis added by the author]. If these priority expenditures could not be satisfied, local governments must not spend money on other projects. Following the promulgation of this document, guaranteeing public sector pay (baogongzi) became a guiding principle for allocating public spending.

Civil service remuneration used to be second to infrastructure financing in the Chinese public sector. With a swelling budget and an institutionalized guarantee of public sector compensation, will remuneration policy perform better? The answer is not clear. On the one hand, informal pay schemes still exist. Overpayments in some government departments have not waned. On the other hand, as will be discussed in Chapter 4, pay arrears because local governments have not compensated their employees as stipulated by the central governments are widespread in China (Shih & Zhang, 2007; Wu, 2010). Though central transfers have poured into local coffers, some fundamental dysfunctions have developed at the local level. Ordinary civil servants, especially those at the grassroots level, feel deprived partially due to the gap between their work output and salary level; thus they tend to enrich
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themselves illegally. Receiving a relatively good formal compensation, senior cadres and high-ranking public officials at the higher levels of government nonetheless enjoy substantial extra benefits beyond their formal pay. The substantial internal pay gap in the public sector has damaged income distribution at large.

In addition, as the expectation gap between the central government’s promise of using substantial civil service pay raises to reduce corruption and the reality is increasingly large, motivating ordinary civil servants becomes very difficult. Some leaders are tempted to improve benefits for their employees by extracting illegal revenues from their jurisdictions. Others, probably the majority, are lukewarm towards civil service remuneration (particularly formal salary). In both scenarios, it is nearly impossible to achieve both good income distribution and improved government legitimacy. The fulfillment of a welfare-based model with an emphasis on improving people’s living conditions thus still lies in the future.

THE IMPLICATIONS FOR GOVERNANCE THEORY

The study of civil service remuneration in China has significant implications for governance theory. Over the past two decades, governance theory has gained traction. As noted by Chhotray and Stoker (2009), the study of “established institutional forms of governance” has faded in interest while informal forms of governance have recently received growing attention (p.3). This trend is exceptionally relevant to the Chinese context. Students of China studies have long realized that rules-in-use (borrowed from Ostrom, 1999, p.38) are fundamental to a sophisticated understanding of the dynamics of Chinese public administration. As will be discussed later, interactions among different players (including non-state players) have had a great impact on the implementation of civil service pay reforms and have also paved the way for further reforms.

I use this definition of governance: “Governance is about the rules of collective decision-making in settings where there are a plurality of actors or organizations and where no formal control system can dictate the terms of the relationship between these actors and organizations” (Chhotray & Stoker, 2009, p.3). The key point here is that there are various actors and institutions involved in both decision-making and policy implementation, while the formal system cannot control and
manage the situation. The Chinese case in public sector remuneration fits this pattern exactly.

The conventional understanding of Chinese civil service remuneration is that the executive branch of the government – the State Council as the top administrative authority of the PRC – makes decisions on remuneration in a top-down fashion, while personnel departments implement remuneration policy. However, real remuneration for public workers is a result of intensive interactions among civil servants, ordinary people, the Ministry of Personnel, People’s Congresses, Political Consultative Bodies, and the like. The formal control system in civil service management, especially in recent years, has not been as effective as is widely supposed. Various actors and organizations attempt to exert influence over the decision-making of remuneration policy and, more broadly, income distribution policy. They also make efforts to change the outcome of policy implementation. For example, in the early period of the PRC, interactions between cadres filled with proletarian enthusiasm, the open-minded Labour minister, conservative party heavyweights and ordinary cadres led to the crucial “rational low wage policy” lasting for several decades. In the latest overhaul of civil service remuneration, disgruntled civil servants with relatively poor pay, ordinary citizens, and members of People’s Congresses at various levels strove to bring overpayment of civil servants to a halt. Nevertheless, it is as yet over-optimistic to argue that rectifying overpayment has achieved the desired goal, as local governments equipped with good financial resources have improvised ways to pocket public money, disproportionately in favor of senior cadres.

Among the interactions, the most salient is the relationship between central and local governments. Thus civil service pay is examined through the lens of a central–local relationship in this study. The central government has the power to determine public sector remuneration, while local governments possess various ways to depress or enhance civil service pay in their jurisdictions. The implementation of civil service remuneration thus is also related to the delegation issue. Bertelli (2006) aptly points out that “delegation is at the heart of new governance reforms” (p.10). Since in reality no formal control system can reign, how to hold local leading officials accountable for their behavior while keeping the central government from encroaching on local autonomy is
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critical in maintaining a well-functioning incentive system (Gong & Wu, 2012a). The delegation issue becomes very intricate as the government needs to make two important trade-offs. First, it needs to reconcile production and income distribution. For a long time, income distribution was secondary to production, wherein government revenue went back to enhance the production capacity of state-owned enterprises, a practice based on socialist ideology. Meanwhile, public workers were unhappy with the mixture of both low wages and low consumption. Second, the government needs to pay great attention to the urban–rural income gap. The gap between urban and rural areas with regard to living conditions, social welfare, and income is substantial in China. Large income disparities between urban and rural areas pose a threat to regime stability. The central leadership therefore has long argued that salary increments for civil servants, the majority of whom live in urban areas, must be considered in light of their impact on rural peasants.

The delegation issue involves Chinese tradition and culture, which are presently intertwined with the socialist ideology imposed by the CCP. For example, the egalitarian imperative in China places a great constraint on utilizing some good practices in human resource management from Western countries. The retreat from performance-related pay is a case in point. A Chinese saying in this regard is “no worry about scarcity but unevenness” (buhuangua er huanbuju) (Cooke, 2005, p. 281), which, to some extent, indicates egalitarianism in traditional Chinese society. When the country became increasingly rich, the uneven distribution of wealth grew into a serious concern in China. As will be noted, in a number of large-scale surveys in recent years, income distribution ranked top in public perception of government dysfunction. People are seriously concerned about the fairness of income distribution. Thus, it is not surprising to learn that local governments suppressed pay disparities in the early period of the PRC, when the central government promoted a pay system with a large pay gap between senior and junior cadres. This policy has been reversed since market reform in the early 1990s. Some local governments try very hard to pocket public money; therefore, a pay gap is substantial between civil servants. The central government attempts to tame the growth of this pay gap in response to public concern. Public sector pay is at present plagued with various dysfunctions because the delegation issue remains problematic.
The Chinese experience of public sector remuneration shows that today’s governance is intricate and multifaceted. Though public personnel management traditionally rests with the bureaucracy, civil service pay reforms suggest that it is worth examining (a) the interactions among citizens and institutions and (b) the delegation issue between central government and local governments.

A NOTE ON METHODOLOGY

Field interviews are the main method of this book. Various statistics related to public finance and personnel issues were also reviewed. Between 2008 and 2010, I interviewed public officials in five tiers of governments who were working in government personnel and fiscal departments at central, provincial, municipal, county, and township levels. Revealing the implementation of public sector remuneration, my interviews with county government officials made up the main component of my field work. As the bulk of public services such as health care and education are provided by county governments, the value of interviewing county government officials is high. I interviewed roughly 60 government officials to decipher the dynamics and dilemmas of civil service remuneration in China.

Two counties (Lianjiang and Minqing) in Fujian Province and another two (Daye and Nanzhang) in Hubei Province were places chosen for exploring the implementation of public sector remuneration. Two counties within the same province, albeit with different GDP per capita revenue generation, are relatively similar. However, counties between provinces are distinct in economic development, government revenue, the size of the wage bill, and the top-down flow of fiscal resources. The whole study employs the least similar case study method; only central mandates on public sector remuneration are the same among the four counties surveyed. The codes for fieldwork, including project title and interview dates, are given when citing the observations of government officials. For example, PA-20090110-1 denotes that the interview was conducted on 10 January 2009. “-1” denotes that it was the first interview on the specified day on which several interviews were conducted.

Fujian is a coastal province with a relatively advanced economic development and a good fiscal capacity. Its economic performance ranks

5. Although the official name of Daye is Daye City (Daye Shi), it is actually a county unit in the Chinese administrative system, part of Huangshi City.
above average in Mainland China (the tenth highest in terms of GDP per capita among 31 provinces in 2010). In general, the eastern and southern parts of Fujian Province are richer than its western and northern regions. The two selected counties (Lianjiang and Minqing) are located in the eastern and central parts of Fujian Province, respectively.

Hubei is an inland province in the middle reach of the Yangtze River. As Unger (2002) suggests, rural China can be broadly categorized as prosperous industrializing coastal localities, impoverished localities in the Western hinterlands, and grain belts in central China. Hubei is a hub of grain production, which together with 12 other provinces accounts for roughly 70 percent of total grain production in the whole country. The industrial sector, which can generate high GDP and climbing government revenue, is less developed in Hubei Province. Thus, compared with the self-sustaining fiscal position of Fujian Province, Hubei Province is a fiscally dependent locality, relying on central transfers to cover its expenditures. Therefore, the implementation of central mandates on public sector remuneration in Hubei would be more challenging. In 2010, its GDP per capita ranked thirteenth among provinces. The two selected counties in Hubei Province (Daye and Nanzhang) are located in the eastern and northern parts of Hubei Province, respectively.

I employ statistical data as well. In addition to the China Statistical Yearbook and the China Labour Statistical Yearbook, compiled by the National Bureau of Statistics, provincial yearbooks compiled by provincial statistical bureaux provide many useful socioeconomic indicators of sub-provincial units. Two sources of fiscal data compiled by the Ministry of Finance have been helpful in studying public sector remuneration in China. The Compendium of Fiscal Statistics for All Prefectures, Cities and Counties (Quanguo dishixian caizheng tongji ziliao) and the Compendium of Local Fiscal Statistics (Difang caizheng tongji ziliao) are compiled by the Treasury Bureau and the Budget Bureau of the Ministry of Finance of the PRC.

In addition, provincial yearbooks (not provincial statistical yearbooks) have also contributed to this study. The editorial boards of provincial yearbooks are made up of heavyweights in local governments, for example, governors, directors of provincial government general offices, and other government department heads. The compilations

6. In recent years, its ranking has risen substantially.
include a summary of individual departments’ activities in the past year; thus, these yearbooks can serve in checking the status of a given policy implementation. This type of second-hand source can be useful in crosschecking the narratives of interviewees.

It should be noted that due to a new budget classification system installed in 2007, some public spending data were separately analysed. For example, when analysing the impact of civil service pay on local government public finance, I investigated the data up to 2007. Subsequent spending would be explored only when data was available. It meant that even if the same spending category such as education spending (jiaoyu zhichu), it might denote recurrent spending on basic education before 2007 and spending on personnel costs and school infrastructure after 2007.

THE STRUCTURE OF THE BOOK

The chapters are organized around key research themes. Below is a summary of the main points examined in the different chapters.

Chapter 1: Introduction

This chapter examines the significance of this study and provides an overall framework for understanding remuneration regime changes in China. Key information presented in this chapter is that we should understand civil service remuneration in the broader context of the Chinese government’s striving to improve both income distribution and government legitimacy. There is much discontent among ordinary citizens, local government actors, and the central leadership in China. This study sheds light on a governance theory wherein no formal rules can govern Chinese civil service remuneration. The actual outcomes really depend on interactions among various players. A note on field-work is appended to this chapter.

Chapter 2: The Evolution of the Civil Service Pay Regime in China

This chapter reviews the evolution of the public sector remuneration regime, before the 2006 equal pay policy was introduced. In addition,
the four remuneration principles of the Chinese public sector are presented, and the ideology debate surrounding civil service remuneration in the early period of the PRC and in the Post-Mao era is examined. The situation for personnel managers in the public sector was weird and unstable, as reformist leaderships preferred using a modern pay system to motivate state cadres, while some Party heavyweights constantly sought to return to the supply system in the period of guerrilla warfare against the Kuomintang. Ordinary wage earners even advocated “working for no pay”. Even though the cash-based remuneration system had survived, egalitarianism dominated public sector pay for decades. Not until the introduction of the market economy in the 1990s did the Chinese central government promote some good practice in human resource management in the public sector. The public sector remuneration regime nonetheless did not improve. Excessive pay disparities appeared in the 1990s, which collapsed the 1993 pay regime.

Chapter 3: The Introduction of the Equal Pay Policy
Though the 1993 pay regime had achieved some success in modernizing the Chinese civil service pay system, the implementation of this remuneration regime was complicated by several macro- and micro-factors. On the one hand, local governments needed to offer better pay to motivate civil servants (who used to manage a planned economy) to operate in a market economy. On the other hand, with inadequate supervision from the central government local pay schemes had been developed too hastily and uncontrollably, causing excessive pay disparities throughout the country. The situation became even worse when the pay of civil servants working in the same city began to differ widely. In order to reduce discontent, the equal pay policy introduced in 2006 attempted to narrow the regional and departmental pay gaps in the public sector. The introduction of the equal pay policy was a manifestation of the bewilderment of those charged with income distribution in a transitional economy, and so we should view the achievements of the 2006 equal pay policy with caution.

Chapter 4: Local Implementation: Remuneration in Fujian and Hubei Provinces
A close scrutiny of civil service remuneration at the grassroots level in China suggests that its implementation has proven problematic in reali-
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ty. Through some methods were developed for gauging the wage bills of local governments, especially at the county level, this chapter reveals that in addition to increased expenditure needs due to modern and diverse society, both the central pay policy and pay raises nationwide have given rise to local fiscal difficulties, which have significant implications for local governments. The public sector wage bill accounts for 60 percent to 80 percent of current spending at the local level – which was slightly higher than the level in many countries (for example, 55 percent in the United Kingdom: see Elliott et al., 2005).

Solely blaming the central government for launching a problematic pay reform is unfair. Local governments promote both bureaucratic expansion and fiscal misallocation to enhance their own interests. Though the people’s-livelihood-centered approach has been promoted by the central government for a decade, the system of prioritized infrastructure finance remains intact. An investigation of the implementation of remuneration suggests that a centralized pay structure, as discussed in Chapter 5, may not be desirable.

The negative impacts of pay arrears (the gap between central policy and local implementation) on society are widespread. Some public sector workers took to the streets to vent their demands, which were granted by the central government. But more often than not civil servants did not protest overtly. Nevertheless, this does not mean that the morale of civil servants has not been dampened. When civil servants are unfairly paid low wages, they resort to corrupt behavior, both to sustain their living standards and to improve their career prospects – through sharing illegal benefits with their supervisors. Though the negative consequences of civil service pay arrears are less serious and visible than those that impose illegal surcharges on peasants, remuneration dysfunctions poses over the long run a great threat to both civil service governance and social stability.

Chapter 5: Decentralized Versus Centralized Pay Setting
Pay setting lies at the forefront of any remuneration regime. As a seemingly rather technical issue, it has been overlooked by the extant literature examining civil service pay in China. This chapter looks into the patterns of pay setting in the Chinese public sector. The first pay regime introduced in 1956 adopted a centralized pay setting compatible with the top-down public administration of the planned economy. Pay
setting was decentralized beginning in 1985 in a bid to harmonize with the new economic reform policy and the market economy. But in 2006, the clock of pay setting turned back to 1956, with a rigid centralized pay system. These dynamics of pay determination reflect the interactions among central actors and local ones.

As pay management is tightly related to fiscal management, this chapter covers central–local fiscal relations. The changes in inter-governmental fiscal relations, more often than not, affect remuneration management in the public sector.

Chapter 6: The Retreat From Performance-based Pay
This chapter elucidates the development of performance-related pay in the public sector. Through linking pay to performance, performance-related pay has been widely applied in the private sector and has spread to the public sector over the past several decades throughout the world. China is no exception. Performance-based pay was introduced by the Chinese government after several decades of turmoil to motivate civil servants to take up the responsibilities of promoting the new economic reform policy. Local governments further developed this pay scheme into two types of pay for performance: routine pay for performance and project-based pay for performance. The amount of performance-based pay, which could be several times base pay, was large compared with other countries’ practices. But now the equal pay policy has brought performance-based pay to a screeching halt. I argue that withdrawing performance-based pay may not be a smart solution.

Chapter 7: Civil Service Pay Levels
This chapter concerns civil service pay levels. I seek to answer some often-asked questions. For example, what is the level of civil service remuneration? Why did the Chinese government seek to increase civil service pay after the late 1990s?

Dating back to the early period of the PRC, the Chinese leadership made a tradeoff between wealth generation and income distribution. Income distribution and salary increases for the public sector should be secondary to wealth generation. It was estimated by the then top Chinese decision-makers that the Chinese citizen could not have a decent life until after 2000. Thus, production accumulation became the top priority of governments at all levels before the projected time came.
when the Chinese could have a good life. Thus, the rational low wage policy dominated for several decades. In addition, ideology mattered. As an encompassing state (Chan & Ma, 2011), the Chinese government attempted to “let everyone have a meal to eat” (Takahara, 1992, p. 44) through its income distribution policy. Thus, public workers could not earn substantially more than other wage earners. More importantly, the pay gap between urban wage earners and rural peasants should not be large.

This situation was reversed in the late 1990s. The Chinese government now strove to improve its legitimacy through welfare enhancement. Improving civil service pay not only served as welfare enhancement but also improved the capacity to recruit and retain talent in the public sector, which was vital for an efficient and effective administration. In addition, civil service pay enhancement was incorporated as a part of the Keynesian-style policy introduced in 1997 in a bid to ward off the economic impact of the 1997–1998 Asian Financial Crisis.

At present, the civil service’s pay level is by no means low in China. Average civil service pay ranked tenth among the nineteen job sectors in China between 2003 and 2010. If informal compensation was taken into consideration, the rank jumped from tenth to fourth among the nineteen job sectors, which included the financial, IT, and manufacturing sectors. Thus, the Chinese civil service is fairly well paid. Unfortunately, an increased pay level does not necessarily lead to a cleaner government.

Chapter 8: Pay and Corruption: Past, Present, and Prospects

This chapter examines from a historical perspective the dynamics and complexities of using good pay to reduce corruption. Some emperors in ancient China paid heed to systems like the “yanglian yin” one in the Qing Dynasty, when government officials were offered extra payments for nourishing incorruptness. Too often, this type of policy encountered serious problems. Both inflation and weak fiscal capacity rendered the policy diluted and unsustainable. Worse, elites, deeply shaped by Confucian philosophy, especially in the latter period of ancient China, discouraged the employment of material benefits to nourish incorruptness (although senior officials were allowed many privileges).

The socialist ideology of the PRC complicates the situation. At the very beginning of the PRC, proletarian enthusiasm rather than material reward was depicted as a crucial factor in promoting civil service integ-
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But serious bureaucratic expansion and inflation, especially during the late 1980s and early 1990s, has made civil service pay unacceptably low, so that corruption has flourished. However, elites have started to discuss the relationship between increased civil service pay and corruption control. Policy makers use a socialist term (yixin yanglian) for corruption control (using adequate pay to ensure a clean government), instead of gaoxin yanglian (reducing corruption by offering civil servants high salaries).

This chapter, drawing on various data, reveals that increased pay does not in fact deter corruption in the Chinese context. As corruption is embedded in complex social settings, its reduction remains a daunting task for policy makers. In addition to increased pay, the government should inspire and strengthen fiscal responsibility among the bureaucracy.

Chapter 9: Conclusions

This chapter brings together the main findings of the study. There is a growing interest in applying governance theory to public administration around the world. Students of China studies are always beset with difficulties in employing governance theory in the Chinese context due to the black box of the authoritarian state. Although both media and non-governmental organizations play an increasingly important role in bringing inside stories to audiences within and outside China, civil service management remains an underexplored area. Governance involves both state and non-state actors, and civil service management in China was overwhelmingly occupied by “traditional government theory”, with an emphasis on formal, hierarchical control systems rather than on “governance theory”. Civil service remuneration in the public sector has adopted the executive-led model since the founding of the PRC. Thus, common wisdom suggests that remuneration in the public sector is ridden with formal, top-down control. Almost none of literature in this area elucidates the roles of non-state actors and the interactions among various actors in public sector remuneration. This study attempts this elucidation by examining the tug-of-war in the making and implementation of civil service pay reforms. In addition, delegation, a part of governance theory, is brought to the fore, focusing on the dilemmas and dynamics of central–local fiscal relations in China.

This chapter also reveals the policy implications of this study, namely that a comprehensive and fundamental reform in the fiscal system
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should be launched in a bid to support administrative reforms, but that central–local fiscal relations have been distorted and dysfunctional thus far. Without an overhaul of intergovernmental fiscal relations, civil service pay cannot function effectively. The central government should reduce new mandates such as civil service pay raises nationwide. In the meantime, the fiscal responsibility of local governments should be substantially enhanced.
 CHAPTER TWO

The Evolution of the Civil Service Pay Regime in China

Four remuneration systems for public officials have existed in China since 1949. This chapter will look at the evolution of the pay regime for public officials over the past six decades. It starts with a comprehensive review of civil service pay principles in China. The principles are fundamental to an in-depth understanding of remuneration in the Chinese public sector. Four pay regimes are investigated chronologically. The changes of the remuneration system reflected socioeconomic and ideological transformations in China. In the early period of the PRC, slogans such as “working for no pay” dominated. A newly-installed cash-based remuneration system for cadres surprisingly received resistance from both Party Conservatives and ordinary wage earners in the early period of the PRC. The ever-changing nature of the pay system was not stabilized until the 1993 pay reform, which, although it introduced some good practices into public sector remuneration, did not realize the policy goals of the reform. I will examine the dynamics and dilemmas of the changes of the civil service pay regime in China over the past six decades.

A caveat is in order. This book is about civil service pay. The civil service system was introduced in 1993. Before that, public sector pay mainly referred to remuneration for cadres. The cadre (ganbu) system was a rough equivalent of the civil service system in many other countries. The term cadre refers to a public official holding a responsible or managerial position, usually full time, in party and government. A cadre may or may not be a member of the CCP, although a person in an important or a sensitive position would almost certainly be a party member.1

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There are four basic principles of the Chinese pay regime.

1. First, “pay according to work performed” (anlao fenpei) means that remuneration is identical for similar work and varies according to job responsibilities and difficulties (Chew, 1990a). “Pay according to work performed” is a key term in Marxist theory. The reformists in China nonetheless interpreted it in a slightly different way. Deng Xiaoping, the reformist Chinese supreme leader argued in 1978, that “In accordance with this principle, a person’s grade on the pay scale is determined mainly by his performance on the job, his technical level and his actual contribution” (Deng, 1984, p. 117). “Political attitude” (zhengzhi taidu) must not, he emphasized, surpass real performance in pay determination. The principle thus serves to clarify the roles of both remuneration and pay determination in a socialist country. Though political loyalty can be beneficial to cadres’ promotions, it should not have an impact on remuneration of public officials. Performance, qualification, and contribution instead matter in the pay determination. Deng’s statement reflected a complex situation at the beginning of economic reform in China. On the one hand, employee motivation should be encouraged in a bid to promote economic development in the country. On the other, Chairman Mao’s enthusiasm for “political attitude” among ordinary cadres still held some popularity in society. Deng, Mao’s successor, needed to strike a balance between promoting economic reform and respecting his former boss’s policy. Deng pointed out that “political attitude” should be testified in good performance in work units. Otherwise, “pay according to work performed” would become “pay according to political attitude”, which was not now blessed by the regime.

“Pay according to work performed” has appeared in almost all important Chinese official documents related to public sector remuneration since the onset of economic reform. It is manifest in the system of “structural pay” (jiegou gongzi), which consists of several components serving distinct purposes. In the 1985 remuneration regime, there were four items. The first item was subsistence salary (jichu gongzi), which mainly guaranteed the basic cost of living for employees. The sum thus covered only “the minimum needs of a worker and is also the same for every employee irrespective of position and employing organization” (Chew, 1990a, p. 356). The second item, position salary (zhiwu gongzi),
was related to a person’s position in the administrative hierarchy. Higher-ranking officials thus received better compensation with regard to position salary. The remaining two items, seniority allowance (*gongling jintie*) and performance-related pay (*jiangli gongzi*), aimed to compensate accumulated contributions and excellent performance, respectively.

The 1993 pay regime added a new item, cost-of-living allowance (*diqu jintie*), which aimed to cover the costs of living in a given locality. Thus the 1993 remuneration regime comprised three main items: base salary (*jiben gongzi*), allowance (*jintie*), and bonus (*jiangjin*). The first one was subdivided into position salary, grade salary, subsistence salary (*jichu gongzi*), and seniority salary (*gongling gongzi*), while the second one included cost-of-living allowance and sectoral allowance (*gangwei jintie*), in which the latter one was applied to employees in specific categories, such as auditors, police officers, and tax-collection officials. The 1993 central pay document stipulated that bonuses should be paid to those with outstanding (*youxiu*) and competent (*chengzhi*) performance. In general, the 1993 remuneration regime enhanced the role of a wage incentive in motivating public workers. The wage not only compensated job responsibilities and difficulties, varying regional costs of living, but also seniorities and performances.

The current remuneration regime, introduced in 2006, inherited the pay structure of the 1993 pay system except some adjustments in base salary. Both subsistence salary and seniority salary (which had become trivial over time) were abolished. Pay consisted of base salary (including position salary and grade salary), allowance, and year-end bonus. The pay structure is actually very similar to standard practices around the world (see OECD, 2005). Bonus is still paid according to civil servants’ performance. Only those with outstanding and competent performance are entitled to a year-end bonus, which is equal to the monthly base salary. As will be noted later, almost all civil servants have competent or outstanding performances; the year-end bonus has in reality become the thirteenth month’s salary.

In addition, policy implementers, more often than not, pay only lip service to the principle of “pay according to work performed”, as civil servants complain about the unfair pay in the civil service across both government departments and regions in China. It means that civil service pay, too often, hinges not on performance and contribution, but on
the financial resources held by government departments. This will be elucidated in Chapter 3.

(2) Second, base pay coexists with variable pay. The base pay, consisting of grade and position salaries, is linked to the job responsibilities of a given position and the seniority of a person. The base pay only sustains the basic livelihoods of civil servants. Meanwhile, the variable pay is a substantial factor in making decent the lives of civil servants. As it “facilitates employee organization partnership by linking the fortunes of both parties” (Schuster & Zingheim, 1992, p. xvii), the variable pay may reflect one's actual performance and contribution to the organization regardless of position and seniority.

Deng Xiaoping, the then paramount leader of the PRC, emphasized the positive role of cash-based wage, which was of course criticized by some conservatives in the CCP. Furthermore, he favored the motivation system of rewarding good performers. Performance-related pay was thus introduced in 1985, several years after the onset of economic reform. According to the 1985 official document on public sector remuneration issued by the Chinese central government, performance-related pay must reward outstanding performers. Equal “variable” pay for all employees was not allowed. It signaled the central government’s determination to reward excellent performers and improve the functions of the government.

Performance-related pay was supposed to be funded from operating budget savings. If the savings in a given government unit were substantial, outstanding performers working for this unit would have a large amount of performance-related pay. It was not surprising to see that this type of civil service remuneration stirred up enthusiasm for working hard among public workers. More importantly, this pay substantially enhanced the role of the cash-based wage system in motivating public workers, as the PRC had never before wholeheartedly promoted a cash-based remuneration system.

However, the 1993 pay reform, unfortunately, abolished performance-related pay while instead creating the bonus. Those with performance assessments being outstanding and competent received year-end bonuses. In order to distinguish this from the 1985 pay system, the 1993 one softened the tone of rewarding good performers through variable pay. As most employees were rated “outstanding” and “competent”,

Governing Civil Service Pay in China
almost all public workers received year-end bonuses. Burns and Wang (2010) report that “In practice the classification of individual performance has turned the official four-grade system into a *de facto* two-grade classification, with over 99 per cent of civil servants being rated ‘outstanding’ and ‘competent’” (pp. 72–3). They went on to argue that “less than 0.3 per cent [of civil servants] nationwide were actually rated ‘incompetent’ while those being rated ‘basic competent’ were equally rare.” Therefore, the year-end bonus actually became the thirteenth month’s salary, which few public workers were denied.

The 2006 remuneration regime inherited the same policy from the 1993 one with regard to variable pay. Nevertheless, the 2006 pay regime restricts the functions of performance-related pay wherein the amount of year-end bonus has been set at the rate of base salary in December in a year. This practice further constrains the role of variable pay. Employees in the private sector can receive handsome year-end bonuses when the market is good; therefore bonuses really link the fortunes of both individuals and employers. By contrast, the 2006 remuneration regime delinks organizations’ performances and individual outputs, as both base salary and bonus, linked to an employee’s post and seniority, have been fixed in a given year. Under the 2006 pay regime, variable pay thus is invariant in reality.

(3) Third, there is the pay parity principle, wherein two pay parities are available. That is, the pay level of civil servants should be commensurable with both employees of state-owned enterprises and teachers in basic education. The Compulsory Education Law of the PRC stipulated that the average wage for basic education teachers must not be lower than the average for civil servants. In addition, the 1993 pay document of the central government stated clearly that civil servants’ salaries should be comparable to those of employees of state-owned enterprises. The emphasis is on the pay parity between civil servants and teachers at present, as most state-owned enterprises were privatized in the 1990s.

The pay parity principle affects both pay management and fiscal management in China. The pay level of civil servants must be adjusted with reference to that of both employees in state-owned enterprises and teachers. Conversely, teachers can demand pay rises when civil servants get them. Thus any pay rises for civil servants mean that payroll costs will increase substantially as nearly all public sector employees will enjoy the benefits. Over decades, civil servants and other public workers had the
same pay adjustments. The 2006 remuneration regime was originally only applied to civil servants. Many basic education teachers therefore took to the streets and argued against exclusive pay increases for civil servants (see Wu, 2010).² The new remuneration reform for teachers thereby was kicked off in a hurry in late 2006.

(4) Fourth, pay setting rests with the executive branch. A pay bargaining system is not available in the Chinese public sector. Though the legislative branch reviews the operating budget whereby the payroll claims the lion’s share of the budget, it has never vetoed the payroll both for central and local governments throughout the history of the PRC. The remuneration issue thus is up to the executive branch of the government. The 1985 pay document from the central government stated clearly that pay setting issues must be handled by the State Council, the Ministry of Labor and Personnel, and the Ministry of Finance. Any adjustments to pay structures and related issues had to be approved by both the Ministry of Labor and Personnel and the Ministry of Finance with an endorsement from the State Council. This policy has remained intact so far, except that the Ministry of Finance is becoming increasingly influential in remuneration setting.

The Ministry of Personnel, the predecessor of the current State Administration of Civil Service of the PRC, is the most important actor promoting civil service reform in China. Traditionally viewed as a cashier (Bachman, 1989), the Ministry of Finance has enhanced its leverage in managing remuneration in the public sector in recent years. The reason behind this is that the central government intends to regain the upper hand in redistributing wealth, because local governments, as Wong (1991) notes, have inappropriately handled this redistribution for several decades. The 2006 pay document remarked that civil service pay reform as a part of income redistribution must be conducted prudently. Any threat to the implementation of the national policy should be prohibited at the local level. Since the central government has increasingly acknowledged that civil service remuneration is an integral part of its redistributive policy, the Ministry of Finance, in charge of central grants, is playing a more crucial role in managing civil service remuneration.

² There is no document explaining why the 2006 pay reform did not cover teachers originally. As teachers make up the bulk of the public sector in China, not taking their interests into consideration has both political and managerial implications.
The Evolution of the Civil Service Pay Regime in China

The heightened role of the Ministry of Finance may improve pay management. The linkage between the pay issue and fiscal management had been largely overlooked by the late 1990s. When pay packages were formulated, policy-makers made no clear plans for aligning them with the budget or positioning them appropriately within the current fiscal system. For example, the within-grade increase mechanism, a common international practice, was introduced in the 1956 pay system. However, there was not enough revenue to accommodate regular payments. As a result, only four within-grade increases were implemented from 1957 through 1978, in a limited number of government institutions (Shi & Wu, 1993). Generally speaking, within-grade increases should be carried out annually or biennially. It seems that now the Ministry of Personnel and the Ministry of Finance have started to work together more closely. As noted in Chapter 3, the 2006 pay reform strove to curb excessive pay disparities among different regions and government departments. An office responsible for reducing pay disparities was set up in the Ministry of Finance. This is evidence that the collaboration has become intensive, especially with regard to pay raises and the pay gap reduction in the public sector since the late 1990s.

A caveat is needed. Though pay determination is an executive-led model, various actors are involved in the making and implementation of civil service remuneration. The present equal pay policy is a result of the complex interactions of players such as public personnel managers, congresspersons, civil servants, and teachers. In many cases, non-state actors articulate their discontents while congresspersons pick up the debate. Over time, the issue of civil service remuneration has become a central plank of China’s Party-state.

THE DYNAMICS OF CIVIL SERVICE PAY REFORMS

Below I examine the remuneration regimes of 1956, 1985, and 1993. Each regime has its own characteristics and constraints. Altogether, the three regimes did not perform very effectively.

The 1956 Remuneration Regime

The first salary system in the PRC was introduced in June 1956. The salary of a state cadre was divided into 30 grades, where each grade corresponded to a fixed sum of money. For example, a cadre of a section head (kezhang) held salary grades ranging from the 14th to the 18th. There were 11 salary
zones according to living costs in a locality. The 11th salary zone located in Northwest China, for example, represented the highest living costs; thus, the same ranking personnel earned 30 percent higher than those working in the 1st salary zone, mainly in Southwest China. In accordance with the central control of the economy, the 1956 pay system adopted a centralized pay management structure, in which the central government developed pay policies and set pay scales with limited autonomy granted to local governments. Egalitarianism dominated in this wage regime.

During the early period of the PRC, the cash-based wage system was not available – “in kind” benefits were provided to cadres as a part of the planned economy. Two major challenges faced the Chinese government at that time; fiscal resources were scarce and professional knowledge about civil service pay management was limited. The central government therefore took a prudent attitude towards salary management while leaving local governments to conduct policy experiments. There were large variations with regard to civil service remuneration among localities. For example, with the help of Soviet advisors, the early Northeast People’s Government adopted a salary system with substantial pay differentials among cadres in its locality. Many other localities in China chose an egalitarian pay system instead. Prior to 1956, an important task of the central government was to unify the salary calculation method – a rather technical matter. Cadres were remunerated using the supply system (gongjizhi) prior to the cash-based wage system. However, localities had various calculation methods for supplies. The central government argued that salaries should be determined according to the price of five kinds of daily necessities, namely grain, cloth, oil, salt, and coal.

Some negative effects came from policy experiments at the local level. For example, there were huge regional pay differentials, which led to substantial cross-regional personnel transfers (Takahara, 1992). Excessive migration was depicted as a threat to the then fragile regime, as public administration was still at a rudimentary stage. In the winter of 1953, in response to the negative consequences of substantial regional pay disparities, an investigation group was sent to Northeast, East, and Central China by the central government. They reported that pay level was too high and pay increases were too fast in these areas (Li, 1991). Li Lishan, the then Minister of Labor, was aware of the situation. He nonetheless hesitated to take action to narrow regional pay gaps since he
thought that reasonable pay disparities could serve to motivate government employees (Takahara, 1992).

The ideology of egalitarianism was dominant at this time. In addition, the historical memory of the negative consequences of income disparities prior to the CCP’s rule rendered both civil servants and ordinary people less tolerant towards wealth inequality. Minister Li’s inaction triggered immediate attacks from party heavyweights, who viewed party ideology as a life-and-death issue. For instance, Chen Boda, Deputy Director of the Central Propaganda Department of the CCP, labeled Li Lishan as ideologically backward because the endorsement of high regional pay gaps by Li would encourage local governments to employ material rewards rather than proletarian enthusiasm to motivate their personnel (Takahara, 1992). From the point of view of orthodox communists, proletarian enthusiasm was the paramount motivator. Cash-based wages should be second and inferior in public sector motivation. More importantly, encouraging cadres to seek material rewards would be a great political incorrectness.

The situation was further complicated by central leaders becoming concerned about regional governments (a greater administrative area, da xingzhengqu), which were huge in both size and population. By 1952, “the costs and risks of regional government had become of concern to Chinese leaders” (Harding, 1981, p. 67). Harding argues that “For one thing, the regional governments were increasingly seen as a drain on scarce human and material resources. They and their Party bureaux were staffers by cadres whose services often could have been better employed in the central economic ministries, in local governments, or in industrial enterprises” (p. 67). The greater administrative area was depicted as a source of both localism and dispersionism. Cadre remuneration as an income distribution mechanism was seen as a tool for aggravating localism.

Against this backdrop, the central leadership decided to contain the growth of a decentralized remuneration system with significant pay disparities. The 1956 remuneration regime – the first one in the history of the PRC – was thus characterized by both centralized pay determination and narrow pay differentials. Once the structure of this pay regime had been formed, pay egalitarianism was strengthened in China.

Pay egalitarianism was not only politically correct but had historical roots. Cooke (2005) points out that “Egalitarianism as a distributive
ideology has for centuries characterized the thinking of the rural class struggle with the property-owning class” (p.290). A traditional saying in China is “no worry about scarcity but unevenness; no worry about poverty but instability” (buhuangua er huanbuju buhuanpin er huanbuan, Cooke, 2005, p. 281). Egalitarianism is a result of both Communist ideology and Chinese tradition. From the time that the first pay regime in the PRC institutionalized pay egalitarianism, this ideology has been reinforced periodically, even after the onset of the economic reform in 1978.

The 1956 cash-based remuneration regime, despite having a narrow pay gap, was attacked soon after its installment. Chairman Mao Zedong favored “spiritual” rather than material rewards for employees in the first place. His political aides also disliked the cash-based wage system, which was alien to these former guerrilla leaders – they embraced the idea of eating from the same pot and addressing difficulties together (the so-called “communist thinking”, see Harding, 1981, p. 192). In 1958, Mao proposed to restore the supply system of previous guerrilla warfare because the remuneration system calculated a cadre’s salary according to his position and work performance, and pay differentials would exist and broaden. Mao was very uneasy with the newly-introduced wage system. With the support of Chairman Mao, the People’s Daily published an article by Zhang Chunqiao, an important Chinese political theorist during the Mao era, attacking the cash-based remuneration system and called for the restoration of the previous supply system. In addition, both the general public and state cadres – wage earners – now turned against the cash-based salary system. 3 After all, political correctness rather than material benefit was more important for them at the time.

In 1958, a semi-supply and semi-salary system (bangongji bangongzi zhi) was introduced in many people’s communes in rural areas. Urban state-run enterprises abandoned voluntarily the 1956 pay system as well. Some argued that “It was a setback to adopt the salary system instead of the supply system. In wartime, people did not care about material rewards. Proletarian enthusiasm rather than material rewards led to the

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3. Why did ordinary civil servants dislike the cash-based wage system? It was probably a result of Party propaganda that many senior cadres, toeing the line of Chairman Mao, attacked the first remuneration system for cadres. In addition, people strove for an equality society after years of struggles between the rural class and the property-owning class. Party propaganda highlighted the struggles to justify the Party’s rule in the early period of the PRC.
success in defeating the Kuomintang. Nevertheless, the wage system stimulates individualism nowadays” (Li, 1991, p. 48). Slogans such as “working for no pay” prevailed all over the country at the time.

Widening pay differentials and promoting appropriate incentives to public workers were the original thrusts of the 1956 pay system (Korzec & Whyte, 1981). Yet, it turned out to be another story. Egalitarianism prevailed and even became stronger in the implementation of the 1956 pay regime. Originally, the 1956 pay scales for government employees allowed for a large pay gap between the highest and lowest ranking personnel. But soon after the new salary system was implemented, pay differentials were narrowed deliberately. At the end of 1956, the State Council stipulated that the pay level of cadres at grade 10 and above should be cut down from January 1957 onward (Chew, 1990a; Li, 1991). In March 1959, salary grades 1 and 3 were merged into a single grade. The 1959 adjustment was only applied to party member cadres. In October 1960, the compensation of people at grade 17 and above was further lowered: cut by 12 percent for grades 1–3, 10 percent for grade 4, 8 percent for grade 5, 6 percent for grade 6, 4 percent for grade 7, 2 percent for grade 8, and 1 percent for grades 9–17 (see Table 2.1). After several pay cuts, the pay differential shrunk by 38 percent between 1956 and 1960.

Later on, the remuneration of high-ranking cadres kept reducing while the pay level of lower-ranking officials was improving. When agricultural and industrial output began to improve because of the Great Leap Forward, a national pay raise was launched in 1963. But this pay raise was only applied to low-level cadres, among whom 40 percent of officials at grade 18 and below enjoyed salary increases. Cadres at salary grade 10 and above were excluded. In 1982, there was a large pay increase in the public sector, by which officials of grade 13 and above were not entitled to the raise. In general, as shown by Burns (2003a), egalitarianism prevailed between 1956 and 1985 (see Table 2.2). In the 11th salary zone, the ratio of the highest to the lowest pay in state organs was 22.4 in 1956 but it shrank to 14.1 in 1960 and 10.2 in 1985. Thus, pay differentials decreased by 54 percent between 1956 and 1985.

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4. The wage differential denotes the first-grade salary divided by that of the 25th grade. To make it comparable with the later three pay systems, messengers and cleaners with the salary of grade 26 and above were excluded.
## Governing Civil Service Pay in China

Table 2.1: Comparison between the 1956 and 1960 pay scales (yuan/month)

<table>
<thead>
<tr>
<th>Grade</th>
<th>All 1956</th>
<th>Party Members 1960</th>
<th>Non-Communist Party Members 1960</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>644</td>
<td>404.8</td>
<td>579.5</td>
</tr>
<tr>
<td>2</td>
<td>581</td>
<td>404.8</td>
<td>522.5</td>
</tr>
<tr>
<td>3</td>
<td>517.5</td>
<td>404.8</td>
<td>465.5</td>
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<tr>
<td>4</td>
<td>460</td>
<td>372.6</td>
<td>414</td>
</tr>
<tr>
<td>5</td>
<td>414</td>
<td>342.7</td>
<td>372.5</td>
</tr>
<tr>
<td>6</td>
<td>368</td>
<td>325.2</td>
<td>346</td>
</tr>
<tr>
<td>7</td>
<td>322</td>
<td>290.4</td>
<td>302.5</td>
</tr>
<tr>
<td>8</td>
<td>287.5</td>
<td>264.6</td>
<td>270</td>
</tr>
<tr>
<td>9</td>
<td>253</td>
<td>243</td>
<td>245.5</td>
</tr>
<tr>
<td>10</td>
<td>218.5</td>
<td>209.9</td>
<td>212</td>
</tr>
<tr>
<td>11</td>
<td>195.5</td>
<td>193.5</td>
<td>195.5</td>
</tr>
<tr>
<td>12</td>
<td>172.5</td>
<td>170.8</td>
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<td>155.5</td>
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<td>25.5</td>
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<tr>
<td>30</td>
<td>23</td>
<td>23</td>
<td>23</td>
</tr>
</tbody>
</table>

Source: Adapted from Li, 1991, p. 146; Shi & Wu, 1993, p. 206.

Note: Pay scale shown in the table refers to the remuneration of the 6th salary zone only.
The Evolution of the Civil Service Pay Regime in China

The 1985 Remuneration Regime

The 1985 remuneration regime set out to address the problems of the 1956 regime. Specifically, the new regime aimed to eradicate egalitarianism in civil service compensation and restore the function of wage. But it turned out to be unsuccessful.

Table 2.2: Pay differentials in selected years (yuan/month)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Highest pay</td>
<td>728</td>
<td>655.2</td>
<td>526.5</td>
<td>457.6</td>
<td>468</td>
<td>530</td>
</tr>
<tr>
<td>Lowest pay</td>
<td>32.5</td>
<td>32.5</td>
<td>32.5</td>
<td>32.5</td>
<td>34.5</td>
<td>52</td>
</tr>
<tr>
<td>Highest/lowest pay</td>
<td>22.40</td>
<td>20.16</td>
<td>16.20</td>
<td>14.08</td>
<td>13.57</td>
<td>10.19</td>
</tr>
</tbody>
</table>

Source: Adapted from Burns, 2003a, p. 53

The political environment in the early 1980s generally favored the overhaul of the public administration system and the pay regime. Harding (1987) claims that “In the nine years between the death of Mao Zedong in 1976 and the National Party Conference in 1985, the center of gravity of the Chinese political spectrum shifted rapidly to the right” (p.66). Thus, “In certain years – for example, 1978 and 1984 – the tide of reform had been at its height, with comprehensive programs adopted, bold new proposals placed on the agenda, and great progress made toward enlivening the economy and relaxing political life” (p.93). As part of the cadre system reforms, the reform of the public sector pay regime had been on the agenda of the central government from 1978. Deng Xiaoping had articulated the need to remove political ideology from pay setting in the public sector, wherein position and work performance should count significantly in pay determination. So a favorable political environment gave impetus to the birth of the new remuneration regime.

The central government set up a National Committee for Salary Reform in 1978. Local governments were instructed to conduct a large-scale investigation concerning the reform. A high-level national conference on the reform in January 1979 criticized the combination of low wages and full employment in China (Takahara, 1992). The 1956 pay system was summarized as being “low-wage (di), egalitarian (ping), rigid (si) and chaotic (luan)” (Li, 1991; Shi & Wu, 1993). As noted by Li (1991), the fact that supervisors and supervisees often earned the
same pay prior to 1985 provided grave disincentives for motivating employees to work hard.

Policy-makers in Beijing proposed four possible policy options in a bid to improve remuneration in the public sector (Shi & Wu, 1993). The first proposal was to fine-tune the old system. Some argued that the crux of the matter lay in poor implementation and some technical problems. For instance, the within-grade pay increase should be conducted biennially, but it had never been carried out regularly after the installation of the 1956 remuneration regime. The second option was to improve the weight of positions held on pay determination. Those high-ups in the hierarchy would earn much more than those at the grassroots level. Underlying this proposal was a plan to eliminate the egalitarian nature of the public sector pay system. The third option was to extend the army pay system to civilian public officials. The army system had a pay structure with only two components: a base pay plus a position allowance, in which the base pay aimed to satisfy the basic needs of army recruits whilst the position allowance was offered to leading officers. Thus, in this salary structure, the gap between leading and non-leading cadres would be very large.

The fourth option was to adopt a structural pay system made up of many components, each of which would serve different purposes. A mixture of various components would not only strengthen the function of remuneration but also could reconcile the needs of various actors, such as senior and ordinary cadres, and Party conservatives and reformists, thereby reducing the overall resistance to the new system. This last option was finally chosen.

Apart from seeking a compromise, three other factors might have contributed to the adoption of the fourth proposal. First, the leadership in Beijing was willing to depart from the old remuneration policy. They did not accept the first option since it was largely akin to the 1956 pay system. The second and third options were rejected because the unprecedentedly heavy weight given to position in pay determination might annoy ordinary cadres. As noted, wealth inequality was a sensitive topic in the public domain. Third, and most importantly, the structural pay system bore some elements of performance-based pay, which was a brand-new idea for state cadres and welcomed by reformists. Echoing Deng Xiaoping’s remark, the then premier Zhao Ziyang stated clearly...
that “everybody eating from the same big pot” should no longer be the slogan, and that the new pay system should embody the principle of reward according to work and performance (Chew, 1990a). The then central leadership in China wanted to make a difference though utilizing various innovations to improve government efficiency and enhance its legitimacy. Under the framework of the structural pay system, the idea of good performers receiving a higher level of compensation would not only motivate ordinary employees but also meet the expectations of the reformers.

The 1985 remuneration regime did not achieve its policy goals. Pay levels deteriorated while egalitarianism triumphed. The ratio of the highest to the lowest pay among state cadres declined substantially. It was 12.27 in 1956 and 6.83 in 1985 with regard to the pay ratio of a minister to a clerk (see Table 2.3).

The low Gini coefficient in the public sector indicates an egalitarian characteristic of income distribution. The smaller the Gini coefficient, the more equal the distribution is. The Gini coefficient in state organs and social organizations was 0.17 in 1985 and 0.16 in 1990. As suggested by the international standard, the Gini coefficient in the government normally should not be lower than 0.2 (Xu et al., 1993).

Thus, even though the 1985 pay reform aimed to rectify the deficiencies of the 1956 one, the period 1985–1993 witnessed plummeting pay levels in the public sector, in addition to an enhanced egalitarianism. Without addressing the fundamental problems embedded in the previous remuneration regime, the unpopular 1985 pay system lasted only eight years.

**The 1993 Remuneration Regime**

Several changes were made in 1993. First, remuneration in other public service units was separated from that of the civil service, although a pay disparity principle still prevailed. As Cooke (2005) notes, “The second pay reform [of 1985] covered a period of eight years with limited success in the implementation of the structural wage system, in part because it tried to cover too broad a range of occupations” (p.284). In order to focus more on a narrower range of occupations, the 1993 pay system

---

5. Remuneration in public service units was delinked from civil service pay, yet salary increase reviews were conducted simultaneously based on various regulations on public sector remuneration.
explicitly separated the salary system of public service units from that of state organs. Second, a new item, a cost-of-living allowance (diqu jintie), was introduced to cover living costs. The salary zone system of previous remuneration regimes was consequently abolished. Song Defu (2005), the then Minister of Personnel, remarked that since a large-scale investigation on cost of living could not be carried out within a short time, the central government would not publish a national circular with regard to the cost-of-living allowance in the near future. As discussed in the next chapter, variations in the cost-of-living allowance gave rise to huge regional pay disparities and triggered the 2006 pay reform. Third, a grade salary was created to compensate the accumulated contribution of an employee. Subsequently therefore, seniority carried more weight in pay determination.

In the turbulent period of the late 1980s and early 1990s, the reform of public sector remuneration was subject to the changing political environment. Deng Xiaoping, the paramount leader during the period, was keen to promote political reform, and civil service reform was brought to the front of the organizational work of the CCP. The open-minded reformists were willing to embrace the western-style civil service system, such as the excluding of civil servants from political appointments (Hou, 2007). In addition, the leadership in Beijing invited international experts to attend the conferences and symposiums held in China to discuss the reform of public sector remuneration (Chew, 1990a). It was agreed that civil service compensation should learn from Western countries in a cabinet meeting in 1988 (Hou, 2007): a relatively well-paid civil service must be put in place in order to make economic transition smooth; both the egalitarianism and the low pay of the previous pay regimes must be removed progressively.

Table 2.3: Pay differentials, 1956 and 1985

<table>
<thead>
<tr>
<th></th>
<th>Ministry-level/Bureau-level</th>
<th>Ministry-level/Division-level</th>
<th>Ministry-level/Section Head</th>
<th>Ministry-level/Clerk</th>
</tr>
</thead>
<tbody>
<tr>
<td>1956</td>
<td>2.67</td>
<td>4.16</td>
<td>5.25</td>
<td>12.27</td>
</tr>
<tr>
<td>1985</td>
<td>2.5</td>
<td>3.38</td>
<td>4.67</td>
<td>6.83</td>
</tr>
</tbody>
</table>

Source: Xu et al., 1993, p.47.
Conservative forces prevailed after the 1989 Tiananmen incident. The proposed civil service reform was labeled as bourgeois liberalism, which should be combatted by the socialist state. The leaders of the Ministry of Personnel became cautious about promoting civil service reform because they were afraid of being purged by Party conservatives (Hou, 2007). Opinions on what should be the next step differed greatly among the senior leadership of the Ministry of Personnel. Eventually, they decided to explain in detail to the central leadership the benefits of the introduction of a reformed civil service system and a modern remuneration regime.

Despite the unfavorable political environment, some top decision-makers in Beijing were fully aware of the negative consequences of a crippled remuneration system. The Ministry of Personnel and the Chinese Academy of Social Sciences therefore were instructed by the State Council to conduct some surveys for creating a new remuneration regime. The research group jointly convened by the above two ministerial bodies later issued a series of reports identifying three fundamental problems in public sector remuneration (Research Unit on Civil Service Pay Reform, 1993).

(1) First, both informal wages and fringe benefits were grotesquely substantial. Government departments were creating various fringe benefits such as housing, transportation subsidies, and even haircut subsidies in a bid to supplement the low formal wages. For example, the apartment rent rate was so low that the price of a packet of cigarettes was equal to a year’s public housing rent. Therefore, civil servants’ real salaries were shrinking while informal wages were enlarging substantially. According to a survey conducted by the National Bureau of Statistics on 35,000 households in China, informal wages were 25.8 percent of the total incomes in 1990 (Research Unit on Civil Service Pay Reform, 1993). In-kind benefits cost the state substantial financial resources. For example, rental subsidies were 58.3 billion yuan in 1988, which was 23.4 percent of national government budgetary expenditure in the same year.

(2) Second, both grade creeping and the upgrading of government departments’ positions were widespread and serious across the country. As the 1985 remuneration regime had introduced a highly weighted position salary, the pressure to increase the ranks of individual civil servants became acute after 1985. The amount of supervisory positions increased...
sharply; thus the ratio of supervisor to employee was exceptionally high across the board. For example, one employee answered to 1.04 supervisors in the Shanghai Municipal Government. Furthermore, since the upgrading of departments’ administrative ranks benefited all the people in the organizations, the ranks of many departments were substantially upgraded in the late 1980s and early 1990s. Many bureau-level organizations, for example, were promoted to vice-minister-level departments (Research Unit on Civil Service Pay Reform, 1993). In brief, though salary for civil servants was compressed, grade and position creeping posed a threat to local personnel and fiscal management.

(3) Third, the pay parity principle was being undermined. The principle required the adjustment of civil service pay in accordance with the wage applied in state-owned enterprises. The pay level of state organs nonetheless was much lower than that of state-owned enterprises after 1985. It meant that civil servants earned much less than those working in the state-owned manufacturing sector.

State-owned enterprises, running ahead of civil service pay reform, had introduced many substantial reforms to remuneration in the early 1980s. Remuneration decision-making was decentralized to enterprise managers while the bonus ceiling was lifted in 1984. Consequently, salaries in enterprises increased rapidly in the late 1980s. The gap between state cadres and state-owned enterprise employees thus broadened sharply. Xu (1992) argues that the salary growth rate in state organs was only 55 percent of that in enterprises between 1986 and 1990. A comparison between the pay levels of new employees in state organs and state-owned enterprises illustrates the remuneration gap as well. University graduates in state organs got a starting salary that was 5.49 percent more than their counterparts in state-owned enterprises in 1957. But new entrants with university degrees in state organs received 37 percent less than those in state-owned enterprises in 1990 (Xu et al., 1993).

The research group jointly organized by the Ministry of Personnel and the Chinese Academy of Social Sciences thus proposed three important reforms in civil service remuneration (Research Unit on Civil Service Pay Reform, 1993). First, the civil service wage should be monetized and made transparent. Non-monetized benefits should be abolished gradually. Second, “pay according to work performed” should
be implemented so that job responsibilities and difficulties could really determine the wage level. Grade creeping, an alternative way to improve civil service remuneration, should be eradicated in the future. Third, “the pay parity principle” should be upheld. It meant not only pay parity between civil servants and state-owned enterprise employees but also a pay trend survey before pay adjustments were applied to civil servants.

The 1993 remuneration regime incorporated all the suggestions made by the above research group. The 1993 pay document issued by the central government emphasized the need to combat grade creeping and address pay parity between state organs and state-owned enterprises. In addition, a cost-of-living allowance was introduced to compensate local diversities in living costs.

It should be noted that although the central government’s document for the 1993 pay regime adopted the suggestions, the fundamental problems inherited in the Chinese wage system were not addressed. For one thing, it was not until the late 1990s that pay parity between civil servants and state-owned enterprise employees began to be actualized. Pay disparities between civil servants and teachers have become salient in recent years. More importantly, informal remuneration has become greatly problematic since the introduction of the 1993 remuneration regime.

DISCUSSION

This chapter has reviewed the four civil service pay principles in China, namely pay according to work performed, base pay coexisting with variable pay, the pay parity principle, and pay setting resting with the executive branch. Furthermore, this chapter has examined the evolution of civil service pay regimes before the 2006 pay reform.

Four remuneration principles deal with distinct but related issues. The principle of “pay according to work performed” is related to pay determination. A public worker’s pay hinges on work performance and position held, rather than political credentials. The second principle is associated to the pay structure in the Chinese public sector wherein variable pay serves for motivating good performers. Variable pay can also be used to attract and retain talent, thus facilitating the development of human resource management in the public sector. The third principle – pay parity – entails the requirement of equal pay for equal work in
the public sector. The pay parity principle is more often referred to as the same pay for men and women in the Western context, but in China, it mainly points to equal pay among employees in the public sector. In 2006, teachers in the compulsory education sector were disgruntled with a nationwide pay rise exclusively for civil servants. The central government had to respond to the concerns of teachers; therefore a similar pay rise was applied to other public employees in addition to civil servants in late 2006. Pay determination resting with the executive branch is a Chinese characteristic. Trade unions negotiating with the government about pay issues does not happen in China. Even though the parliament has the power to review the budget, this power remains on paper. Civil service pay is decided solely by the executive branch of the Chinese government. This fact has some profound implications, not only on the remuneration front but also on the political one. It explains why civil service pay systems have evolved greatly since 1956. When the policy did not become legitimized among civil servants and the general public, it was doomed to a sluggish implementation and to local resistance. In reality, despite the executive-led model, civil service remuneration has involved intensive interactions, mainly informally, among various actors, including non-state actors, which have complicated the situation in recent years.

The macro political environment has a great impact on the development of civil service remuneration. Over decades, a combination of Communist ideology and Chinese tradition limited the development of a well-functioning pay system for civil servants. On the one hand, the pay differential among civil servants was very small given the egalitarian nature of the income system. Informal wages, on the other hand, flourished in government organizations. As will be discussed in the next chapter, civil service pay level was largely decided by a government department rather than tailored to the seniority or performance of the public worker. This practice provided great disincentives to good performers in various government departments and localities.
CHAPTER THREE

The Introduction of Equal Pay Policy

This chapter gives a detailed account of the 2006 civil service pay reform, which aimed to promote an equal pay policy in the public sector. This policy strove to close the excessive regional and departmental pay gap among civil servants. The making of the equal pay policy reflected the complexity of wealth distribution in developing countries like China. Through examining the dynamics of the equal pay policy, I argue that despite a seemingly successful strategy promoted by the central government, the actual impact of the equal pay policy on civil service remuneration remains problematic.

The chapter is organized as follows. It reviews theories related to pay differentials and pay disparities in the public sector. Attention then turns to examine China’s pay disparities and their reasons. The equal pay policy is investigated in detail. The final section makes some preliminary assessments of the effects of the equal pay policy.

Theorizing Pay Inequalities

Standard public personnel management theory endorses the idea that appropriate pay differentials between senior and junior civil servants are beneficial, and motivate employees. Also, both egalitarianism and excessive pay gaps among civil servants generate negative consequences for public sector remuneration. A vast literature suggests that civil servants tend to be predatory when they are poorly compensated (Wei, 1999). Nevertheless, higher pay may not lead to a lower incidence of corruption and other predatory behaviors (Gong & Wu, 2012b). The perception of an unfair remuneration caused by excessive pay inequalities, even under a high remuneration regime, can have the same negative impacts on civil service governance as low pay or egalitarianism does. A perceived unfairness of remuneration, as the organizational justice literature reveals, is associated with bad work performance. People compare their own workloads and salaries with others. The situation may be acuter when
comparisons are directed at colleagues in the same work unit. Thus the importance of both internal pay justice and remuneration parity is widely recognized by modern human resource management theories. As we shall see later, the negative effects of internal pay inequalities among Chinese civil servants were grave.

THE WIDENED PAY GAP AFTER 1985

Pay inequalities existed extensively among regional governments and individuals within a city. The regional pay gap was largely acceptable between 1956 and 1985. But problems nonetheless began in the mid-1980s. The pay gap between the eastern and the western parts of China widened after the installation of the 1985 remuneration regime. Table 3.1 provides information on the top 10 highest-remuneration provinces between 1985 and 2000. In the early years, the northwestern provinces had the highest pay levels; thus, five western provinces (Tibet, Qinghai, Xinjiang, Gansu, and Ningxia) were among the top 10, while three eastern provinces (Guangdong, Shanghai, and Fujian) were in the same list in 1985. Four years later, only three provinces in western China, namely Tibet, Qinghai, and Xinjiang, remained in the top 10. Despite that, the rankings of Qinghai and Xinjiang declined. In 2000, only Tibet and Qinghai remained in the top 10 list and their rankings dropped substantially. Meanwhile, five provinces (Shanghai, Zhejiang, Guangdong, Jiangsu, and Fujian) in the eastern part of China had the highest pay levels. In addition, the rankings of the eastern cohort increased sharply. Shanghai ranked the top in terms of civil service pay level.

Figure 3.1 shows that the regional pay gap between western and eastern China broadened conspicuously from 1985 to 2000. The average annual pay gap between the five eastern and western provinces was 165 yuan in 1990, 2,342 yuan in 1995, and 6,391 yuan in 2000. A civil servant working in an eastern province could earn twice as much as one in a western province in 2000.

Some might assume that the pay gap would narrow if the growth rate of civil service remuneration in the western part of China was higher than that in the East. In this case, the compensation level in western provinces would catch up with that in the eastern provinces sooner or later. Policy-makers also held a similar view; and therefore central grants were offered to 22 relatively poor provinces for the October 2001
Table 3.1: Top 10 highest government employee compensation in China in selected years (yuan/year), 1985–2000

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Tibet</td>
<td>2,029</td>
<td>Tibet</td>
<td>3,135</td>
<td>Shanghai</td>
<td>8,619</td>
<td>↑ 4</td>
<td>Shanghai</td>
<td>20,659</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Qinghai</td>
<td>1,785</td>
<td>Guangdong</td>
<td>2,681</td>
<td>↑ 2</td>
<td>Guangdong</td>
<td>8,592</td>
<td>Beijing</td>
<td>17,908</td>
<td>↑ 2</td>
</tr>
<tr>
<td>3</td>
<td>Xinjiang</td>
<td>1,610</td>
<td>Qinghai</td>
<td>2,464</td>
<td>↓ 1</td>
<td>Tibet</td>
<td>8,288</td>
<td>Shanghai</td>
<td>17,439</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Guangdong</td>
<td>1,335</td>
<td>Xinjiang</td>
<td>2,386</td>
<td>↓ 1</td>
<td>Beijing</td>
<td>8,011</td>
<td>Zhejiang</td>
<td>15,473</td>
<td>↑ 1</td>
</tr>
<tr>
<td>5</td>
<td>Gansu</td>
<td>1,283</td>
<td>Shanghai</td>
<td>2,178</td>
<td>↑ 1</td>
<td>Zhejiang</td>
<td>7,315</td>
<td>Guangdong</td>
<td>14,974</td>
<td>↓ 3</td>
</tr>
<tr>
<td>6</td>
<td>Shanghai</td>
<td>1,219</td>
<td>Hainan</td>
<td>2,146</td>
<td></td>
<td>Hainan</td>
<td>7,051</td>
<td>Jiangsu</td>
<td>13,822</td>
<td>↑ 1</td>
</tr>
<tr>
<td>7</td>
<td>Beijing</td>
<td>1,207</td>
<td>Tianjin</td>
<td>2,114</td>
<td>↑ 1</td>
<td>Jiangsu</td>
<td>7,040</td>
<td>Tianjin</td>
<td>13,176</td>
<td>↑ 1</td>
</tr>
<tr>
<td>8</td>
<td>Ningxia</td>
<td>1,185</td>
<td>Liaoning</td>
<td>2,064</td>
<td></td>
<td>Tianjin</td>
<td>7,002</td>
<td>Fujian</td>
<td>11,759</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Inner Mongolia</td>
<td>1,148</td>
<td>Fujian</td>
<td>2,048</td>
<td>↑ 2</td>
<td>Xinjiang</td>
<td>6,025</td>
<td>Qinghai</td>
<td>10,662</td>
<td>↑ 1</td>
</tr>
<tr>
<td>10</td>
<td>Fujian</td>
<td>1,125</td>
<td>Zhejiang</td>
<td>2,042</td>
<td></td>
<td>Qinghai</td>
<td>5,818</td>
<td>Liaoning</td>
<td>9,991</td>
<td></td>
</tr>
</tbody>
</table>


Note: Columns 6, 9 and 12 indicate changes in province ranking.
pay raise and the 2003 pay raise. Seven provinces (also called “the rich club of seven provinces”) were excluded from receiving central grants. Nevertheless, the signs of catching up were never seen. Instead, the pay gap widened substantially. As indicated by Tables 3.2 and 3.3 (excluding the 2001 pay raises) the average growth rate of civil service remuneration in the five western provinces lagged further behind than in the eastern ones between 2000 and 2005. Furthermore, the disparity in growth rate widened after 2003. For example, the gap of salary growth between the East and the West was 1.13 percent in 2000, but jumped to 8.31 percent in 2003 and 7.01 percent in 2005. More specifically, Jiangsu Province, in the eastern cohort, for example, saw a 20.30 percent salary increase

Table 3.2: Civil service pay raises of five provinces in eastern China (%), 2000–2005

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shanghai</td>
<td>19.99</td>
<td>12.53</td>
<td>10.96</td>
<td>12.72</td>
<td>9.18</td>
<td>9.72</td>
</tr>
<tr>
<td>Jiangsu</td>
<td>10.64</td>
<td>18.46</td>
<td>12.86</td>
<td>20.30</td>
<td>19.44</td>
<td>20.81</td>
</tr>
<tr>
<td>Zhejiang</td>
<td>17.84</td>
<td>38.77</td>
<td>14.76</td>
<td>19.01</td>
<td>22.53</td>
<td>24.85</td>
</tr>
<tr>
<td>Fujian</td>
<td>11.58</td>
<td>16.67</td>
<td>10.38</td>
<td>8.87</td>
<td>10.55</td>
<td>15.81</td>
</tr>
<tr>
<td>Guangdong</td>
<td>13.23</td>
<td>20.95</td>
<td>20.00</td>
<td>19.89</td>
<td>14.12</td>
<td>12.13</td>
</tr>
<tr>
<td>Average</td>
<td>14.66</td>
<td>21.48</td>
<td>13.79</td>
<td>16.16</td>
<td>15.16</td>
<td>16.67</td>
</tr>
</tbody>
</table>

The Introduction of Equal Pay Policy

in 2003, while Zhejiang Province had a 19.01 percent raise. In stark contrast, the highest one in the western cohort was only 8.39 percent in 2003. The reasons behind such discrepancies were: (1) the central government did not fulfill its promise of bearing the full cost of pay raises; thus, the pay rate of poor localities did not increase as stipulated by the central government; and (2) local governments diverted the central

Table 3.3: Civil service pay raises of five provinces in western China (%), 2000–2005

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shaanxi</td>
<td>11.57</td>
<td>24.27</td>
<td>12.58</td>
<td>8.05</td>
<td>9.71</td>
<td>10.67</td>
</tr>
<tr>
<td>Gansu</td>
<td>13.06</td>
<td>28.06</td>
<td>12.79</td>
<td>9.39</td>
<td>5.17</td>
<td>10.34</td>
</tr>
<tr>
<td>Qinghai</td>
<td>15.18</td>
<td>34.82</td>
<td>8.24</td>
<td>5.85</td>
<td>9.68</td>
<td>10.90</td>
</tr>
<tr>
<td>Ningxia</td>
<td>16.02</td>
<td>30.55</td>
<td>13.45</td>
<td>6.60</td>
<td>14.60</td>
<td>11.06</td>
</tr>
<tr>
<td>Xinjiang</td>
<td>11.82</td>
<td>36.13</td>
<td>11.67</td>
<td>9.34</td>
<td>6.89</td>
<td>5.33</td>
</tr>
<tr>
<td>Average</td>
<td>13.53</td>
<td>30.76</td>
<td>11.75</td>
<td>7.85</td>
<td>9.21</td>
<td>9.66</td>
</tr>
</tbody>
</table>


Table 3.4: Annual salary of state organs and public service units in Liaoning Province (yuan/year) in selected years

<table>
<thead>
<tr>
<th></th>
<th>1991</th>
<th>1998</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shenyang</td>
<td>2,624</td>
<td>9,630</td>
<td>24,572</td>
</tr>
<tr>
<td>Dalian</td>
<td>2,589</td>
<td>8,756</td>
<td>27,914</td>
</tr>
<tr>
<td>Anshan</td>
<td>2,440</td>
<td>8,126</td>
<td>20,487</td>
</tr>
<tr>
<td>Fushun</td>
<td>2,401</td>
<td>8,069</td>
<td>20,247</td>
</tr>
<tr>
<td>Benxi</td>
<td>2,600</td>
<td>8,155</td>
<td>19,367</td>
</tr>
<tr>
<td>Dandong</td>
<td>2,432</td>
<td>7,115</td>
<td>19,529</td>
</tr>
<tr>
<td>Jinzhou</td>
<td>2,429</td>
<td>8,009</td>
<td>18,014</td>
</tr>
<tr>
<td>Yingkou</td>
<td>2,124</td>
<td>7,013</td>
<td>18,341</td>
</tr>
<tr>
<td>Fuxin</td>
<td>2,194</td>
<td>6,492</td>
<td>14,773</td>
</tr>
<tr>
<td>Liaoanyang</td>
<td>2,332</td>
<td>8,370</td>
<td>18,867</td>
</tr>
<tr>
<td>Panjin</td>
<td>2,126</td>
<td>7,955</td>
<td>18,053</td>
</tr>
<tr>
<td>Tieling</td>
<td>2,208</td>
<td>6,641</td>
<td>15,861</td>
</tr>
<tr>
<td>Chaoyang</td>
<td>2,342</td>
<td>6,344</td>
<td>14,878</td>
</tr>
<tr>
<td>Jinx (Huludao after 1994)</td>
<td>2,209</td>
<td>7,394</td>
<td>15,845</td>
</tr>
<tr>
<td>Average</td>
<td>2,361</td>
<td>7,719</td>
<td>19,053</td>
</tr>
</tbody>
</table>

Sources: The 1991 data are taken from Li (1993, p. 109) while others come from the Liaoning Provincial Statistical Yearbook 1999 and 2006.
Governing Civil Service Pay in China

monies for pay raises to other uses (including building infrastructure or paying due salaries).

In addition to the substantial regional pay gap, intra-provincial disparities in civil service compensation had grown since the early 1990s. As seen in Table 3.4, for example in Liaoning Province (located in the northeast of the country), the pay gap between Shenyang City with the highest compensation and Panjin City with the lowest compensation was 500 yuan (more than one-fifth of the average salary of state organs in Liaoning Province, which was 2,361 yuan) in 1991. The salary gap between the above two cities soon grew to 3,286 yuan (more than one-third of average salary of civil servants in Liaoning Province) in 1998, and jumped to 13,141 yuan (69 percent of the average salary) in 2005. The aggregate data show a similar trend in other provinces as well.

As seen in Table 3.5, the pay gap between prefectural cities with the highest and lowest compensation in the coastal Fujian Province was 5,214 yuan (commensurate to the average salary of civil servants, which was 5,438 yuan) in 1994. The gap became 10,929 yuan (exceeding the average salary of 10,713 yuan) in 1999 and rose further to 14,188 yuan (higher than the average salary of Fujian Province in 2001).

Likewise, as indicated by the salary survey of the Statistical Bureau of Guangdong Province (a coastal province) conducted in 2004, intra-pro-

Table 3.5: Annual salary of state organs and public service units in Fujian Province (yuan/year) in selected years

<table>
<thead>
<tr>
<th></th>
<th>1994</th>
<th>1999</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fuzhou</td>
<td>5,245</td>
<td>10,894</td>
<td>14,817</td>
</tr>
<tr>
<td>Xiamen</td>
<td>9,817</td>
<td>19,133</td>
<td>25,012</td>
</tr>
<tr>
<td>Putian</td>
<td>4,738</td>
<td>9,560</td>
<td>12,618</td>
</tr>
<tr>
<td>Sanming</td>
<td>5,046</td>
<td>9,490</td>
<td>12,069</td>
</tr>
<tr>
<td>Quanzhou</td>
<td>5,365</td>
<td>11,652</td>
<td>15,260</td>
</tr>
<tr>
<td>Zhangzhou</td>
<td>4,723</td>
<td>9,858</td>
<td>12,064</td>
</tr>
<tr>
<td>Nanping</td>
<td>4,786</td>
<td>8,628</td>
<td>10,994</td>
</tr>
<tr>
<td>Longyan</td>
<td>4,621</td>
<td>8,997</td>
<td>11,884</td>
</tr>
<tr>
<td>Ningde</td>
<td>4,603</td>
<td>8,204</td>
<td>10,824</td>
</tr>
<tr>
<td>Average</td>
<td>5,438</td>
<td>10,713</td>
<td>13,949</td>
</tr>
</tbody>
</table>

The Introduction of Equal Pay Policy

Table 3.6: Civil service pay in Guangdong Province (yuan/month), 2001

<table>
<thead>
<tr>
<th>County</th>
<th>County Head</th>
<th>County Deputy</th>
<th>Section Head</th>
<th>Section Deputy</th>
<th>Section Member and Clerk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guangzhou</td>
<td>3,094</td>
<td>3,001</td>
<td>2,878</td>
<td>2,828</td>
<td>2,362</td>
</tr>
<tr>
<td>Shenzhen</td>
<td>5,118</td>
<td>4,612</td>
<td>4,052</td>
<td>3,520</td>
<td>3,134</td>
</tr>
<tr>
<td>Shaoguan</td>
<td>1,645</td>
<td>1,508</td>
<td>1,185</td>
<td>1,044</td>
<td>930</td>
</tr>
<tr>
<td>Zhanjiang</td>
<td>1,247</td>
<td>1,238</td>
<td>1,165</td>
<td>1,081</td>
<td>919</td>
</tr>
<tr>
<td>Huizhou</td>
<td>1,910</td>
<td>1,705</td>
<td>1,415</td>
<td>1,256</td>
<td>1,101</td>
</tr>
<tr>
<td>Shantou</td>
<td>2,004</td>
<td>1,860</td>
<td>1,648</td>
<td>1,471</td>
<td>1,285</td>
</tr>
<tr>
<td>Meizhou</td>
<td>1,453</td>
<td>1,182</td>
<td>1,017</td>
<td>887</td>
<td>816</td>
</tr>
<tr>
<td>Zhaoqing</td>
<td>1,618</td>
<td>1,485</td>
<td>1,277</td>
<td>1,064</td>
<td>1,191</td>
</tr>
<tr>
<td>Yangjiang</td>
<td>1,710</td>
<td>1,631</td>
<td>1,332</td>
<td>1,167</td>
<td>983</td>
</tr>
<tr>
<td>Dongguan</td>
<td>3,633</td>
<td>3,176</td>
<td>2,698</td>
<td>2,407</td>
<td>2,121</td>
</tr>
<tr>
<td>Average</td>
<td>2,343</td>
<td>2,140</td>
<td>1,867</td>
<td>1,673</td>
<td>1,484</td>
</tr>
</tbody>
</table>


Provincial disparities were enormously high. The average monthly salaries of county-level cadres in Shenzhen City and Dongguan City in 2001 were 4.1- and 2.91-fold higher than that of civil servants in the poorest county, Zhanjiang. Thus, a section member in Shenzhen City and a section head in Dongguan City earned more than county executives in the majority of localities in Guangdong Province (see Table 3.6).

Pay inequalities were large among those working in the same city. Su and Yang (2008) observe that employees of powerful departments, for example, regulatory agencies and courts, had better remuneration. Even the compensation for those working in the same department but in different branches diverged substantially. For example, based on a survey in 2004 and 2005, Su and Yang (2008) found that in a city in Liaoning Province, the average monthly formal salary was 1634.72 yuan in the Finance Department while it was 1198.37 yuan in the Water Conservancy Bureau. This meant that civil servants in the Finance Department earned more than 30 percent higher than those in the Water Conservancy Bureau. In a city in Guangdong Province, civil servants of the Urban Management Bureau earned 500 yuan higher than those working for the Department of Public Security. Some government departments in rich localities paid their employees substantial fringe benefits, which could be more than twice as high as those working in
other government departments (Su & Yang, 2008). Together with fringe benefits, the inter-departmental pay gap was 2–3-fold or even 5–6-fold in the same locality (Wu, 2006).

**THE CAUSES OF THE PAY GAP**

There was a macro-level and a micro-level cause of this growing pay gap. (1) First (macro-level), regional economic inequalities had an impact on income disparities. Lu and Song (2004) observe that the regional imbalance became prominent in the 1990s as measured by GDP per capita, average income, and consumption (p.530). There were several factors accounting for such an imbalance. Globalization and trade openness contributed to regional inequalities, since some localities enjoyed more benefits from globalization, due to their better human and natural resources (Kanbur & Zhang, 2005; Wan, Lu & Chen, 2007). The regional development policy added to the inequalities. The “post-Mao unbalanced regional development policy, which offered preferential measures and strategies in the coastal region,” led to regional disparities (Lu & Song, 2004, p. 544).

Apart from the macroeconomic factors, public sector pay inequalities were associated with decentralized pay determination and the government’s “ability to pay”. Pay setting decentralization has become common across the globe. Nevertheless, pay decentralization in 1985 and 1993 paved the way for pay disparities, due to poor fiscal discipline in local China.

The 1985 remuneration regime started to decentralize pay determination to local governments. In this pay regime, the central government only set the pay scales for itself and provincial governments, while the pay rates of prefectural, county and township governments were decided by local governments. Resource-rich governments could compensate their employees more generously, with poor localities being hardly able to keep their employees’ heads above water.

Since the base salary was the same across-the-board, pay disparities were mainly reflected in the value of non-base salary items, such as a...
The Introduction of Equal Pay Policy

cost-of-living allowance managed by local governments. According to the China Labor and Salary Statistical Yearbook (1990), non-base salary items constituted 40 percent of the total pay in 1989. Such a percentage remained stable between 1997 and 2001, but dropped to 39.66 percent in 2002. Thereafter, the share increased sharply from 41.48 percent in 2003 to 49.95 in 2005 (Figure 3.2). According to the literature, the real share of non-base salary items was much higher than indicated by official statistics. For example, empirical evidence shows that the proportion of non-base salary items in the total formal wage was 67 percent (Wang, 2006). Officials in the Department of Personnel in Guangdong Province admitted that non-base salary accounted for 70 percent of total salaries for southern coastal localities in 1998 (Cheung & Poon, 2001). An interviewed senior remuneration researcher affiliated to the Ministry of Personnel reported that non-base salaries in many localities accounted for 60 to 70 percent of the total pay, but the proportion they deemed acceptable or reasonable was only 20–30 percent (Interview note, PA-20090615).

(2) Second (micro-level), the variation in the fiscal capacity of government was essentially the root cause of the pay disparities. As shown in Tables 3.7 and 3.8, the fiscal revenues of all localities had increased between 1999 and 2005, but the gap between rich and poor localities

Figure 3.2: Proportion of non-base salary in civil servant pay (%), 1997–2005

![Graph showing the proportion of non-base salary in civil servant pay from 1997 to 2005. The graph shows a trend where the proportion increased from 35% to 51% over the years.](source: China Local Fiscal Statistical Materials 1997–2005.)
broadened. Fiscal revenue per capita averaged 1,116 yuan in the five rich provinces and 312 yuan in the poor ones in 1999, with the difference being 804 yuan. The gap soon widened to 1,319 yuan in 2002 and 2,357 yuan in 2005. Even after excluding the data of Shanghai because of its far higher fiscal revenue than that of other cities in the rich cohort, the gap between the rich and poor cohorts remained wide (368.84 yuan in 1999, 666.83 yuan in 2002, and 1,110.61 yuan in 2005). Figure 3.3 indicates that, except for 2004, the average growth rate of fiscal revenues in poor localities was much lower than that in rich ones from 2000 to 2005. In sum, the fiscal resource of local governments was one of determinants of overpayments or pay arrears in a locality, while the decentralization of pay determination opened the windows for local governments’ deviations.

Table 3.7: Fiscal revenue of five provinces in eastern China (yuan/capita), 1999–2005

<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shanghai</td>
<td>2,859</td>
<td>3,084</td>
<td>3,776</td>
<td>4,363</td>
<td>5,180</td>
<td>6,407</td>
<td>8,053</td>
</tr>
<tr>
<td>Jiangsu</td>
<td>477</td>
<td>612</td>
<td>778</td>
<td>872</td>
<td>1,078</td>
<td>1,322</td>
<td>1,774</td>
</tr>
<tr>
<td>Zhejiang</td>
<td>550</td>
<td>749</td>
<td>1,085</td>
<td>1,220</td>
<td>1,510</td>
<td>1,715</td>
<td>2,218</td>
</tr>
<tr>
<td>Fujian</td>
<td>632</td>
<td>690</td>
<td>797</td>
<td>877</td>
<td>953</td>
<td>1,228</td>
<td></td>
</tr>
<tr>
<td>Guangdong</td>
<td>1,063</td>
<td>1,144</td>
<td>1,491</td>
<td>1,529</td>
<td>1,654</td>
<td>1,745</td>
<td>2,066</td>
</tr>
<tr>
<td>Average</td>
<td>1,116</td>
<td>1,256</td>
<td>1,586</td>
<td>1,754</td>
<td>2,059</td>
<td>2,428</td>
<td>3,068</td>
</tr>
<tr>
<td>Average (excluding Shanghai)</td>
<td>680</td>
<td>799</td>
<td>1,038</td>
<td>1,102</td>
<td>1,279</td>
<td>1,434</td>
<td>1,821</td>
</tr>
</tbody>
</table>

Source: China Fiscal Yearbook 2000–2006

Table 3.8: Fiscal revenue of five provinces in western China (yuan/capita), 1999–2005

<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shaanxi</td>
<td>295</td>
<td>318</td>
<td>371</td>
<td>409</td>
<td>481</td>
<td>581</td>
<td>742</td>
</tr>
<tr>
<td>Gansu</td>
<td>231</td>
<td>240</td>
<td>272</td>
<td>294</td>
<td>337</td>
<td>399</td>
<td>474</td>
</tr>
<tr>
<td>Qinghai</td>
<td>280</td>
<td>323</td>
<td>379</td>
<td>399</td>
<td>450</td>
<td>503</td>
<td>625</td>
</tr>
<tr>
<td>Ningxia</td>
<td>349</td>
<td>377</td>
<td>490</td>
<td>463</td>
<td>518</td>
<td>642</td>
<td>806</td>
</tr>
<tr>
<td>Xinjiang</td>
<td>404</td>
<td>428</td>
<td>507</td>
<td>611</td>
<td>663</td>
<td>799</td>
<td>908</td>
</tr>
<tr>
<td>Average</td>
<td>312</td>
<td>337</td>
<td>404</td>
<td>435</td>
<td>490</td>
<td>585</td>
<td>711</td>
</tr>
</tbody>
</table>

The Introduction of Equal Pay Policy

Both the Ministry of Personnel and the Ministry of Finance reported the disincentives generated by the pay gap among civil servants across-the-board in 2006 (Xinhua, 2006). When holding similar jobs in the public sector in the same city, some civil servants were much better paid simply due to the financial position of their hosting departments (Wu, 2006). Low-paid civil servants certainly felt upset and frustrated. The pervasive pattern of movement to rich areas further aggravated the situation in poor localities. The brain drain degraded government performance in poor regions (Chen, 1993).

LOCAL EXPERIMENTS TO NARROW THE PAY GAP

The equal pay policy, aiming to force down the internal pay gaps among civil servants, first appeared in the form of local governments’ experiments. A general consensus existed about combating excessive pay inequalities among the bureaucrats. In a longitudinal survey, senior public officials (bureau deputy or above) enrolled in the Central Party School

Figure 3.3: Growth rate of ten provinces in eastern and western China (%), 2000–2005

Source: China Fiscal Yearbook 2000–2006

Note: The five eastern provinces in the figure refer to Shanghai, Jiangsu, Zhejiang, Fujian, and Guangdong while those in western China refer to Xinjiang, Ningxia, Qinghai, Gansu, and Shaanxi.
of the CCP were asked to name issues of public concern for the past year. Corruption, the reform of state-owned enterprises, and mass layoff were among the top three from 1998 to 2004. Beginning in 2005, the pay gap became the most prominent issue (Blue Book of China’s Society, 1998–2008). The growing civil service pay gap was brought up time and again at annual meetings of the Chinese People’s Political Consultative Conference (CPPCC) and the National People’s Congress (NPC). In March 2006, Wang Jianlun, a member of the CPPCC (a former Vice Minister of Labor and Social Security) argued that regulating income distribution in China should begin with rectifying the civil service pay gap (Member of the CPPCC proposes to curb non-base salaries, 2006); otherwise, the rationalization of income distribution would be futile. In addition, a member of the NPC proposed at the annual meeting of the NPC in 2005 a nationwide sunshine salary system, which focused on curbing overpayments in some government departments (Hua, 2005).

State actors and non-state actors actually worked together to pressure local governments to take some action against excessive pay disparities. Local governments went ahead of the central government and took experimental measures to narrow the pay gap in their jurisdictions. For example, the Beijing Municipal Government adopted a uniform pay scale – the amount of salary was decided solely by position ranking – within the municipal government from 2004. The monthly pay for civil servants was 3,000, 5,000, 8,000, and 10,000 yuan for section-, division-, bureau-, and ministry-level positions, respectively (Qi & Sun, 2006). Compared with the remuneration experiment in Beijing, where position was the sole determinant of pay, the Zhejiang Province’s trial was more a fine-tuning of current pay policies than a complete overhaul. The Provincial Government instructed its constituent departments (zucheng bumen) to cap the annual amount of non-base-salary items at 12,000 yuan per head from 2003 (Wang, 2006).

At the same time, the Guangdong Provincial and Shanghai Municipal Governments engaged in more sophisticated reforms to prevent pay disparities from broadening. Shanghai City set up a “three-step” framework to narrow the pay gap among government departments in 2003 (Sunshine salary is being implemented, 2004; Wang, 2006). According to Shanghai’s experiment, the first step was to redefine the salary payment procedure; i.e. civil service salaries should be directly paid by the
The Introduction of Equal Pay Policy

finance department of the municipal government rather than by individual work units. This measure empowered the finance department to monitor salary payment formerly controlled by work units. The second step was to standardize the rates of non-base salary items.\(^2\) Previously, the rates were unregulated and largely depended on the fiscal capacity of government units. The third was to create formal rules on civil service remuneration for government departments to abide by. The Shanghai City even tried to pass a law for the equal pay policy but the plan failed.\(^3\)

Guangdong Province underwent a similar reform in 2003. Its Personnel Department conducted a survey among 70 government departments on the cost-of-living allowances in 2002. Based on the survey, the Provincial Government came up with several steps for regulating civil service pay. First, the Department of Finance, the Department of Personnel, and the Department of Supervision jointly issued a document to all government units at the provincial level requiring all individual departments to report their non-base salary payments and sources of funding for remuneration. Second, the audit and fiscal departments checked the bank accounts of 88 government units of the Provincial Government. Thus, funding for irregular remuneration could be eradicated. Third, the Provincial Government set a guideline for cost-of-living allowances and implemented direct salary disbursement by the fiscal department (Standardizing civil service compensation in Guangdong Province, 2004).

Local experiments enabled knowledge accumulation and diffusion, which would be conducive to successive national reforms. However, local reforms were by no means successful. For example, the Guangdong Provincial Government promised to cap the pay difference of governor/clerk at 3.39/1 with regard to cost-of-living allowance (Standardizing civil service compensation in Guangdong Province, 2004). No evidence suggested that the Guangdong Provincial Government had yet successfully curbed overpayments and met its goals.

It was imperative for the central government to step in. Local experiments in curbing pay disparities in some localities especially in some

---

2. How and to what extent the rates of non-base-salary items in Shanghai were actually regulated remained unknown. Nevertheless, the attempt to standardize the rates implied that pay disparities were grave.

3. It appears that the corruption scandal involving Chen Liangyu (the former Party boss of Shanghai City) has slowed the process of civil service pay reform in Shanghai.
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rich regions served to ease public discontent in poor localities. The income gap between rich and poor localities nonetheless still remained substantial. As early as 1999, the State Council – the chief administrative authority of the PRC – had established an income distribution reform committee (Ren, 2006). Furthermore, two central official documents were released in 2005 and 2006, respectively. Overpayments for civil servants were reckoned as one type of corruption that was to be curbed and punished under Party disciplines and criminal codes.

Despite different measures taken at the central and local levels, it was not until the ratification of the first civil service law of the PRC in 2006 that signs of meaningful movement appeared. The revision of civil service compensation was incorporated into the Civil Service Law, which was drafted starting in 2000. The Civil Service Law eventually took effect in 2006. The law stipulated that a unified pay system should be applied to civil servants nationwide with an emphasis on position and grade salaries, which implied that any excessive pay gap due to the financial positions of individual departments or governments would not be tolerated any more. A Politburo meeting, the highest decision-making body in the country, was held in May 2006 to discuss civil service pay reform and pertinent income distribution. The message delivered after this meeting was to tighten the management of income distribution and public sector pay (The Politburo meeting discusses income distribution, 2006). In June 2006, the State Council issued the Notification on Civil Service Pay System Reform (State Council Document, No. 22), marking the beginning of the 2006 pay reform.

THE CONTENTS OF THE EQUAL PAY POLICY

The introduction to the 2006 central pay document stated that, “This reform is to strengthen pay management, monitor implementations strictly, and narrow the regional pay gap effectively, in a bid to maintain the pay gap within a reasonable range.” According to the pay reform, first, the amount of bonus should be identical to that of the December base salary. This regulation ruled out the possibility of overpaying civil servants in the name of rewarding good performers. Second, the cost-of-living allowance, which was a disguise for overpayments in many

The Introduction of Equal Pay Policy

regions, should be reshuffled. The central government would prescribe the component of the cost-of-living allowance and approve or veto the rates of the cost-of-living allowance proposed by provincial governments. This served to tame the growth of regional informal wages. But a dilemma existed. The cost-of-living allowance was instrumental in compensating the variations in living costs of different localities, yet it also provided a loophole for overpayments offered by individual departments or governments.

In 1993, Song Defu, the then Minister of Personnel, suggested that, “[As a vast country] different localities have different natural environments and economic developments. Therefore, the consumer prices and living costs are diverse. In this case, the existence of regional pay differentials is an objective reality” (Song, 2005, p.9). He meant that the cost-of-living allowance should be put in place in order to respond to diversification in a geographically huge country. The cost-of-living allowance was the great innovation of the 1993 pay system.

Nevertheless, the central government failed to issue a detailed guideline on the cost-of-living allowance though it promised to publish it in 1994 (Song, 2005). It was, Song admitted, a challenging and time-consuming issue, and a large-scale investigation had to be conducted to measure living costs and economic developments between regions before the central guideline could be promulgated. The failure to produce the guideline nevertheless was by no means simply due to technical incapability. The implementation of the cost-of-living allowance was in effect a thorny principal–agency problem. The central government was afraid that local governments might abuse or misuse the guideline for their own interests (see Song, 2005). For example, the rate of the cost-of-living allowance should be linked to the inflation level in a given locality. If local governments intended to channel more public money to civil servants, they might inflate the inflation data as well. Nevertheless, the consequence of cooking statistics could be as serious as failing to implement some other central mandates.

Before the central government found a way to address the principal–agency problem, it was reluctant to issue a central guideline. Even today, though acknowledging the problem of the cost-of-living allowance, the central government has chosen to review the rate of the cost-of-living allowance on a case-by-case basis rather than issuing a guideline that...
local governments can follow directly. But since the central government is reluctant to institutionalize a regional variable salary, it risks being sabotaged by local governments, as they can develop many pay schemes when the central monitoring is loose.

The 2006 pay system, in response to excessive pay inequalities among civil servants, made an effort to curtail the discretionary power of local governments. According to the author’s fieldwork, county governments proposed for their localities an annual cost-of-living allowance. Although the proposed amount was reasonable, provincial governments could still veto it because they had to take the attitude of the central government and subordinate governments into consideration (see PA-20080325-1, PA-20081227, and PA-20090106). Pay determination is a top-down practice wherein lower-level governments have very limited power to decide on civil service compensation according to the living costs and fiscal capacity in their jurisdiction. Employing their hierarchical control, the central government’s job is to restrain any opportunities local governments may exploit to line their own pockets with public money.

The equal pay policy has instituted a regulation concerning civil service pay – “equal pay for equal work in the same city”. In any city, civil servants with comparable administrative ranks and seniorities must be remunerated equally. Civil servants working for rich departments, such as the finance department, will no longer earn more than other government departments. Interregional pay disparities will be reduced by a top-down approach with the central government being active in taming the growth of overpayments in some rich areas.

In addition to combating overpayments through improving cost-of-living allowances, the 2006 remuneration regime has enlarged salary grades substantially. The total salary grades expanded from 15 to 27, which differentiated civil service pay and permitted more opportunities for seniority-based salary increments. This change will benefit grassroots public officials, as these employees generally have a low administrative ranking.

Pay disparities noted previously mainly refer to horizontal salary gaps among different localities. However, the vertical pay gap was also

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5. Overpayments in some government units also annoyed those in the private sector. Thus non-state actors often put pressure on provincial governments. Provincial governments in turn became very careful in approving salary rates submitted by subordinate governments.
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serious. As higher authorities have higher administrative ranks in China, those working for the central government hold superior positions from the start. For a middle-level civil servant in the central government, his or her administrative rank can be bureau deputy whereas the rank of middle-level personnel in county governments can never be higher than county deputy. Thus, with similar education attainments and qualifications, civil servants closer to the core of power earn far more than those at the grassroots level because base salary is closely related to position held. Grievances caused by the horizontal pay gap should be mitigated to some extent by the 2006 pay reform.

Personnel data in China show that 92 percent of civil servants hold the ranks of section head and below (Questions and answers on the issues of the pay reform by the Ministry of Personnel et al, 2006). According to the regulation promulgated by the Party Central Organization Department and the Ministry of Personnel, the starting rank for a university graduate is section member. As a result, if a university graduate works in the county government, there remain only two administrative ranks, deputy section head and section head, by which to advance in his/her entire career for most civil servants. Consequently, pay raises on the basis of promotion are rare at the grassroots level. Therefore, routine pay increases are largely contingent on seniority rather than promotion or good performance.

In the 1993 pay system, the salary grades reflecting seniority were seriously inadequate. If a section member was promoted to section head during tenure, he/she might begin with the 14th grade, and reach the 9th grade (for salary grade, see Table 3.9), with a promotion of only five salary grades, in his/her entire career.

The 2006 remuneration regime, in contrast with the 1993 pay regime, had 27 salary grades with 279 pay scales. Each administrative post is entitled to a range of salary grades. Within each range, a considerable salary gap exists between the highest/lowest pay scales. For example, a civil servant of the 16th grade is entitled to a grade salary ranging from 786 yuan to 1,579 yuan per month and the actual pay within this range is dependent on his/her length of service. It means that civil servants with long service at the grassroots level can earn as handsome a salary as those working for provincial or central governments do.
A special arrangement was introduced for the first time to further reward seniority when promotion is not possible. Take for example a county executive who has held his/her position for 10 years. His/her grade salary will reach the ceiling of pay scales. Under this special arrangement, he/she is eligible to get the grade salary of the next higher position although his/her administrative rank remains unchanged.

The above arrangements serve to reward seniority and mitigate horizontal pay disparities between higher authorities and grassroots governments. In addition, addressing the horizontal pay gap and enhancing the importance of grade salary can serve to alleviate grade creeping and the upgrading of government departments, which plagued the government for decades. A caveat: the merit of placing a greater emphasis on seniority in the 2006 pay regime should be viewed with caution since the position salary is more substantial than the grade salary for most posts.

**SUBSTANTIAL PAY RISES FOR CONSOLIDATING EQUAL PAY**

Apart from curbing overpayments, the central government has improved the compensation of civil servants across-the-board considerably. The benefit is palpable. As civil servants in poor localities earn much higher wages than before, resource-rich governments pay even higher salaries for their employees to maintain the previous regional or departmental
The Introduction of Equal Pay Policy

Figure 3.4: Average annual salary growth of state organs and GDP per capita (yuan), 2003–2008

<table>
<thead>
<tr>
<th>Year</th>
<th>Average Annual Salary of State Organs</th>
<th>GDP per capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>8,000</td>
<td>7,000</td>
</tr>
<tr>
<td>2004</td>
<td>8,500</td>
<td>7,200</td>
</tr>
<tr>
<td>2005</td>
<td>9,000</td>
<td>7,500</td>
</tr>
<tr>
<td>2006</td>
<td>9,500</td>
<td>7,800</td>
</tr>
<tr>
<td>2007</td>
<td>10,000</td>
<td>8,100</td>
</tr>
<tr>
<td>2008</td>
<td>10,500</td>
<td>8,400</td>
</tr>
</tbody>
</table>


pay gap. Paying higher-than-stipulated salary nonetheless risks being punished according to the equal pay policy. It is thus possible that the pay gap will be narrowed as civil servants in poor localities are better compensated while those overpaid previously receive comparable or lower pay. The local experiment on the equal pay policy in the Beijing Municipal Government manifested this trend. According to Qi and Sun (2006), after the reform in 2004 about 20 percent of civil servants receiving overpayments got pay cuts while the rest enjoyed pay rises or remained on the same wages. But, as discussed previously, the central efforts to tame the regional gap of civil service compensation may not be effective, as local governments can still circumvent central policy if they wish.

Aggregate data as shown in Figure 3.4 suggest that in general civil service pay rose substantially in 2007 and 2008 across the country. In absolute terms, the average annual salary of state organs was much higher than GDP per capita. In 2007, the growth rate of civil service pay was 23.11 percent while that of GDP per capita was 17.13 percent. Thus, the gap between the above two indicators widened from 4,991 yuan in 2003 to 6,718 yuan in 2006, reaching 9,237 yuan in 2007. The
significant increase observed in 2007 is indicative of the impact of the 2006 pay reform on salary level.

In addition, the average growth rate of civil service pay was higher than that of the manufacturing, social security, and welfare sectors (see Figure 3.5). For example, in 2007, the growth rate of salary was 23.11 percent in state organs, but only 16.24 percent in the manufacturing sector, and 18.24 percent in the social security and welfare sector. The rate of salary increase was 16.13 percent in the civil service, 13.71 in the manufacturing sector, and 14.67 percent in the social security and welfare sectors from 2003 to 2007. It should be noted that the growth rate of salary in the education sector was slightly higher than that of civil service compensation during the same period, probably due to teachers’ pressing the government for higher compensation. Although the growth rate of salary in the education sector was higher, the average annual salary in the education sector was lower than that of civil servants, with a gap of 2,009 yuan in 2007.

Moreover, the growth of the total salary bill of the government apparatus was considerable. The amount of national civil service salary totaled 177.05 billion yuan in 2003 and 246.58 billion yuan in 2005.
The Introduction of Equal Pay Policy

The year 2007 saw the largest increase with a 25.1 percent rise in the total wage bill annually (355.38 billion yuan). The amount of civil service salary totaled 427.6 billion yuan in 2008, 20.3 percent higher than that in 2007.

Pay rises in the civil service were not eroded by inflation. As discussed in Chapter 7, the “wage–price spiral” was a vexing problem facing compensation practitioners in China in the late 1980s and early 1990s. Serious inflation induced by public sector pay increases nullified the effort to improve civil service compensation. Nevertheless, the pay rise in real terms after 2006 was very impressive. The average civil service pay increased by 17.35 percent between 2006 and 2007 while the total wage bill of civil servants rose by 19.62 percent. On the other hand, the inflation level measured by the consumer price index was only 1.5 percent and 4.8 percent in 2006 and 2007, respectively.

DISCUSSION

This chapter has reviewed the 2006 pay reform with an emphasis on the dynamics and main characteristics of the reform. A combination of dysfunctional pay systems and fiscal mismanagement and macroeconomic trends led to serious pay inequalities in China. With an economic policy in favor of coastal areas, these regions generally benefited most from economic development. Therefore, civil servants in coastal areas had a better remuneration than those in inland China. Given that the cost of living in coastal China was much higher than that in inland China, a considerably better wage in coastal areas was acceptable. But problematic pay and fiscal management rendered the issue more intricate. Civil servants in resource-rich departments could earn a good pay even in inland China, while those in resource-poor departments in coastal areas might be compensated very poorly. Thus the pay gap did not hinge on economic development and the cost of living in a given locality. Rather it epitomized the complex pay and fiscal dysfunction in some localities.

The current solution – the equal pay policy – warrants further investigation. The policy intends to reinforce the principle of “pay according to work performed” wherein civil service pay is not determined by the financial resources of government departments but by job performance and work difficulty. Relying on recentralizing pay setting nonetheless may not be an effective way to curb overpayments around the country. A
top-down approach on civil service remuneration triggers new counter-
measures developed by local governments and also leads to pitfalls when
implementing the policy at the grassroots level. This will be elaborated
in the next chapter.
CHAPTER FOUR

Local Implementation:
Remuneration in Fujian and Hubei Provinces

Since the equal pay policy was instituted in China in 2006, civil service remuneration, on average, has improved substantially across the board. But this statement is made against a nationwide aggregate evaluation. When examining civil service remuneration using a disaggregated approach, the situation becomes more intricate and subtle. An unintended consequence of the equal pay policy and the continuous pay raises in the public sector since 1997 is that pay arrears, arising from local governments not paying as stipulated by the central remuneration policy, have appeared in many localities in China, even in some fiscally self-sustaining provinces such as Fujian. This chapter investigates the pay arrears at the local level.

Four counties with diversified socioeconomic conditions were purposely selected in a bid to examine the implementation of civil service remuneration at the grassroots level. The main text of this chapter is devoted to an investigation of four counties in Fujian and Hubei Provinces in terms of civil service pay implementation. The reasons for pay arrears will be discussed briefly before a conclusion is drawn.

BASIC INFORMATION ON THE TWO FIELD SITES

Fujian Province is a relatively rich coastal area as compared with Hubei Province, the other field site in my study. As measured by GDP per capita in 2010, Fujian ranked 10th among 31 provincial units. Fujian, along with Guangdong, was a testing ground for several important reforms after the economic reforms of 1978. In the 1980s, Fujian and Guangdong were granted “the most generous provisions” (Wong, 1992, p. 208) in terms of fiscal management. However, when the tax-sharing system installed
in 1994 the situation was reversed. The central government is no longer especially generous toward Fujian, despite its contributing a large share of revenue to the central government. Fujian is now categorized as a member of “the club of seven rich provinces”, which are not eligible for many kinds of central fiscal subsidies. In terms of fiscal capacity, Fujian Province is largely a self-sustaining locality.

Hubei Province, economically disadvantaged as compared with coastal provinces, can be characterized as a dependent province, because its public expenditure, especially at the grassroots level, hinges largely on central transfers. Hubei in Chinese means north of the lake (Dongting Lake, a flood-basin of the Yangtze River). In contrast to Fujian Province, Hubei Province is by no means a resource-poor province. In terms of food output, Hubei Province is called “the Land of Fish and Rice” (yumi zhixiang). The province also has rich mineral and hydro-electric resources. Thus, during the Mao era, Hubei Province was rapidly developed into an important industrial center in central China. But the advantages brought by its geographic location and resource endowment soon disappeared with the onset of economic reform, for two reasons. First, the national development strategy is in favor of coastal areas like Fujian Province. For example, some rigid policies on attracting foreign direct investment (FDI) have been relaxed in coastal areas while they are still valid in inland localities such as Hubei Province. Although some reforms have since been launched in inland provinces, these localities have fewer advantages for attracting FDI. Second (similar to the situation in Minqing County in Fujian Province), in many localities of Hubei outdated techniques abound in the manufacturing sector, which is dominated by state-owned enterprises. There are few competitive advantages in this old technology.

Though Hubei, together with other provinces in central China, has persuaded the central government to grant it preferential policies and high central transfers, it faces many difficulties in implementing the central remuneration policy.

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1. Before 2006, Fujian did not receive any central transfer for funding salary increases. It was only after repeated complaints made to the central government that Fujian Province became eligible for the transfer with regard to pay raises from 2006.
PAY IMPLEMENTATION IN FUJIAN AND HUBEI PROVINCES

There has been a large vertical gap among the governmental hierarchy in terms of civil service remuneration. Many civil servants at the county level have not been compensated as required by the central government. It would be wrong to argue that pay arrears occur in all counties, but the counties I visited all suffered arrears in civil service remuneration. In December 2008 and January 2009, besides Lianjiang and Minqing Counties, I also visited some rich localities in Fujian Province – all of them suffered from the same problem. In Zhenghe County, teachers, alongside other public sector employees, took to the streets because the 2006 pay raise was not implemented on time.2 The Party boss of Fujian Province was shocked by the protest and he put pressure on local governments to deal with the situation properly and promptly.

With regard to the introduction of the 2006 equal pay system, Fujian pioneered this in some ways. Before the central government standardized civil service pay nationwide in 2006, the Personnel Department in the Fujian Provincial Government had already surveyed the variations in civil service allowances in its locality in 2005. Thus here it was much easier to carry out the 2006 pay rise than in other localities without such prior experience. (However, the counties I examined in Fujian Province reported delays in pay increase implementation.)

Launching the 2006 pay reform required a conversion from the old system to the new one. The new base salary and cost-of-living allowance had to be implemented on 1 July 2006 and 1 January 2007, respectively (CCP Central Commission for Discipline Inspection Document No. 17, 2006; State Council, 2006a). Nevertheless, the Personnel Department of the Fujian Provincial Government noted that only a portion of those eligible received the new base salary in 2007, half a year later than the stipulated date (Interview note, PA-20101126). Worse still, civil servants in the counties I visited in December 2008 and January 2009 had not yet received any new cost-of-living allowances.

I visited Hubei Province in June 2009, half a year after I conducted the fieldwork in Fujian Province. Three years had passed since the central government had instituted the 2006 new pay system, but the pay

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raise had been only partially implemented. Both Daye and Nanzhang Counties reported fiscal difficulties created by the central pay mandates. In Daye County, 6,000 out of 20,000 budgeted employees enjoyed the new base salary and cost-of-living allowance of 11,000 yuan per year. Interviewees acknowledged that no one knew when the 2006 pay raise would be fully implemented in all county government departments as stipulated by the central government (Interview note, PA-20090526-1).

In Nanzhang County, a compromise had been made. Beginning in 2008, civil servants and other budgeted employees such as school teachers – those on the payroll of the Chinese government paid by coffers at a different level – could receive a new cost-of-living allowance, which was as low as 5,040 yuan per year. More importantly, 60 percent of the cost incurred was borne by the county coffer, while the remaining 40 percent was borne by individual government departments (Interview note, PA-20090527-1) 3

INSTITUTIONS FOR CIVIL SERVICE PAY MANAGEMENT

Before presenting the fieldwork findings, the institutions related to civil service pay administration and fiscal management warrant some brief discussion. The sub-national pay determination, similar to the cadre selection, is under the purview of the personnel department. Beginning in 1984, personnel management in China has applied the Socialist style “one-level-down” principle, which remains intact so far (Wang, 2012). That is, the key personnel issues at the provincial level must be approved by the central government while those at the prefectural level should be sanctioned by provincial governments (Burns, 1994). 4 In terms of civil service remuneration, county governments should seek the approval from prefecture-level governments.

The Division of Salary, Benefit, and Retirement Management (DSBMR) in the Ministry of Personnel has a leadership relationship 5

3. The arrangement might have negative consequences. Because 40 percent of cost-of-living allowances were to be financed by individual departments, the inter-departmental remuneration gap before the 2006 pay reform would persist. In addition, this arrangement was not consistent with the directives issued by the central government regarding the 2006 pay reform.

4. The administrative reform responded to the strategy of “playing to the provinces” by Deng Xiaoping (see Shirk, 1990).

5. A leadership relationship between two government units, Mertha (2005) argues, refers to the situation in which the subordinate unit is “governed by binding orders”, while a professional relationship stands for the connection that is based on non-binding instructions.
with the DSBRM at the provincial level. Huang (1996) argues that “Most provincial bureaux do not have a chuizhi (vertical) relationship with their central ministries and most receive commands directly from the provincial authorities” (p. 30). The situation remains largely the same nowadays though some departments have been centralized in recent years (Mertha, 2005). Nevertheless, the situation of civil service remuneration is quite distinct. Provincial civil service compensation should be approved by the DSBRM in the Ministry of Personnel (the State Administration of Civil Service since March 2008).

The DSBRM in the Department of Personnel, similar to other regions, is responsible for the implementation of civil service remuneration in Fujian Province. To carry out the 2006 pay reform, the DSBRM prescribed a guideline for determining a cost-of-living allowance across the board. This guideline was endorsed by the Governor of Fujian Province and approved by the Ministry of Personnel in Beijing. Not until this approval is granted can local governments implement compensation policies.

In the hierarchy of pay administration in China, the county personnel bureau is one of the lowest. The major routine work of the DSBRMs at this level is to review the salaries of all government departments before payday. The approval of individual within-grade salary increases is another important routine duty of theirs. In addition, nationwide pay increases and pay reforms will add substantial workloads to DSBRMs at the county level.

Pay implementation depends on the locality’s “ability to pay”; thus, civil service pay is inherently a fiscal issue. My field research suggests that pay arrears occur mainly due to a low fiscal capacity of lower governments in China.

(p. 797). In daily management, if the major decision-making in one unit must be endorsed by another unit, these two units have leadership relationships. On the other hand, if a unit only issues some guiding opinions to another unit in which the latter has high autonomy in implementing the above instructions, then their relationship is professional. For example, details about provincial civil service remuneration should be approved by the Ministry of Personnel of the PRC, implying a leadership relationship. Conversely, if local governments can decide their pay levels within a range set by the central government, their relationship will be defined as professional.

6. The provincial government set three baselines for prefectural and county governments before the implementation of cost-of-living allowances. Thus, it was an ex ante regulation. In the existing literature, scholars tend to focus more on bottom-up and ex post approvals in personnel management, while little attention has been paid to top-down and ex ante instructions. It is evident that prescriptions play an important role in pay determination. This inflexible arrangement causes much discontent among civil servants.
Governing Civil Service Pay in China

REVENUE AT COUNTY LEVEL

Sources of fiscal revenues at the county level have in recent years become more diversified than ever. Budgetary revenues and extra-budgetary revenues constitute the lion’s share of county government incomes. Among budgetary revenues, value-added and business taxes are the largest items. In 2007, the total local value-added tax (VAT) was 386.76 billion yuan, equivalent to 20 percent of the total local tax revenue in China. Because the value-added tax is closely related to industrial development, it is not surprising to see “finances still in good shape [when localities] have successful rural industry or are able to attract outside investment, whether foreign or domestic” (Oi & Zhao, 2007, p. 77). It also explains why local governments are eager to develop various industries and enhance fixed investments in China. Business tax is associated with the development of sectors such as transportation, real estate, and construction. In recent years, the real estate boom has contributed much to the increase in business tax collected (Wang Haoqian, 2006). Academic efforts were made to determine the amount of extra-budgetary revenue in China, which is a key to understanding the real situation of local public finance (see Hussain & Stern, 2008; Wedeman, 2000). The findings are by no means widely accepted because governments try various ways to conceal the facts. In examining why extra-budgetary items emerged and grew in the 1990s, the following reasons stood out. As the central government recentralized revenue in 1994, local governments had to extract more revenues to meet increasing demand for expenditures (Gong, 2006; World Bank, 2002). Wong (2007b) argues that the central government endorsed implicitly extra-budgetary revenue as a side-payment for compensating the weakened fiscal capacity of local governments.

7. The World Bank (2007b) argues that “Nationwide, at both county and township levels, the VAT, business tax (BT), and the income taxes (enterprise and personal) are the main sources of revenue. In 2003, these four taxes combined accounted for 54 percent and 53 percent of total revenues at the county and township levels, respectively” (p. 42).

8. As we shall see later, however, over-spending on industrial development projects poses a threat to public sector remuneration payment.

9. The local government is a stakeholder reaping the fruits of the real estate boom together with the real estate developer, because both GDP and government revenue can be simultaneously enhanced in the boom (see Wang, Haoqian, 2006).

10. The Statistical Yearbook of China also reports on extra-budgetary revenue. Nevertheless, it only covers the monies deposited in the bank accounts supervised by the finance departments. Thus, it may underestimate the real amount of the extra-budgetary revenue.
Another source of revenue at the local level is an off-budgetary fund. As Gong (2006) argues, “Off-budgetary funds are not only irregular but also illegal, as they are collected without the approval of the central government and, in many cases, against the state’s policies” (p. 93). Similar to extra-budgetary revenue, off-budget income expanded from the 1990s and local governments rely heavily on off-budget finance (Wong, 2007). Wong estimates that the national off-budgetary revenue amounted to 19–27 percent of GDP in the late 1990s.11

In recent years, transfers from upper-level governments have become increasingly important for county treasuries. At the beginning of the 1994 tax-sharing reform, central transfer was reckoned as an effective instrument to narrow regional inequalities with poorer localities receiving more central transfers. However, central transfers have not improved the fiscal capacity of poor localities as anticipated (see Gong & Wu, 2012a). The deep-rooted reason behind this, provided by the then Auditor-General Li Jinhua in an interview to a journalist, is that: “The central transfer system is like a very long canal running from the central to the local government. However, the canal is leaky. More often than not, there is no water flowing from the center to the localities” (Ye, 2006). This highlights the problem of central transfers being diverted by recipients and higher authorities to other uses. In addition, as cited by Smith (2009), the bargaining for central subsidies works as follows: “The money goes up, and then the money comes down. It’s like a huge school of fish, with each one dining out on the next smallest one in the chain, while the innumerable small fish at the bottom [county and township governments] desperately seek ways to nibble at the big fish [central government]” (p. 55). Thus, it also implies the prevalence of corruption in central transfers. In sum, on the one hand, some county governments, among other local governments, spend lots of monies on top-down resource flow, thereby depleting the fiscal capacity of local governments. On the other hand, higher-level governments may retain some resources for their own use rather than pooling resources for

11. The figure provided by Wong may overestimate the real amount of off-budgetary revenue because the budgetary revenue only accounted for 12.3 percent and 17.3 percent of GDP in 1993 and 2005, respectively. According to her article in 2000, non-budgetary revenue equals half the budgetary revenue (p. 14).
Governing Civil Service Pay in China

Table 4.1: Categorization of central transfers in China

<table>
<thead>
<tr>
<th>Items</th>
<th>Year of Implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal capacity transfers</td>
<td></td>
</tr>
<tr>
<td>General-purpose transfer (yibanxing zhuanyizhifu)</td>
<td>1995</td>
</tr>
<tr>
<td>Transfer for ethic minority areas (minzudiqu zhuanyizhifu)</td>
<td>2000</td>
</tr>
<tr>
<td>Transfer for tax-for-fee reform (nongcunshuifei gaige zhuanyizhifu)</td>
<td>2000</td>
</tr>
<tr>
<td>Transfer for salary increase (tiaozhenggongzi zhuanyizhifu)</td>
<td>1999</td>
</tr>
<tr>
<td>Transfer for county-township rewards and subsidies (xianxiang jiangbu)</td>
<td>2001</td>
</tr>
<tr>
<td>Other fiscal capacity transfers</td>
<td>1994</td>
</tr>
<tr>
<td>Social security subsidy (shehuibaozhang zhichu)</td>
<td>NA</td>
</tr>
<tr>
<td>Special-purpose transfers</td>
<td></td>
</tr>
<tr>
<td>Agricultural subsidy (nongye zhichu)</td>
<td>NA</td>
</tr>
<tr>
<td>Education, science, and health subsidy (jiaoyu keji weisheng zhichu)</td>
<td>NA</td>
</tr>
<tr>
<td>Other special-purpose transfers</td>
<td>NA</td>
</tr>
</tbody>
</table>

NA: Not available.

Source: Li and Xu (2006), pp. 50, 52.

grass-roots governments, who desperately need the money for covering central mandates and other expenditure needs prescribed by law.\textsuperscript{12}

In general, central transfers can be divided into conditional transfers (conditional grants or categorical grants) and unconditional transfers (unconditional grants or block grants) according to international practice (Heady, 1997; Rosen & Gayer, 2008).\textsuperscript{13} Table 4.1 lists the major transfer items at the country level.

The transfer for salary increase is directly related to this study. The central government has launched several nationwide public sector pay

\textsuperscript{12} On intermediate governments (such as provincial governments) grabbing central grants, see Wu and Wang (2013).

\textsuperscript{13} In the case of conditional transfers, recipients are obliged to implement the central policies (the conditions) and may be asked to arrange matching funds. Unconditional transfers do not require matching funds, nor are other central requirements attached. That is, a lump sum of money is transferred from the central government to localities for some general purposes; for example, improving education or health care provision. Hence, unconditional transfers are considered more progressive in combating regional inequality (World Bank, 2002; Yep, 2004, 2008). The categorization of central transfers in China is different from international practice.
Local Implementation: Remuneration in Fujian and Hubei Provinces

Raises since the late 1990s. Improving the remuneration level of civil servants without central government subsidies, however, was criticized by local governments (see Chen, 2003). As a result, beginning in 1999, the Ministry of Finance offered subsidies for salary increases. Table 4.2 sketches the amount of transfers for salary adjustments. The absolute sum was eye-catching, yet it was relatively tiny as compared with the expenditure demands incurred by salary increases.

Table 4.2: Transfers for salary increase, 1999–2009

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (billion yuan)</th>
<th>Share of total transfers (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>10.8</td>
<td>2.6</td>
</tr>
<tr>
<td>2000</td>
<td>21.7</td>
<td>4.6</td>
</tr>
<tr>
<td>2001</td>
<td>62.3</td>
<td>10.4</td>
</tr>
<tr>
<td>2002</td>
<td>80.7</td>
<td>11</td>
</tr>
<tr>
<td>2003</td>
<td>89.1</td>
<td>10.8</td>
</tr>
<tr>
<td>2004</td>
<td>99.4</td>
<td>9.6</td>
</tr>
<tr>
<td>2005</td>
<td>99.4</td>
<td>NA</td>
</tr>
<tr>
<td>2006</td>
<td>172.356</td>
<td>12.78</td>
</tr>
<tr>
<td>2007</td>
<td>223.4</td>
<td>12.32</td>
</tr>
<tr>
<td>2008</td>
<td>239.2</td>
<td>10.43</td>
</tr>
<tr>
<td>2009</td>
<td>236.6</td>
<td>8.19</td>
</tr>
</tbody>
</table>

Source: Adapted from Gong and Wu, 2012a, p. 322.

Expenditure and the Pay Bill at County Level
When the sources of fiscal revenue become diversified and the amount of revenue increases, does expenditure need go up in step? Or does expenditure demand far outpace revenue? The local expenditure responsibilities defined by the State Council are as follows:

Local budgets are mainly responsible for the running costs of local party and state organs, the needs of local economic development, a part of the running costs of the military police and militia, locally financed capital investments, the technical renovation of local enterprises and new product development costs, the costs of support to agriculture, urban maintenance and construction, and the costs of local culture, education, and health, price subsidies and other expenditures (World Bank, 2002, p. 27).
Table 4.3: Main composition of the national government budgetary expenditure (100 million yuan), 1978–2006

<table>
<thead>
<tr>
<th>Year</th>
<th>Capital Construction</th>
<th>Technical Updating</th>
<th>Social Expenditure</th>
<th>Admin. Expenditure</th>
<th>Total Subsidies</th>
<th>National Defense</th>
<th>Agriculture</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>451.92</td>
<td>63.24</td>
<td>131.57</td>
<td>49.09</td>
<td>11.14</td>
<td>167.84</td>
<td>76.95</td>
<td>37.94</td>
<td>989.69</td>
</tr>
<tr>
<td>1980</td>
<td>346.36</td>
<td>80.45</td>
<td>176.57</td>
<td>66.79</td>
<td>117.71</td>
<td>193.84</td>
<td>82.12</td>
<td>45.42</td>
<td>1109.26</td>
</tr>
<tr>
<td>1985</td>
<td>554.56</td>
<td>103.42</td>
<td>347.85</td>
<td>130.58</td>
<td>276.09</td>
<td>191.53</td>
<td>101.04</td>
<td>64.74</td>
<td>1769.81</td>
</tr>
<tr>
<td>1990</td>
<td>547.39</td>
<td>153.91</td>
<td>672.33</td>
<td>303.10</td>
<td>391.7</td>
<td>290.31</td>
<td>221.76</td>
<td>83.12</td>
<td>2663.62</td>
</tr>
<tr>
<td>1991</td>
<td>559.62</td>
<td>180.81</td>
<td>775.32</td>
<td>343.60</td>
<td>386.85</td>
<td>330.31</td>
<td>243.55</td>
<td>90.75</td>
<td>2910.81</td>
</tr>
<tr>
<td>1992</td>
<td>555.90</td>
<td>223.62</td>
<td>859.41</td>
<td>424.58</td>
<td>332.27</td>
<td>377.86</td>
<td>269.04</td>
<td>108.65</td>
<td>3151.33</td>
</tr>
<tr>
<td>1993</td>
<td>591.93</td>
<td>421.38</td>
<td>1033.04</td>
<td>535.77</td>
<td>317.78</td>
<td>425.80</td>
<td>323.42</td>
<td>125.28</td>
<td>3774.40</td>
</tr>
<tr>
<td>1994</td>
<td>639.72</td>
<td>415.13</td>
<td>1373.32</td>
<td>729.43</td>
<td>331.8</td>
<td>550.71</td>
<td>399.70</td>
<td>164.9</td>
<td>4604.71</td>
</tr>
<tr>
<td>1995</td>
<td>789.22</td>
<td>494.45</td>
<td>1582.52</td>
<td>872.68</td>
<td>399.69</td>
<td>636.72</td>
<td>430.22</td>
<td>169.08</td>
<td>5374.58</td>
</tr>
<tr>
<td>1996</td>
<td>907.44</td>
<td>523.02</td>
<td>1886.93</td>
<td>1040.80</td>
<td>496.84</td>
<td>720.06</td>
<td>510.07</td>
<td>188.97</td>
<td>6274.13</td>
</tr>
<tr>
<td>1997</td>
<td>1019.50</td>
<td>643.20</td>
<td>2232.01</td>
<td>1137.16</td>
<td>604.16</td>
<td>812.57</td>
<td>560.77</td>
<td>209.78</td>
<td>7219.15</td>
</tr>
</tbody>
</table>

(Continued next page)
Table 4.3: The Main Composition of the National Government Budgetary Expenditure (100 million yuan), 1978–2006 (continued)

<table>
<thead>
<tr>
<th>Year</th>
<th>Capital Construction</th>
<th>Technical Updating</th>
<th>Social Expenditure</th>
<th>Admin. Expenditure</th>
<th>Total Subsidies</th>
<th>National Defense</th>
<th>Agriculture</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>1387.74</td>
<td>641.18</td>
<td>2750.01</td>
<td>1326.77</td>
<td>754.48</td>
<td>934.70</td>
<td>626.02</td>
<td>204.69</td>
<td>8625.59</td>
</tr>
<tr>
<td>1999</td>
<td>2116.57</td>
<td>766.05</td>
<td>3605.5</td>
<td>1525.68</td>
<td>754.05</td>
<td>1076.40</td>
<td>677.46</td>
<td>211.76</td>
<td>10733.47</td>
</tr>
<tr>
<td>2000</td>
<td>2094.89</td>
<td>865.24</td>
<td>4254.45</td>
<td>1787.58</td>
<td>1113.34</td>
<td>1207.54</td>
<td>766.89</td>
<td>238.19</td>
<td>12328.12</td>
</tr>
<tr>
<td>2001</td>
<td>2510.64</td>
<td>991.56</td>
<td>5348.42</td>
<td>2197.52</td>
<td>764.22</td>
<td>1442.04</td>
<td>917.96</td>
<td>299.13</td>
<td>14471.49</td>
</tr>
<tr>
<td>2002</td>
<td>3142.98</td>
<td>968.38</td>
<td>6615.3</td>
<td>2979.42</td>
<td>664.04</td>
<td>1707.78</td>
<td>1102.70</td>
<td>335.27</td>
<td>17515.87</td>
</tr>
<tr>
<td>2003</td>
<td>3429.30</td>
<td>1092.99</td>
<td>7161.42</td>
<td>3437.68</td>
<td>629.23</td>
<td>1907.87</td>
<td>1134.86</td>
<td>392.17</td>
<td>19185.52</td>
</tr>
<tr>
<td>2004</td>
<td>3437.50</td>
<td>1243.94</td>
<td>8259.73</td>
<td>4059.91</td>
<td>808.24</td>
<td>2200.01</td>
<td>1693.79</td>
<td>483.66</td>
<td>22186.78</td>
</tr>
<tr>
<td>2005</td>
<td>4041.34</td>
<td>1494.59</td>
<td>9803.04</td>
<td>4835.43</td>
<td>1016.64</td>
<td>2474.96</td>
<td>1792.40</td>
<td>576.85</td>
<td>26035.25</td>
</tr>
<tr>
<td>2006</td>
<td>4390.38</td>
<td>1744.56</td>
<td>11787.76</td>
<td>5639.05</td>
<td>1404.1</td>
<td>2979.38</td>
<td>2161.35</td>
<td>723.07</td>
<td>30829.65</td>
</tr>
</tbody>
</table>


Notes: (a) The expenditure in Column 10 (total) only accounts for 76 percent of the budgetary expenditure indicated in the China Statistical Yearbook; thus, it is the main component of budgetary expenditure in the table. (b) Social expenditure includes expenditure for culture, education, science, and health, plus expenditure for social security; (c) Total subsidies equal price subsidies plus appropriation for working capital of enterprises.
Although local governments do not need to bear the cost of national defense and foreign affairs as prescribed by the State Council, they have heavy burdens in implementing central mandates and legal requirements. Wong (2005) argues that “China is the most decentralized country in the world” (p. 5). Furthermore, burdens on local governments are much heavier because demands for better social security, among others, have expanded in recent years (Wong, 2005). Roughly, county governments should pay 70 percent of expenditures for basic education and 55–60 percent of those for health care. In other words, central, provincial, and prefectural levels provide the remaining 30 percent of expenditures for basic education and less than 45 percent of expenditures for health care (World Bank, 2002).\textsuperscript{14} Needless to say, the majority of civil servants and budgeted employees are paid by county governments as well. Worse still, the remaining cost, which cannot be clearly defined among various tiers of government, must be borne by county and township governments (Dollar & Hofman, 2008; Martinez-Vazquez, Qiao, Wang & Zou, 2008; World Bank, 2007a, 2007b). Thus, when the central government proposes a new policy such as pay increments in the public sector, county governments will worry about whether the project is a new unfunded mandate (Interview notes, PA-20090114; PA-20090526).

The above discussion refers to the expenditure assignment among different levels of government. Before I turn to the composition of expenditure at the county level, Tables 4.3 and 4.4 provide information on the overall picture of national expenditure, which may shed light on the spending of local governments. It should be noted that the spending breakdown has changed substantially since 2007; therefore the data after 2007 cannot be included for comparison. First, in absolute terms, every expenditure item increased substantially in the reform era. For example, capital construction expenditure rose from 45 billion yuan in 1978 to 439 billion yuan in 2006, while administrative expenditure increased from 4.9 billion yuan to 564 billion yuan. Second, as Wong, Heady and Woo (1995) point out, changing trends in the expenditure composition in China, such as investment spending relative to the total, were sim-

\textsuperscript{14} In addition, Martinez-Vazquez et al. (2008) note that “The most conspicuously inappropriate assignment is the responsibility assigned to city- or county-level governments for pensions, unemployment, and income support schemes. These assignments are replicated almost nowhere else in the world; in most countries, these programs are central government responsibilities” (p. 89).
**Local Implementation: Remuneration in Fujian and Hubei Provinces**

Table 4.4: Percentages of the main composition of the national government budgetary expenditure (%), 1978–2006

<table>
<thead>
<tr>
<th>Year</th>
<th>Capital Construction</th>
<th>Technical Updating</th>
<th>Social Expenditure</th>
<th>Admin. Expenditure</th>
<th>Total Subsidies</th>
<th>National Defense</th>
<th>Agriculture</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>31.22</td>
<td>7.25</td>
<td>15.92</td>
<td>6.02</td>
<td>10.61</td>
<td>17.47</td>
<td>7.40</td>
<td>4.09</td>
</tr>
<tr>
<td>1985</td>
<td>31.33</td>
<td>5.84</td>
<td>19.65</td>
<td>7.38</td>
<td>15.60</td>
<td>10.82</td>
<td>5.71</td>
<td>3.66</td>
</tr>
<tr>
<td>1992</td>
<td>17.64</td>
<td>7.10</td>
<td>27.27</td>
<td>13.47</td>
<td>10.54</td>
<td>11.99</td>
<td>8.54</td>
<td>3.45</td>
</tr>
<tr>
<td>1993</td>
<td>15.68</td>
<td>11.16</td>
<td>27.37</td>
<td>14.19</td>
<td>8.42</td>
<td>11.28</td>
<td>8.57</td>
<td>3.32</td>
</tr>
<tr>
<td>1994</td>
<td>13.89</td>
<td>9.02</td>
<td>29.82</td>
<td>15.84</td>
<td>7.21</td>
<td>11.96</td>
<td>8.68</td>
<td>3.58</td>
</tr>
<tr>
<td>1995</td>
<td>14.68</td>
<td>9.20</td>
<td>29.44</td>
<td>16.24</td>
<td>7.44</td>
<td>11.85</td>
<td>8.00</td>
<td>3.15</td>
</tr>
<tr>
<td>1996</td>
<td>14.46</td>
<td>8.34</td>
<td>30.07</td>
<td>16.59</td>
<td>7.92</td>
<td>11.48</td>
<td>8.13</td>
<td>3.01</td>
</tr>
<tr>
<td>1997</td>
<td>14.12</td>
<td>8.91</td>
<td>30.92</td>
<td>15.75</td>
<td>8.37</td>
<td>11.26</td>
<td>7.77</td>
<td>2.91</td>
</tr>
<tr>
<td>1998</td>
<td>16.09</td>
<td>7.43</td>
<td>31.88</td>
<td>15.38</td>
<td>8.75</td>
<td>10.84</td>
<td>7.26</td>
<td>2.37</td>
</tr>
<tr>
<td>1999</td>
<td>19.72</td>
<td>7.14</td>
<td>33.59</td>
<td>14.21</td>
<td>7.03</td>
<td>10.03</td>
<td>6.31</td>
<td>1.97</td>
</tr>
<tr>
<td>2000</td>
<td>16.99</td>
<td>7.02</td>
<td>34.51</td>
<td>14.50</td>
<td>9.03</td>
<td>9.80</td>
<td>6.22</td>
<td>1.93</td>
</tr>
<tr>
<td>2001</td>
<td>17.35</td>
<td>6.85</td>
<td>36.96</td>
<td>15.19</td>
<td>5.28</td>
<td>9.96</td>
<td>6.34</td>
<td>2.07</td>
</tr>
<tr>
<td>2002</td>
<td>17.94</td>
<td>5.53</td>
<td>37.77</td>
<td>17.01</td>
<td>3.79</td>
<td>9.75</td>
<td>6.30</td>
<td>1.91</td>
</tr>
<tr>
<td>2003</td>
<td>17.87</td>
<td>5.70</td>
<td>37.33</td>
<td>17.92</td>
<td>3.28</td>
<td>9.94</td>
<td>5.92</td>
<td>2.04</td>
</tr>
<tr>
<td>2004</td>
<td>15.49</td>
<td>5.61</td>
<td>37.23</td>
<td>18.30</td>
<td>3.64</td>
<td>9.92</td>
<td>7.63</td>
<td>2.18</td>
</tr>
<tr>
<td>2005</td>
<td>15.52</td>
<td>5.74</td>
<td>37.65</td>
<td>18.57</td>
<td>3.90</td>
<td>9.51</td>
<td>6.88</td>
<td>2.22</td>
</tr>
<tr>
<td>2006</td>
<td>14.24</td>
<td>5.66</td>
<td>38.24</td>
<td>18.29</td>
<td>4.55</td>
<td>9.66</td>
<td>7.01</td>
<td>2.35</td>
</tr>
</tbody>
</table>


Notes: (a) The items above were regrouped by Wong et al. (1995); (b) Social expenditure includes expenditure for culture, education, science, and health, plus expenditure for social security; (c) Total subsidies equal price subsidies plus appropriation for working capital of enterprises.
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ilar to those in developing countries. However, the declining share of in-budget investment expenditure does not denote a reduction in total investment spending (budgetary and non-budgetary expenditures). In addition, the ever-increasing administrative expenditure is worrisome. Hussain and Stern (2008) note that salaries for the public sector make up much of this expense (p. 25). This may reflect bureaucratic expansion.

The expenditure at the county level is similar to the national and sub-national one with regard to the changing trend, but different in the shares of given items. As noted by Fock and Wong (2008), the share of social services and administration spending at the county level is higher than that at the national level. Further, the share of capital investment at the county level is lower than the national one as well, indicating that provincial and prefectural governments invest more in budgetary-funded infrastructure.

THE CASE OF LIANJIANG COUNTY: A PROSPEROUS INDUSTRIALIZING LOCALITY

In this section, wage bills borne by the county government are examined in order to evaluate the impacts of central pay mandates. There were subsidies flowing from upper-level governments to ease the fiscal burdens of the county government. Nevertheless, the subsidies play limited roles in preventing deterioration in fiscal capacity.

Basic Socio-Economic Indicators in Lianjiang County

As a coastal county, economic development in Lianjiang is relatively high with regard to Fujian Province. Lianjiang, traditionally a fishing

15. As will be explained later, education spending, retired personnel spending, and administrative spending are the largest three budgetary expenditure items in counties surveyed in both Fujian and Hubei Provinces.
16. The World Bank (2002) argues that “Provincial governments play a more important role in capital construction and price subsidies” (p. 34).
17. This study borrows the categorization of Chinese counties from Unger. Unger (2002) categorizes rural China as prosperous industrializing coastal localities, impoverished localities of the Western hinterlands, and grain belts of central China.
18. There are no exact pay bills available in Fujian Fiscal Yearbooks and other sources. During the fieldwork, some interviewees kindly told me the amount of pay bills. However, all of them declined to offer written documents on this. Thus, the study relies mainly on the estimations developed by the author. The estimations have been corroborated with other sources including field notes.
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county, is housing a growing number of manufacturing industries, while also developing a seasonal tourism industry.

Average Salary-based Pay Bills in Lianjiang County

In order to examine pay bills, I developed two estimation methods: average salary-based and budget item-based. In the former, two sets of data are crucial. One is the number of civil servants; the other is the average pay level of civil servants. For the latter, administrative spending plus education spending constitutes a large portion of personnel costs because the majority of public sector employees in local China are civil servants and teachers. According to the Government Organization Establishment Yearbook of Fujian Province (Fujian jigou bianzhi nianjian) 2004, the civil servant quota (xingzheng renyuan bianzhi) for Lianjiang county-level government departments was 480, including 161 for the CCP, 20 for the local People’s Congress, 262 for the government, 15 for the local political consultative system, and 22 for mass organizations, such as the Communist Youth League. The number of civil servants at the township level was 590. Thus, the total number of civil servants in the Lianjiang County Government was 1,070. However, the interviewees, including a senior official working on the Lianjiang Organizational Establishment Committee, admitted that the data provided by establishment departments underestimated the number of actual employees on the payroll (Interview note, PA-20090110-1). An official in the local Finance Bureau said that:

It is common that persons working in the government do not receive formal approval from the establishment department. They are not defined as civil servants, but they do enjoy the same pay level as other civil servants. For example, in my bureau, of 43 persons, 21 are not civil servants, even though the finance bureau is of course part of the local government (Interview note PA-20090111).

19. These methods are inspired by the existing literature and developed from interviewees’ accounts in the fieldwork.

20. The reason suggested by the above interviewee for this is the conflicting interest between the establishment department and other individual government departments. He points out, for example, that as guided by the Ministry of Finance county-level finance bureaux have set up social security branches in recent years. However, the establishment department refuses to add civil servant quotas for new branches because maintaining a slow growth of administrative establishments is the primary concern of the establishment department (see Interview note as well, PA20090111).
The number of budgeted employees, as indicated by the Fujian Fiscal Yearbooks, is far larger than the quota for civil servants in the county. On average, out of 100 people in Lianjiang County, 2.1–2.2 persons are fiscally supported by the government budget (see Table 4.5).

As Table 4.6 shows, the average salary-based wage bill in Lianjiang was 167 million yuan in 2002, 249 million yuan in 2005, and 411 million yuan in 2007, in which the average growth rate of pay bills was as high as 20.74 percent for the period 2002–2007. A crucial caveat is in order: the real wage bill in the county may be underestimated. As found in other developing countries, there are “ghost employees” who are paid by the government but not reported as budgeted employees (see Interview notes, PA-20080325-1, PA-20090107, PA-20090111). For example, the Personnel Department of the Fuzhou City Government claimed that they discovered a 65,600 yuan pay bill for “ghost employees” in 2006 (Fuzhou Yearbook, 2007, p. 318). It means that some employees in the payroll have never really worked for the government. It may suggest that some government departments inflate the number of employees in order to receive more public money. In the meantime, the respondent also suggests that many city inspectors never appear in the formal payroll of county and township governments, but are paid by government funds (Interview note, PA-20090110-2).

Table 4.5: Budgeted employees in Lianjiang County, 2002–2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Population</th>
<th>Budgeted employees</th>
<th>2/1 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>616,300</td>
<td>13,785</td>
<td>2.24</td>
</tr>
<tr>
<td>2003</td>
<td>613,100</td>
<td>13,473</td>
<td>2.20</td>
</tr>
<tr>
<td>2004</td>
<td>611,600</td>
<td>13,144</td>
<td>2.15</td>
</tr>
<tr>
<td>2005</td>
<td>611,000</td>
<td>13,302</td>
<td>2.18</td>
</tr>
<tr>
<td>2006</td>
<td>611,900</td>
<td>13,511</td>
<td>2.21</td>
</tr>
<tr>
<td>2007</td>
<td>613,400</td>
<td>13,849</td>
<td>2.26</td>
</tr>
</tbody>
</table>


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Table 4.6: Government pay bills in Lianjiang County, 2002–2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual average salary of state organs per person (yuan)</th>
<th>Budgeted employees (person)</th>
<th>Pay bills (million yuan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>12,132</td>
<td>13,785</td>
<td>167</td>
</tr>
<tr>
<td>2003</td>
<td>13,244</td>
<td>13,473</td>
<td>178</td>
</tr>
<tr>
<td>2004</td>
<td>16,005</td>
<td>13,144</td>
<td>210</td>
</tr>
<tr>
<td>2005</td>
<td>18,693</td>
<td>13,302</td>
<td>249</td>
</tr>
<tr>
<td>2006</td>
<td>19,864</td>
<td>13,511</td>
<td>268</td>
</tr>
<tr>
<td>2007</td>
<td>29,647</td>
<td>13,849</td>
<td>411</td>
</tr>
</tbody>
</table>


BUDGET ITEM-BASED PAY BILLS IN LIANJIANG COUNTY

In many countries, the government provides the expenditure breakdown in terms of type and function. However, although the categories of government expenditure have been reorganized in recent years, the Chinese local governments choose to only report expenses according to function, with personnel costs scattered among various items, such as administrative spending and education expenditure. Thus, it is important to go carefully through government expenditure tables and make a reasonable estimation.

Wong et al. (1995) make a preliminary attempt to re-group Chinese government expenditure for research purposes. The expenditure for culture, education, science, health, and social security are merged into the category of social expenditure, while price subsidies and appropriation for working capital of enterprises are classified as total subsidies. This effort has advanced our understanding of central government expenditures. The expenditure composition at the local level, however, is different from that of the central government. There are more items shown in county budgets.

22. A budget classification approach adopted by developing countries is to divide the government spending in terms of economic type (jingji fenlei) and function (gongneng fenlei). Hence, expenditures are classified in economic type as wages and salaries, subsidies and transfers, investment in fixed assets, and so on. In terms of function, spending is categorized into defense, education, general administration, and so forth (World Bank, 1988, p. 108).

23. The World Bank (2002) notes that “there are multiple headings showing expenditures on a single major function. For example, administrative expenditures are scattered through several headings including ‘administration’ and ‘other administration’” (p. 32).
Zhang and Zou (1998) have also re-categorized government spending. In their study, there are six main expenditure items, namely administration, development, defense, human capital, and urban maintenance. Spending on development refers to capital construction, enterprise upgrading, technical research and design, and agricultural expenditure, while human capital spending denotes expenditure on culture, education, science, and health care. Urban maintenance expenditure comprises spending on both urban maintenance and urban youth employment. Compared with the attempt made by Wong et al., this study goes one step further to include capital construction, technical upgrading, and agricultural spending into expenditure for economic development. On the other hand, neither Wong et al. nor Zhang and Zou cover all government spending items at the county level. In addition, some items are not applicable to county governments.

According to interviewees’ qualitative accounts and the above literature, I group government expenditures into expenditure on economic development, administrative expenditure, social expenditure, defense spending, and other spending. The expenditure for economic development can yield economic advantages in the future while administrative expenditure includes mainly the costs of both personnel and the overall running of the government. Social expenditure is distinct from other categories in that it provides human needs for education, health, and social security. It should be noted that social spending includes personnel costs in the public sector as well. The four unrelated items, including supporting undeveloped areas, government debt service, and earmarked expenditure, are grouped into the item of “Others.”

Table 4.7 illustrates my categorization.


25. In the original table, “others” (qita zhichu) are merged into administrative expenditure. According to the interviewees, this spending at the county level roughly goes to the compensation for village officials in rural areas and people working in resident committees in urban localities (Interview notes, PA-20080409, PA-20090106, PA-2009011, and PA-20090526-1). Many scholars notice the increasing sum of “other” spending in government budgets (World Bank, 2002, p. 30).
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According to the Original Expenditure in Table 4.8 shown below, of the 31 spending items for the period of 2002–2007, education spending, retired personnel spending, and administrative spending are the three largest, accounting for 29 percent, 13 percent and 12 percent of total expenditure from 2002 to 2006. It should be noted that the Original Expenditure breakdown is re-grouped by the author according to similar principles although the 2007 spending items were reclassified nationwide by the Ministry of Finance (see Table 4.9).

After restructuring, Table 4.10 shows the amount and share of five spending items categorized by the author. Administrative expenditure was 124.29 million yuan in 2002 and 379.61 million yuan in 2007. Thus, the share of administrative expenditure against the total ranged from 45 percent to 49 percent between 2002 and 2007. The social expenditure was 94.14 million yuan in 2002 and rose to 396.11 million yuan in 2007; therefore, the share of social expenditure fluctuated between 36 percent

Table 4.7: Re-categorized expenditure items at county level in Fujian Province

<table>
<thead>
<tr>
<th>Re-categorized item</th>
<th>Original expenditure item</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social expenditure</td>
<td>Education, Science, Health, Social Relief &amp; Welfare, and Social Security</td>
</tr>
<tr>
<td>Defense</td>
<td>Defense</td>
</tr>
<tr>
<td>Others</td>
<td>Supporting Undeveloped Areas, Government Debt Service, and Earmarked Expenditure</td>
</tr>
</tbody>
</table>

Source: Compiled by the author

Notes: (a) both defense and foreign affairs are the duties of the central government; however, local governments pay a part of the cost in practice. (b) The re-categorization only refers to the spending breakdown before 2006. Since 2007, the Chinese government has adopted a new budget classification system, which is not compatible with the old one.

According to the Original Expenditure in Table 4.8 shown below, of the 31 spending items for the period of 2002–2007, education spending, retired personnel spending, and administrative spending are the three largest, accounting for 29 percent, 13 percent and 12 percent of total expenditure from 2002 to 2006. It should be noted that the Original Expenditure breakdown is re-grouped by the author according to similar principles although the 2007 spending items were reclassified nationwide by the Ministry of Finance (see Table 4.9).

After restructuring, Table 4.10 shows the amount and share of five spending items categorized by the author. Administrative expenditure was 124.29 million yuan in 2002 and 379.61 million yuan in 2007. Thus, the share of administrative expenditure against the total ranged from 45 percent to 49 percent between 2002 and 2007. The social expenditure was 94.14 million yuan in 2002 and rose to 396.11 million yuan in 2007; therefore, the share of social expenditure fluctuated between 36 percent

26. There were 30 spending items between 2002 and 2003 in Fujian county-level governments. Expenditure related to cars was only reported beginning from 2004.
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## Table 4.8: Original expenditure breakdown and their volumes in Lianjiang County (10,000 yuan), 2002–2006

<table>
<thead>
<tr>
<th>Item</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Construction</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>20</td>
</tr>
<tr>
<td>Enterprises Innovation Funds</td>
<td>263</td>
<td>63</td>
<td>153</td>
<td>35</td>
<td>0</td>
</tr>
<tr>
<td>Geological Prospecting</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Technological Upgrading and R &amp;D</td>
<td>192</td>
<td>317</td>
<td>336</td>
<td>132</td>
<td>101</td>
</tr>
<tr>
<td>Working Capital</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Agriculture</td>
<td>1,224</td>
<td>1,325</td>
<td>1,541</td>
<td>1,732</td>
<td>1,955</td>
</tr>
<tr>
<td>Forest</td>
<td>212</td>
<td>362</td>
<td>308</td>
<td>269</td>
<td>473</td>
</tr>
<tr>
<td>Irrigation and Weather Forecast</td>
<td>1,184</td>
<td>552</td>
<td>795</td>
<td>773</td>
<td>1,132</td>
</tr>
<tr>
<td>Industry, Transport, &amp; Commerce</td>
<td>126</td>
<td>427</td>
<td>461</td>
<td>569</td>
<td>578</td>
</tr>
<tr>
<td>Logistics</td>
<td>27</td>
<td>22</td>
<td>118</td>
<td>126</td>
<td>131</td>
</tr>
<tr>
<td>Culture, Sports, &amp; Broadcasting</td>
<td>1,141</td>
<td>2,022</td>
<td>1,517</td>
<td>1,726</td>
<td>1,987</td>
</tr>
<tr>
<td>Education</td>
<td>7,110</td>
<td>10,067</td>
<td>9,980</td>
<td>11,651</td>
<td>16,164</td>
</tr>
<tr>
<td>Science</td>
<td>58</td>
<td>85</td>
<td>89</td>
<td>119</td>
<td>108</td>
</tr>
<tr>
<td>Health</td>
<td>1,230</td>
<td>1,319</td>
<td>1,374</td>
<td>1,560</td>
<td>3,213</td>
</tr>
<tr>
<td>Other Operating Costs</td>
<td>961</td>
<td>1,293</td>
<td>1,231</td>
<td>1,266</td>
<td>2,585</td>
</tr>
<tr>
<td>Social Relief &amp; Welfare</td>
<td>946</td>
<td>1,287</td>
<td>1,524</td>
<td>1,940</td>
<td>1,980</td>
</tr>
<tr>
<td>Retired Staff Expense</td>
<td>3,412</td>
<td>4,170</td>
<td>4,765</td>
<td>5,167</td>
<td>6,602</td>
</tr>
<tr>
<td>Social Security</td>
<td>70</td>
<td>343</td>
<td>158</td>
<td>200</td>
<td>415</td>
</tr>
<tr>
<td>Defense</td>
<td>44</td>
<td>61</td>
<td>383</td>
<td>100</td>
<td>81</td>
</tr>
<tr>
<td>Government Administration</td>
<td>2,905</td>
<td>3,234</td>
<td>3,958</td>
<td>4,709</td>
<td>7,503</td>
</tr>
<tr>
<td>Foreign Affairs</td>
<td>50</td>
<td>13</td>
<td>10</td>
<td>4</td>
<td>27</td>
</tr>
<tr>
<td>Armed Police</td>
<td>195</td>
<td>221</td>
<td>221</td>
<td>185</td>
<td>179</td>
</tr>
<tr>
<td>Public Security, Procuratorate, Court, and Justice Bureau</td>
<td>2,138</td>
<td>2,536</td>
<td>2,702</td>
<td>3,485</td>
<td>3,549</td>
</tr>
<tr>
<td>Urban Maintenance</td>
<td>275</td>
<td>284</td>
<td>306</td>
<td>327</td>
<td>408</td>
</tr>
<tr>
<td>Price Subsidies</td>
<td>257</td>
<td>210</td>
<td>233</td>
<td>178</td>
<td>3,913</td>
</tr>
<tr>
<td>Supporting Undeveloped Areas</td>
<td>171</td>
<td>226</td>
<td>194</td>
<td>204</td>
<td>281</td>
</tr>
<tr>
<td>Sea Area Devel. / Site Usage Fee Expenses</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>3</td>
<td>21</td>
</tr>
<tr>
<td>Vehicle Tax and Fee</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Government Debt Service</td>
<td>0</td>
<td>0</td>
<td>347</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Earmarked Expenditure</td>
<td>411</td>
<td>307</td>
<td>527</td>
<td>475</td>
<td>791</td>
</tr>
<tr>
<td>Others</td>
<td>1,199</td>
<td>1,117</td>
<td>1,864</td>
<td>946</td>
<td>2,096</td>
</tr>
<tr>
<td>Total Expenditure</td>
<td>25,801</td>
<td>31,863</td>
<td>35,095</td>
<td>37,881</td>
<td>56,293</td>
</tr>
</tbody>
</table>

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Many China-based scholars view the administrative expenditure as a proxy of personnel costs. It underestimates the real situation because personnel costs of the education sector – constituting a substantial part of local wage bills – are excluded. As noted by several sources (Interview notes, PA-20090111, PA-20090106; World Bank, 2007a), salaries for teachers in the education sector take up a large share of wage bills of county government. Thus, I sum up administrative expenditure and education spending to obtain an approximation of the wage bill. The budget item-based pay bill was 195 million yuan in 2002, 302 million yuan in 2005, and 598 million yuan in 2007. Thus, the wage bill accounted for 75.73, 79.62 and 70.47 percent of the budgetary expenditure in 2002, 2005 and 2007, respectively, with an average of 76 percent of

Table 4.9: Original expenditure breakdown and their volumes in Lianjiang County (10,000 yuan), 2007

<table>
<thead>
<tr>
<th>Item</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Public Services</td>
<td>17,918</td>
</tr>
<tr>
<td>Defense</td>
<td>155</td>
</tr>
<tr>
<td>Public Security</td>
<td>6,378</td>
</tr>
<tr>
<td>Education</td>
<td>21,792</td>
</tr>
<tr>
<td>Science</td>
<td>1,015</td>
</tr>
<tr>
<td>Culture, Sports, and Media</td>
<td>771</td>
</tr>
<tr>
<td>Social Security</td>
<td>12,806</td>
</tr>
<tr>
<td>Medical and Health Care</td>
<td>3,998</td>
</tr>
<tr>
<td>Environment Protection</td>
<td>592</td>
</tr>
<tr>
<td>Urban and Rural Community Affairs</td>
<td>998</td>
</tr>
<tr>
<td>Agriculture, Forestry, and Water Conservancy</td>
<td>5,488</td>
</tr>
<tr>
<td>Transportation</td>
<td>360</td>
</tr>
<tr>
<td>Industry, Commerce, and Banking</td>
<td>8,841</td>
</tr>
<tr>
<td>Others</td>
<td>3,693</td>
</tr>
<tr>
<td>Total Expenditure</td>
<td>84,805</td>
</tr>
</tbody>
</table>


and 47 percent for the period 2002–2007. The share of government expenditure for economic development ranged from 8 percent to 14 percent.
Governing Civil Service Pay in China

Table 4.10: Expenditure breakdown in Lianjiang County (10,000 yuan), 2002–2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Expenditure for economic development</th>
<th>Administrative expenditure</th>
<th>Social expenditure</th>
<th>Defense expenditure</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>3,332 (12.91%)</td>
<td>12,429 (48.17%)</td>
<td>9,414 (36.49%)</td>
<td>44 (0.17%)</td>
<td>582 (2.26%)</td>
<td>25,801</td>
</tr>
<tr>
<td>2003</td>
<td>2,829 (8.88%)</td>
<td>15,339 (48.14%)</td>
<td>13,101 (41.12%)</td>
<td>61 (0.19%)</td>
<td>533 (1.67%)</td>
<td>31,863</td>
</tr>
<tr>
<td>2004</td>
<td>3,366 (9.59%)</td>
<td>17,153 (48.88%)</td>
<td>13,125 (37.40%)</td>
<td>383 (1.09%)</td>
<td>1,068 (3.04%)</td>
<td>35,095</td>
</tr>
<tr>
<td>2005</td>
<td>3,122 (8.24%)</td>
<td>18,510 (48.68%)</td>
<td>15,470 (40.84%)</td>
<td>100 (0.26%)</td>
<td>679 (1.79%)</td>
<td>37,881</td>
</tr>
<tr>
<td>2006</td>
<td>7,615 (13.53%)</td>
<td>25,645 (45.56%)</td>
<td>21,880 (38.87%)</td>
<td>81 (0.14%)</td>
<td>1,072 (1.90%)</td>
<td>56,293</td>
</tr>
<tr>
<td>2007</td>
<td>7,078 (8.35%)</td>
<td>37,961 (44.76%)</td>
<td>39,611 (46.71%)</td>
<td>155 (0.18%)</td>
<td>0 (0.00%)</td>
<td>84,805</td>
</tr>
</tbody>
</table>

Note: # Numbers in parentheses indicate the share of a given item among the total.

budgetary expenditure in Lianjiang County between 2002 and 2007. As noted in the previous section, the average salary-based wage bill ranged from 167 to 411 million yuan between 2002 and 2007 in Lianjiang County, in which it accounted for 57.08 percent of the total expenditure (see Table 4.11). Thus, I argue that the real wage bill falls roughly within 60–80 percent according to the two estimation methods.

Table 4.11: Budgetary expenditure and pay bills borne by county government in Lianjiang, 2002–2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Local budgetary expenditure (100 million yuan)</th>
<th>Average salary-based pay bills (100 million yuan)</th>
<th>Share of Pay bills ① among local budgetary expenditure (%)</th>
<th>Share of Pay bills ② among local budgetary expenditure (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>2.58</td>
<td>1.67</td>
<td>64.82</td>
<td>1.95</td>
</tr>
<tr>
<td>2003</td>
<td>3.19</td>
<td>1.78</td>
<td>56.00</td>
<td>2.54</td>
</tr>
<tr>
<td>2004</td>
<td>3.51</td>
<td>2.10</td>
<td>59.94</td>
<td>2.71</td>
</tr>
<tr>
<td>2005</td>
<td>3.79</td>
<td>2.49</td>
<td>65.64</td>
<td>3.02</td>
</tr>
<tr>
<td>2006</td>
<td>5.63</td>
<td>2.68</td>
<td>47.68</td>
<td>4.18</td>
</tr>
<tr>
<td>2007</td>
<td>8.48</td>
<td>4.11</td>
<td>48.42</td>
<td>5.98</td>
</tr>
</tbody>
</table>
Local Implementation: Remuneration in Fujian and Hubei Provinces

Although the gap between 60 percent and 80 percent is by no means small, the estimation is satisfactory since it matches well with the figures in the existing literature. Fock and Wong (2008) argue that “personnel costs are by far the largest component of expenditure for local governments, accounting for some 70 percent of total subnational budgetary expenditure in 2004” (p. 39). Burns (2007) estimates that wage bills account for 70–80 percent of total expenditure in poor localities. Nevertheless, he admits that the burden should be much higher due to across-the-board pay rises. Interviewees in Fujian Province note that the pay bill accounts for 80 percent of the budgetary expenditure (Interview notes, PA-20090111, PA-20090114).

Revenue and Ability to Pay in Lianjiang County

As wage bills increased substantially, then to what extent can the county government revenue cover increasing expenditure demands? In the past three decades following the introduction of economic reform the budgetary revenue in Lianjiang County grew considerably. As indicated by Figure 4.1, for the period 1978–1993 the local revenue kept increasing despite a decline in some years; for example, the growth rate was as low as -34.82 percent in 1984. With the installation of the 1994 tax-sharing system, there was negative growth in that year, followed by a 110.09 percent rebound in 1995, which offset the 1994 drop. On average, the annual growth rate of local budget revenue between 1978 and 1997 was 21.98 percent.

For the period 1998–2007, the average annual growth rate of revenues in Lianjiang County was 14.53 percent, which was much slower than that between 1978 and 1997 (see Figure 4.2). Not counting the revenue of 2007, the growth rate was only 9.66 percent between 1998 and 2006. The situation is a result of an upward concentration of revenues in upper-level governments. However, downward transfers, filtered through various administrative tiers, may not compensate the declining fiscal capacity of the county government.

In detail, similar to the nationwide trend, the largest source of local budgetary revenue in Lianjiang County is business tax (see Table 4.12). Similar to other countries, the sheer number of small businesses makes the collection cost mount; and therefore, the volume of business tax remains fluctuating. However, owing to the real estate boom in recent
Figure 4.1: Local budgetary revenue in Lianjiang County (10,000 yuan), 1978–1997


Note: The dramatic increase in 1995 is probably due to the tax-sharing reconfiguration between central and local governments in 1994.

Figure 4.2: Local budgetary revenue in Lianjiang County (10,000 yuan), 1998–2007


Note: The jump in 2007 is probably due to the real estate boom in the locality.
years, the share of business tax, which benefits from the turnovers of real estate, has exceeded 30 percent of the total local budgetary revenue in Lianjiang County between 2004 and 2007. As compared with the real estate boom in the county, the local manufacturing industry was not flourishing, as the share of value-added tax was relatively smaller, although the year 2007 saw a large increase in revenue from value-added tax.

In sum, Lianjiang County presents a mixed picture of budgetary revenue. On the one hand, the real estate boom and industrial catch-up paint a rosy future for government revenue generation. On the other hand, the growth rate of budgetary revenue is relatively slow as compared with mounting demands for expenditure. Furthermore, many central mandates come thick and fast. Pay raises, among others, give rise to depleted fiscal coffers at the county level although Lianjiang County is relatively rich among the four counties surveyed in this study. As Table 4.13 shows, the share of the average salary-based pay bill as a percentage of local budgetary revenue was 79.52 percent in 2002, 89.14 percent in 2005, and 83.15 percent in 2007. The data of the budget item-based wage bill, shown in Column 6 of Table 4.12, also display an upward trend between 2002 and 2007. Share of pay bill above 100 percent means that the wage bill exceeds the revenue. The period 2003–07 saw bankruptcy

Table 4.12: Sources of local budgetary revenue in Lianjiang County (%), 1998–2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Value-added tax (%)</th>
<th>Business tax (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>8.26</td>
<td>24.65</td>
</tr>
<tr>
<td>1999</td>
<td>6.49</td>
<td>22.98</td>
</tr>
<tr>
<td>2000</td>
<td>6.88</td>
<td>22.00</td>
</tr>
<tr>
<td>2001</td>
<td>7.52</td>
<td>22.58</td>
</tr>
<tr>
<td>2002</td>
<td>7.82</td>
<td>25.39</td>
</tr>
<tr>
<td>2003</td>
<td>7.51</td>
<td>24.56</td>
</tr>
<tr>
<td>2004</td>
<td>4.92</td>
<td>31.44</td>
</tr>
<tr>
<td>2005</td>
<td>7.94</td>
<td>35.14</td>
</tr>
<tr>
<td>2006</td>
<td>9.16</td>
<td>37.13</td>
</tr>
<tr>
<td>2007</td>
<td>13.64</td>
<td>32.25</td>
</tr>
</tbody>
</table>

in county governments with only budgetary revenue, and the situation deteriorated further: the budget item-based pay bills were almost 1.2 times more than the budgetary revenue in the locality in both 2006 and 2007.

How then do central subsidies for salary increases work? If subsidies can cover the cost of pay raises, central mandates may not have a negative effect on the fiscal capacity of local governments. As noted by Shah and Shen (2008) and Wong (2007a), the central transfer for salary increases has been one of the fastest growing central subsidies in recent years. In 1999, the volume of the central transfer for salary increases was 10.8 billion yuan, accounting for 10.8 percent of total transfers. It soon rose to 99.4 billion yuan in 2004, 223.4 billion yuan, and 239.2 billion yuan in 2008 (see Table 4.2).

The increase in central subsidies for pay raises, however, did not ease the fiscal burden of Lianjiang County. In 2006, the Lianjiang County Government received for the first time 16.33 million yuan of upper-level government transfers for salary increases and 23.57 million yuan of transfers in 2007. Thus, the share of central transfers for salary increases against the average salary-based wage bill in Lianjiang County was 6.08 percent in 2006 and 5.74 percent in 2007. The share of these transfers among the budget item-based wage bill was 3.91 percent and 3.94 per-

Table 4.13: Budgetary revenues and pay bills borne by county government in Lianjiang, 2002–2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Local budgetary revenue (100 million yuan)</th>
<th>Average salary-based pay bill (100 million yuan)</th>
<th>Share of pay bill among local budgetary revenue (%)</th>
<th>Budget item-based pay bill (100 million yuan)</th>
<th>Share of pay bill among local budgetary revenue (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>2.10</td>
<td>1.67</td>
<td>79.52</td>
<td>1.95</td>
<td>92.90</td>
</tr>
<tr>
<td>2003</td>
<td>2.46</td>
<td>1.78</td>
<td>72.62</td>
<td>2.54</td>
<td>103.40</td>
</tr>
<tr>
<td>2004</td>
<td>2.51</td>
<td>2.10</td>
<td>83.95</td>
<td>2.71</td>
<td>108.28</td>
</tr>
<tr>
<td>2005</td>
<td>2.79</td>
<td>2.49</td>
<td>89.14</td>
<td>3.02</td>
<td>108.12</td>
</tr>
<tr>
<td>2006</td>
<td>3.22</td>
<td>2.68</td>
<td>83.43</td>
<td>4.18</td>
<td>129.96</td>
</tr>
<tr>
<td>2007</td>
<td>4.94</td>
<td>4.11</td>
<td>83.15</td>
<td>5.98</td>
<td>121.01</td>
</tr>
</tbody>
</table>

Source: Calculated by the author.
Local Implementation: Remuneration in Fujian and Hubei Provinces

cent in 2006 and 2007, respectively. That is, the effect of central transfers for salary increases on the fiscal capacity of county governments should not be overstated.

THE CASE OF MINQING COUNTY: A GLOOMY INDUSTRIAL LOCALITY

This section examines wage bills borne by the county government and the implementation of central pay mandates on the government of Minqing County in Fujian Province. The share of central subsidies relative to wage bills in Minqing County is higher than that in Lianjiang County. However, Minqing County suffers from a more serious over-staffing problem. Thus, the county government has difficulty making ends meet.

Basic Socio-Economic Indicators in Minqing County

Located in the northwest of Fuzhou, Minqing County used to be a predominantly state-owned economy but nowadays is a rust belt in which the role of the manufacturing sector is significant, but declining.

The social indicators of Minqing County paint a similar picture as its economic aspects. For one thing, there are a large number of teachers engaged in primary and secondary education. The ratio of teachers to the total population ranked the highest in the locality. The ratio of teachers to total population was 1.43 percent in Minqing County in 2007 while it was only 0.91 percent in Lianjiang County. The teacher–student ratio (the number of teachers divided by that of students) in Minqing County was pretty high as well (9.22 percent in 2007, the second highest in Fujian Province). Because the payroll of teachers is borne by the county government, the large number of teachers in primary and secondary education gives rise to fiscal difficulties in the county. The reason offered by interviewees for the large teacher population is that Minqing County is a mountainous area and remote villages have a smaller class size, thus requiring more teachers (Interview note, PA-20090106). However, this may not be so. Mountainous Yongtai County, also subordinate to Fuzhou City, has a much smaller number of teachers on the county

27. Industrial outputs accounted for 58.25 percent and 27.56 percent of GDP in 2007 in Minqing and Lianjiang Counties, respectively. Thus, compared with Lianjiang County, Minqing County is an industrial locality.
payroll. The difference between teacher–student ratios may be due to past experiences.28

**Average Salary-based Pay Bills in Minqing County**

On average, the civil service pay level in Minqing County is lower than that in Lianjiang County for the period 2002–2007. The average annual salary in the state organs of Minqing County almost doubled between 2002 and 2007, rising from 11,141 yuan to 21,690 yuan. At the same time, the average growth rate of civil service compensation in Minqing County was slower (14.5 percent) compared with that (20.46 percent) in Lianjiang County.

Similar to Lianjiang County, Minqing County had a very small population of government employees (only 811 civil servants) in 2004 as indicated by the Fujian Provincial Organizational Establishment Committee. Nevertheless, the number of budgeted employees in Minqing County was 12,116 in 2002, 11,933 in 2004, and 11,183 in 2007. Minqing County has a large government size, which is measured by the ratio of budgeted employees to the total population (3.84 percent between 2002 and 2007).29 As indicated by Figure 4.3, several downsizing movements launched by the central government did not result in a sustainable decline in government size.30 There have indeed been declines in numbers of budgeted employees in some years in the four counties surveyed in this study; however, this does not paint a rosy picture in terms of government retrenchment. First, the share of government expenditure relative to GDP, a standard way to measure government size, increased substantially in all four counties between 2000 and 2007. Thus, declines in numbers of budgeted employees may not truly reflect the real situation in local China.31 Second, the resilience

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28. The majority of the counties with a large number of teachers in Fujian Province are former important areas for developing the state-owned economy. Thus, I assume that some of the former schools subordinate to state-owned enterprises were transferred to county governments, thereby increasing the size of the teaching staff paid by local governments. Meanwhile, some laid-off workers with a good education level might become teachers when state-owned enterprises were privatized in the 1990s.

29. The proportion of budgeted employees to total population was 2.21 percent in Lianjiang County, 2.47 percent in Daye County, and 2.96 in Nanzhang County at the same time.

30. See Burns (2003b) and Wu and Lin (2012).

31. Local governments have incentives to magnify achievements of government retrenchment because financial rewards would be offered to those with good performance in solving the overstaffing problem.
Local Implementation: Remuneration in Fujian and Hubei Provinces

Figure 4.3: Number of budgeted employees in Minqing County, 2002–2007

![Graph showing the number of budgeted employees in Minqing County, 2002–2007.](image)


Of bureaucratic expansion is shown in both Lianjiang and Minqing Counties. For example, in 2006, the number of budgeted employees in Minqing County reached its lowest at 10,798 persons. However, the year 2007 saw a strong rebound in the number of budgeted employees.

With the data on budgeted employees and pay levels obtained, the average salary-based pay bills borne by the Minqing County Government can be calculated. Table 4.14 shows that the sum was 1.35 billion yuan in

Table 4.14: Government pay bills in Minqing County, 2002–2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Average annual salary of state organs per person (yuan)</th>
<th>Budgeted employees (person)</th>
<th>Pay bills (million yuan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>11,141</td>
<td>12,116</td>
<td>135</td>
</tr>
<tr>
<td>2003</td>
<td>12,163</td>
<td>12,070</td>
<td>147</td>
</tr>
<tr>
<td>2004</td>
<td>14,804</td>
<td>11,933</td>
<td>177</td>
</tr>
<tr>
<td>2005</td>
<td>15,367</td>
<td>11,235</td>
<td>173</td>
</tr>
<tr>
<td>2006</td>
<td>17,549</td>
<td>10,798</td>
<td>189</td>
</tr>
<tr>
<td>2007</td>
<td>21,690</td>
<td>11,183</td>
<td>243</td>
</tr>
</tbody>
</table>

Source: Data of annual state organ salaries from 2004–2007 are taken from the Population and Labor Section, Fujian Socio-economic Statistical Yearbook 2005–2008, while the rest of the data related to salaries are estimated using the method developed in this study. Data of budgeted employees are taken from Fujian Fiscal Statistical Yearbook 2003–2008.
2002, 1.77 billion yuan in 2004, and 2.43 billion yuan in 2007, averaging 12.92 percent for the annual growth rate for the period.

Budget Item-based Pay Bills in Minqing County

Budget item-based wage bills borne by the county government have been discussed in the previous section. Among the 31 expenditure items, education spending, retired personnel spending, and administrative spending rank the top three, as in the case of Lianjiang. The shares of education and retired personnel spending among the total, however, are higher than those in Lianjiang County, revealing the weakness of old industrial zones such as Minqing County, for which the government has to bear a heavy burden of personnel cost.

Since the expenditure regrouping has been explained above, I turn directly to the data descriptions. The budget item-based wage bill was 136 million yuan in 2002, 186 million yuan in 2005, and 229 million yuan in 2007. In sum, the average salary-based pay bills relative to local budgetary expenditures averaged 74.08 percent for the period 2002–07. Meanwhile, the share of budget item-based pay bills against local expenditures was 75.17 percent during the same period (see Table 4.15).

Table 4.15: Budgetary expenditures and pay bills borne by county government in Minqing, 2002–2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Local budgetary expenditure (100 million yuan)</th>
<th>Average salary-based pay bills (100 million yuan)</th>
<th>Share of pay bills ① among local budgetary expenditure (%)</th>
<th>Budget item-based pay bills (100 million yuan) ②</th>
<th>Share of pay bills ② among local budgetary expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>1.73</td>
<td>1.35</td>
<td>77.88</td>
<td>1.36</td>
<td>78.38</td>
</tr>
<tr>
<td>2003</td>
<td>1.91</td>
<td>1.47</td>
<td>76.85</td>
<td>1.46</td>
<td>76.63</td>
</tr>
<tr>
<td>2004</td>
<td>2.08</td>
<td>1.77</td>
<td>85.13</td>
<td>1.66</td>
<td>79.97</td>
</tr>
<tr>
<td>2005</td>
<td>2.41</td>
<td>1.73</td>
<td>71.51</td>
<td>1.86</td>
<td>76.97</td>
</tr>
<tr>
<td>2006</td>
<td>2.71</td>
<td>1.89</td>
<td>69.93</td>
<td>2.15</td>
<td>79.43</td>
</tr>
<tr>
<td>2007</td>
<td>3.84</td>
<td>2.43</td>
<td>63.18</td>
<td>2.29</td>
<td>59.62#</td>
</tr>
</tbody>
</table>

Source: Calculated by the author.

Note: The low value in 2007 (#) is a puzzle. The interviewee in Minqing County argues that it may be due to the conversion from the old budget classification system into the new one in 2007.
Local Implementation: Remuneration in Fujian and Hubei Provinces

Thus, the personnel cost in Minqing County ranged around 75 percent of local budgetary expenditures. Again, the above estimation related to wage bills in Minqing County is similar to Fock and Wong (2008).

**Revenue and Ability to Pay in Minqing County**

The local budgetary revenue showed an upward trend in Minqing County between 1998 and 2007 (Figure 4.4), but the curve was not as steep as that in Lianjiang County. The average annual growth rate of the local budgetary revenue was 10.13 percent from 1998 to 2007 while it was 14.53 percent in Lianjiang County.

For the sources of budgetary revenue, value-added tax constituted the largest share of the total revenue, ranging from 12.59 percent to 36.25 percent between 1998 and 2007. Business tax fluctuated between 8.49 percent and 15.84 percent at the same time (Table 4.16). These data imply that, compared with Lianjiang County, the Minqing County Government relies heavily on the revenue generated from manufacturing industry rather than the real estate and service industries.
Governing Civil Service Pay in China

Table 4.16: Sources of local budgetary revenue in Minqing County (%), 1998–2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Value-added tax (%)</th>
<th>Business tax (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>12.59</td>
<td>13.77</td>
</tr>
<tr>
<td>1999</td>
<td>11.53</td>
<td>11.46</td>
</tr>
<tr>
<td>2000</td>
<td>12.03</td>
<td>11.04</td>
</tr>
<tr>
<td>2001</td>
<td>13.11</td>
<td>9.50</td>
</tr>
<tr>
<td>2002</td>
<td>43.28</td>
<td>8.75</td>
</tr>
<tr>
<td>2003</td>
<td>29.54</td>
<td>14.09</td>
</tr>
<tr>
<td>2004</td>
<td>32.67</td>
<td>15.84</td>
</tr>
<tr>
<td>2005</td>
<td>42.48</td>
<td>10.85</td>
</tr>
<tr>
<td>2006</td>
<td>40.60</td>
<td>8.49</td>
</tr>
<tr>
<td>2007</td>
<td>36.25</td>
<td>10.20</td>
</tr>
</tbody>
</table>

Sources: Data between 2002 and 2007 are taken from Fujian Fiscal Statistical Yearbook 2003–2008 while those from 1998 to 2001 are from Fujian Statistical

Similar to the situation in Lianjiang County, as noted in Table 4.17, pay bills estimated by the two methods approximated or exceeded budgetary revenues in most years. Without the fiscal transfer system, the county government would go bankrupt.

The central transfers for pay raises are limited. In 2004, a central transfer of 3.3 million yuan was offered to the county government for

Table 4.17: Budgetary revenues and pay bills borne by county government in Minqing, 2002–2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Local budgetary revenue (100 million yuan)</th>
<th>Average salary-based pay bill (100 million yuan)</th>
<th>Share of pay bill among local budgetary revenue (%)</th>
<th>Budget item-based pay bill (100 million yuan)</th>
<th>Share of pay bill among local budgetary revenue (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>1.95</td>
<td>1.35</td>
<td>69.14</td>
<td>1.36</td>
<td>69.59</td>
</tr>
<tr>
<td>2003</td>
<td>1.41</td>
<td>1.47</td>
<td>104.09</td>
<td>1.46</td>
<td>103.78</td>
</tr>
<tr>
<td>2004</td>
<td>1.48</td>
<td>1.77</td>
<td>119.46</td>
<td>1.66</td>
<td>112.21</td>
</tr>
<tr>
<td>2005</td>
<td>1.88</td>
<td>1.73</td>
<td>91.84</td>
<td>1.86</td>
<td>98.86</td>
</tr>
<tr>
<td>2006</td>
<td>2.19</td>
<td>1.89</td>
<td>86.51</td>
<td>2.15</td>
<td>98.27</td>
</tr>
<tr>
<td>2007</td>
<td>2.35</td>
<td>2.43</td>
<td>103.41</td>
<td>2.29</td>
<td>97.58</td>
</tr>
</tbody>
</table>

Source: Calculated by the author.
Local Implementation: Remuneration in Fujian and Hubei Provinces

remuneration. In 2006 and 2007, a total of 37.95 million yuan and 26.92 million yuan respectively were transferred from upper-level governments for civil service salary increases. Although the amount of central transfers for pay raises was higher in Minqing County than in Lianjiang County, it still accounted for a small fraction of the total cost incurred by nationwide pay raises. The share of central transfer for pay raises relative to the average salary-based and budget item-based wage bills in Minqing County was 20.08 percent and 17.65 percent respectively in 2006. In 2007, the central transfer for salary increases was cut by 29 percent. Thus, the share of central transfer for pay raises relative to the average salary-based and budget item-based wage bills was 11.08 percent and 11.76 percent respectively in 2007.

The Case of Daye County: A Prosperous Inland Locality

As categorized by Unger (2002), the majority of counties in Hubei Province are grain belts relying on agricultural output. Yet Daye County is an exception. As indicated by the share of secondary industry (53.65%), Daye has shifted from an agricultural economy to an industrial one equipped with a developed manufacturing sector. Similar to Minqing County in Fujian Province, Daye County has industrial enterprises with very high gross output value (14.22 billion yuan).

As shown in Figure 4.5, economic development (GDP per capita) in Daye is lower than that in Fujian Province. Among the four counties, the gap in GDP per capita between Daye, Lianjiang and Minqing is still large, but the growth of GDP per capita is the fastest in Daye, followed by Nanzhang. Furthermore, Daye County has attracted substantial investment in fixed assets in recent years.

Estimation of Wage Bills in Daye County

Analyses of fiscal activities depend largely on the availability of data. The quality of data compiled in provincial fiscal statistical yearbooks varies among provinces. The research is relatively easy to carry out when specific and detailed fiscal data are available. Apart from some unique items related to geographical conditions, the composition of

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32. Heavy industry accounts for 83.17 percent of industrial products.
33. In 2002, the ratio of investment in fixed assets to GDP in Daye was 23.12 percent before it expanded to 29.58 in 2004 and 36.85 in 2007. The ratio averaged 31.18 percent (the highest among the four counties) for the period 2002–2007.
expenditure is largely comparable. However, public sources contained in the Hubei Fiscal Yearbooks report county government expenditures in only 11 items (31 in Fujian Province). Fortunately, I obtained the budget speeches of Daye and Nanzhang Counties during my field work.\(^{34}\) Budget speeches have up-to-date data and can be re-categorized. Thus, estimations of wage bills in this section are made mainly using data from budget speeches.

According to the original expenditure breakdown\(^ {35}\) shown in Table 4.18, the expenditure related to education, government administration, and agriculture are the largest among the 23 items. The education spending accounted for 21.06 percent and 21.84 percent in 2005 and 2006 respectively while the share of administrative spending was 12.26 percent and 11.48 percent respectively. In both 2007 and 2008, educa-

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34. Budget speeches (caizheng baogao) delivered by heads of the Finance Bureau at annual meetings of local People’s Congress. They contain 23 items.

35. Similar to fiscal yearbooks, both the structure and the style of budget speeches vary, even in the same province. Daye County provides more detailed revenue and expenditure outlays while Nanzhang County offers only sketches of fiscal activities.
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Table 4.18: Original expenditure breakdown and its volumes in Daye County (10,000 yuan), 2005–2006

<table>
<thead>
<tr>
<th>Item</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprises Innovation Funds</td>
<td>4,098</td>
<td>4,306</td>
</tr>
<tr>
<td>Geological Prospecting</td>
<td>70</td>
<td>0</td>
</tr>
<tr>
<td>Technological Upgrading and R&amp;D</td>
<td>1,162</td>
<td>4,190</td>
</tr>
<tr>
<td>Agriculture</td>
<td>5,999</td>
<td>7,985</td>
</tr>
<tr>
<td>Forest</td>
<td>719</td>
<td>866</td>
</tr>
<tr>
<td>Irrigation and Weather Forecast</td>
<td>1,154</td>
<td>1,733</td>
</tr>
<tr>
<td>Industry, Transport, &amp; Commerce</td>
<td>855</td>
<td>1,496</td>
</tr>
<tr>
<td>Logistics</td>
<td>300</td>
<td>349</td>
</tr>
<tr>
<td>Culture, Sports, &amp; Broadcasting</td>
<td>1,318</td>
<td>2,334</td>
</tr>
<tr>
<td>Education</td>
<td>14,272</td>
<td>20,432</td>
</tr>
<tr>
<td>Science</td>
<td>88</td>
<td>173</td>
</tr>
<tr>
<td>Health</td>
<td>3,266</td>
<td>6,276</td>
</tr>
<tr>
<td>Other Operating Costs</td>
<td>4,981</td>
<td>5,124</td>
</tr>
<tr>
<td>Social Relief &amp; Welfare</td>
<td>1,643</td>
<td>3,269</td>
</tr>
<tr>
<td>Social Security</td>
<td>3,571</td>
<td>3,227</td>
</tr>
<tr>
<td>Government Administration</td>
<td>8,309</td>
<td>10,745</td>
</tr>
<tr>
<td>Public Security, Procuratorate, Court, and Justice Bureau</td>
<td>5,648</td>
<td>7,520</td>
</tr>
<tr>
<td>Urban Maintenance</td>
<td>4,586</td>
<td>5,949</td>
</tr>
<tr>
<td>Price Subsidies</td>
<td>32</td>
<td>435</td>
</tr>
<tr>
<td>Supporting Undeveloped Areas</td>
<td>317</td>
<td>336</td>
</tr>
<tr>
<td>Vehicle Tax and Fee</td>
<td>630</td>
<td>1,058</td>
</tr>
<tr>
<td>Earmarked Expenditure</td>
<td>1,838</td>
<td>2,334</td>
</tr>
<tr>
<td>Others</td>
<td>2,919</td>
<td>3,435</td>
</tr>
<tr>
<td>Total Expenditure</td>
<td>67,775</td>
<td>93,572</td>
</tr>
</tbody>
</table>


The expenditure for general public services stems from administrative spending, but is far larger than the latter in terms of volume, since general public services have incorporated several items related to government running costs since 2007.
Table 4.19: Original expenditure breakdown and its volumes in Daye County (10,000 yuan), 2007–2008

<table>
<thead>
<tr>
<th>Item</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Public Services</td>
<td>23,131</td>
<td>32,679</td>
</tr>
<tr>
<td>Public Security</td>
<td>7,611</td>
<td>10,006</td>
</tr>
<tr>
<td>Education</td>
<td>27,881</td>
<td>32,790</td>
</tr>
<tr>
<td>Science</td>
<td>1,502</td>
<td>1,651</td>
</tr>
<tr>
<td>Culture, Sport, and Media</td>
<td>1,292</td>
<td>1,611</td>
</tr>
<tr>
<td>Social Security</td>
<td>7,277</td>
<td>12,715</td>
</tr>
<tr>
<td>Medical and Health Care</td>
<td>6,935</td>
<td>9,788</td>
</tr>
<tr>
<td>Environment Protection</td>
<td>870</td>
<td>5,257</td>
</tr>
<tr>
<td>Urban and Rural Community Affairs</td>
<td>15,968</td>
<td>13,404</td>
</tr>
<tr>
<td>Agriculture, Forestry, and Water Conservancy</td>
<td>13,514</td>
<td>15,882</td>
</tr>
<tr>
<td>Transportation</td>
<td>3,875</td>
<td>5,320</td>
</tr>
<tr>
<td>Industry, Commerce, and Banking</td>
<td>2,413</td>
<td>7,506</td>
</tr>
<tr>
<td>Others</td>
<td>7,306</td>
<td>5,066</td>
</tr>
<tr>
<td>Total Expenditure</td>
<td>119,575</td>
<td>153,675</td>
</tr>
</tbody>
</table>


Table 4.20 shows that administrative expenditure becomes the largest item in Daye County after the re-categorization of government spending items. It was 244 million yuan in 2005 and 621.88 million yuan in 2008. The share of administrative expenditure among the total ranged from 33.13 percent to 40.47 percent between 2005 and 2008, which was lower than that in Lianjiang and Minqing Counties. The social expenditure was 234.7 million yuan in 2005 and 569.44 million yuan in 2008. The share of social expenditure relative to the total varied between 34.63 and 37.05 percent for the same period, which was slightly lower than that in Lianjiang and Minqing Counties. Nevertheless, the share of government expenditure for economic development in Daye was much higher than that in Fujian, ranging from 22.48 percent to 27.21 percent between 2005 and 2008.
Table 4.20: Expenditure breakdown in Daye County (10,000 yuan), 2005–2008

<table>
<thead>
<tr>
<th>Year</th>
<th>Expenditure for economic development</th>
<th>Administrative expenditure</th>
<th>Social expenditure</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>17,750 (26.19#)</td>
<td>24,400 (36.00)</td>
<td>23,470 (34.63)</td>
<td>2,155 (3.18)</td>
<td>67,775 (100)</td>
</tr>
<tr>
<td>2006</td>
<td>25,464 (27.21)</td>
<td>31,003 (33.13)</td>
<td>34,435 (36.80)</td>
<td>2,670 (2.85)</td>
<td>93,572 (100)</td>
</tr>
<tr>
<td>2007</td>
<td>30,352 (25.38)</td>
<td>45,628 (38.16)</td>
<td>43,595 (36.46)</td>
<td>0</td>
<td>119,575 (100)</td>
</tr>
<tr>
<td>2008</td>
<td>34,543 (22.48)</td>
<td>62,188 (40.47)</td>
<td>56,944 (37.05)</td>
<td>0</td>
<td>153,675 (100)</td>
</tr>
</tbody>
</table>

Source: Compiled by the author according to the budget speeches of the Daye Fiscal Bureau, 2006–2009

Note: Numbers in parentheses indicate the share of a given item among the total.

According to the data described above, the budget item-based wage bill in Daye County, measured by administrative expenditure plus education spending, was 387 million yuan in 2005 and 950 million yuan in 2008, accounting for 57 percent of the budgetary expenditure in 2005 and 62 percent in 2008. The Research Unit of the Finance Bureau of Xiaogan City in Hubei Province (2005) reports that wage bills make up 70 percent of budgetary expenditure at the county level in the whole province (p. 49). As noted previously, the interviewees provided a much higher estimation on wage bills (Interview notes, PA-20090111, PA-20090114, and PA-20090526-1). Nevertheless, the budget item-based wage bill in Daye County is lower than the above estimations.

Fortunately, the fiscal bureau head in Daye County showed me the budgeted employee wage bills of some years. This source provided an important clue to the validity of the above estimation methods. According to the data shown in the budget speech delivered in May 2008, the pay bill in Daye County was 202 million yuan in 2003, 326 million yuan in 2005, and 525 million yuan in 2007, which roughly accounted for 44–55 percent of budgetary expenditure in Daye between 2003 and 2007 (see Table 4.21). However, the Daye County Government might have underreported actual pay bills when they ignored the personnel costs of ghost employees. The number of budgeted employees covered

37. The estimation is close to that of Fock and Wong (2008).
by the speech of the fiscal bureau head was much lower than that indicated in Hubei Fiscal Statistical Yearbooks.

Revenue and Ability to Pay in Daye County

Over the past decade, similar to other counties surveyed in this study, Daye County has substantially increased its budgetary revenue. As shown in Figure 4.6, it was 154.94 million yuan in 2000, 248.36 million yuan in 2004, and 622.85 million yuan in 2008. The average annual growth rate of revenue was 19.66 percent between 2000 and 2008, which was comparable to that in Lianjiang County. (The growth of budgetary revenue was much slower in Minqing and Nanzhang Counties.)

Although the budgetary revenue increases considerably, expenditure needs balloon as well. For one thing, the ratio of pay bills (retrieved from the 2008 budget speech) to county budgetary revenue was 110.99 percent in 2003 and 102.94 in 2007. Meanwhile, the ratio of budget item-based wages bills to government revenues was 124.44 percent in 2005 and 152.49 percent in 2008, in which the pay bills in Daye County exceeded its budgetary revenues by 1-1.5-fold (see Table 4.22). Thus, the fiscal position in Daye is much worse than that in Lianjiang and Minqing.

Table 4.21: Budgetary expenditures and pay bills in Daye County, 2003–2008

<table>
<thead>
<tr>
<th>Year</th>
<th>Local budgetary expenditure (100 million yuan)</th>
<th>Pay bills retrieved from the 2008 budget speech (100 million yuan)</th>
<th>Share of Pay bills among local budgetary expenditure (%)</th>
<th>Share of pay bills among local budgetary expenditure (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>366</td>
<td>202</td>
<td>55.19</td>
<td>N.A.</td>
</tr>
<tr>
<td>2004</td>
<td>498</td>
<td>256</td>
<td>51.43</td>
<td>N.A.</td>
</tr>
<tr>
<td>2005</td>
<td>678</td>
<td>326</td>
<td>48.03</td>
<td>387</td>
</tr>
<tr>
<td>2006</td>
<td>936</td>
<td>413</td>
<td>44.18</td>
<td>534</td>
</tr>
<tr>
<td>2007</td>
<td>1196</td>
<td>525</td>
<td>43.91</td>
<td>735</td>
</tr>
<tr>
<td>2008</td>
<td>1537</td>
<td>N.A.</td>
<td>N.A.</td>
<td>950</td>
</tr>
</tbody>
</table>


#Note: The data shown under the item of “Others” in 2003 and 2004 are too large, thus they are not included in the above estimations.
Local Implementation: Remuneration in Fujian and Hubei Provinces

Figure 4.6: Local budgetary revenue in Daye County (10,000 yuan), 2000–2008


THE CASE OF NANZHANG COUNTY: A TYPICAL GRAIN BELT

This section examines the factors related to pay implementation in Nanzhang County. It is the poorest locality in terms of GDP per capita in this study. Nevertheless, the poor economy does not stop the government from expanding its size and allocating excessive resources to enhance economic development just as in other localities.

Table 4.22: Budgetary revenues and pay bills in Daye County, 2003–2008

<table>
<thead>
<tr>
<th>Year</th>
<th>Local budgetary revenue (100 million yuan)</th>
<th>Pay bills retrieved from the 2008 budget speech (100 million yuan)</th>
<th>Share of pay bills among local budgetary revenue (%)</th>
<th>Budget item-based pay bills (100 million yuan)</th>
<th>Share of pay bills among local budgetary revenue (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>1.82</td>
<td>2.02</td>
<td>110.99</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
<tr>
<td>2004</td>
<td>2.48</td>
<td>2.56</td>
<td>103.23</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
<tr>
<td>2005</td>
<td>3.11</td>
<td>3.26</td>
<td>104.82</td>
<td>3.87</td>
<td>124.44</td>
</tr>
<tr>
<td>2006</td>
<td>3.94</td>
<td>4.13</td>
<td>104.82</td>
<td>5.34</td>
<td>135.53</td>
</tr>
<tr>
<td>2007</td>
<td>5.1</td>
<td>5.25</td>
<td>102.94</td>
<td>7.35</td>
<td>144.12</td>
</tr>
<tr>
<td>2008</td>
<td>6.23</td>
<td>N.A.</td>
<td>N.A.</td>
<td>9.5</td>
<td>152.49</td>
</tr>
</tbody>
</table>

Nanzhang County is a typical “grain belt” county in central China (Unger, 2002). Its economic development is the most backward among the four counties examined. GDP per capita in Nanzhang was 6,765 yuan in 2007, about 45 percent of that in Daye and 35 percent of that in Lianjiang. Although Nanzhang County places much emphasis on the manufacturing sector, both agriculture outputs and tourism contribute significantly to its local GDP. The catch-up trend is obvious in Nanzhang County because investment in fixed assets has accelerated in recent years. The ratio of investment in fixed assets was 17.47 percent in 2002, 18.41 percent in 2004, and 33.22 percent in 2007.

Estimation of Wage Bills in Nanzhang County
In Nanzhang County, the expenditure for economic development was 19.65 million yuan in 2004 and 46.77 million yuan in 2008 while the administrative expenditure was 76.71 million yuan and 155.84 million yuan for the same years, respectively (see Table 4.23). For the share of individual items among the total expenditure, the expenditure for public administration ranked middle while the share of social expenditure was the highest among the four counties studied.

According to the above basic descriptive data, I present budget item-based wage bills in Nanzhang County here. As measured by administrative expenditure plus education spending, the pay bill was 151 million

Table 4.23: Expenditure breakdown in Nanzhang County (10,000 yuan), 2004–2008

<table>
<thead>
<tr>
<th>Year</th>
<th>Expenditure for economic development</th>
<th>Administrative expenditure</th>
<th>Social expenditure</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>1,965 (8.97*)</td>
<td>7,671 (35.00)</td>
<td>12,160 (55.49)</td>
<td>120 (0.55)</td>
<td>21,915 (100)</td>
</tr>
<tr>
<td>2005</td>
<td>2,692 (10.20)</td>
<td>9,476 (35.89)</td>
<td>14,087 (53.35)</td>
<td>148 (0.56)</td>
<td>26,403 (100)</td>
</tr>
<tr>
<td>2006</td>
<td>2,902 (9.35)</td>
<td>10,440 (33.63)</td>
<td>17,444 (56.19)</td>
<td>258 (0.83)</td>
<td>31,043 (100)</td>
</tr>
<tr>
<td>2007</td>
<td>4,166 (10.71)</td>
<td>14,810 (38.07)</td>
<td>19,921 (51.21)</td>
<td>0 (0.00)</td>
<td>38,897 (100)</td>
</tr>
<tr>
<td>2008</td>
<td>4,677 (10.94)</td>
<td>15,584 (36.45)</td>
<td>22,498 (52.62)</td>
<td>0 (0.00)</td>
<td>42,759 (100)</td>
</tr>
</tbody>
</table>


Note: Numbers in parentheses indicate the share of a given item among the total.
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Table 4.24: Budgetary expenditures and pay bills in Nanzhang County, 2003–2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Local budgetary expenditure (million yuan)</th>
<th>Budget item-based pay bills (million yuan)</th>
<th>Share of pay bills among local budgetary expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>219</td>
<td>151</td>
<td>68.83</td>
</tr>
<tr>
<td>2005</td>
<td>264</td>
<td>181</td>
<td>68.37</td>
</tr>
<tr>
<td>2006</td>
<td>310</td>
<td>207</td>
<td>66.73</td>
</tr>
<tr>
<td>2007</td>
<td>389</td>
<td>287</td>
<td>73.91</td>
</tr>
<tr>
<td>2008</td>
<td>428</td>
<td>319</td>
<td>74.58</td>
</tr>
</tbody>
</table>


Note: Although I have tried various ways to access alternatives of wage bills in Nanzhang County, the average annual salary of the public sector and the official wage bills are not available.

yuan in 2004 and 319 million yuan in 2008. Therefore, the share of pay bills as percentages of total local budgetary expenditure was 67–75 percent for the period 2004–2008 (see Table 4.24).

Revenue and Ability to Pay in Nanzhang County

The local budgetary revenue in Nanzhang County increased between 2000 and 2008, despite fluctuations in some years, which was similar to the situation in Minqing County. As Figure 4.7 shows, the local revenue was 87.08 million yuan in 2000; however, it declined to 54.55 million yuan in 2002 and 52.5 million yuan in 2005. Nevertheless, it soon rebounded to 76.19 million yuan in 2007 and 100.72 million yuan in 2008. The average annual growth of the local budgetary revenue, which stood at 4.49 percent for the period 2000–2008, was the lowest among the four counties examined in this study.

38. It is not uncommon to see that the budgetary revenue at the county level declined somewhat around 2002 because the latest central-local tax-sharing rearrangement in income taxes took effect at the same time. The fluctuations later on may reflect the impact of tax-for-fee reform in China. OECD (2006) also notes that the decline of farmer burdens led to a weak fiscal capacity of county governments (p. 93). Furthermore, other central mandates may reduce the revenues of local governments. For example, in the 2005 budget speech, the head of the Finance Bureau in Nanzhang County reports that the county revenue declined by 8.86 million yuan in 2004 due to the central requirement to raise the income tax threshold.
In contrast to its fiscal capacity, the wage bills borne by the county government in Nanzhang are not small. Thus, the impact of central pay mandates on the county government in Nanzhang is serious. The wage bills outpaced the budgetary revenues by more than three-fold between 2005 and 2008 (see Table 4.25). With no other resources available, the Nanzhang County Government would go bankrupt. Nevertheless, the level of pay arrears in Nanzhang County is not the worst among the four counties surveyed.

Table 4.25: Budgetary revenues and pay bills borne by county government in Nanzhang, 2004–2008

<table>
<thead>
<tr>
<th>Year</th>
<th>Local budgetary expenditure (million yuan)</th>
<th>Budget item-based pay bills (million yuan)</th>
<th>Share of pay bills among local budgetary expenditure (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>66</td>
<td>151</td>
<td>227.33</td>
</tr>
<tr>
<td>2005</td>
<td>53</td>
<td>181</td>
<td>343.85</td>
</tr>
<tr>
<td>2006</td>
<td>62</td>
<td>207</td>
<td>335.06</td>
</tr>
<tr>
<td>2007</td>
<td>76</td>
<td>287</td>
<td>377.32</td>
</tr>
<tr>
<td>2008</td>
<td>101</td>
<td>319</td>
<td>316.64</td>
</tr>
</tbody>
</table>

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Figure 4.8: Ratio of budgetary expenditure to GDP in the four counties surveyed (government size, %)


THE REASONS FOR THE POOR IMPLEMENTATION OF PAY REFORM

In addition to a central mandate, both bureaucratic expansion and fiscal misallocation account for the poor implementation of pay raises at the grassroots level. Though the central government has launched several rounds of public sector retrenchment over the decades, local government size remains very large. The local government size, measured by local budgetary expenditure relative to local GDP, despite some fluctuations, has increased in both Fujian and Hubei Provinces. Figure 4.8 illustrates the government size of the four counties surveyed.

Bureaucratic expansion exists, then, but which departments expand the most and why? To my knowledge, empirical evidence is very limited. Brødsgaard (2002) argues that chaobian, as the number of actual employees exceeding the establishment plan, is “a very important phenomenon which remains unresearched in Western literature on China’s administrative system and practices” (p. 366). Data sources seriously limit the possibility of carrying out this kind of research. Hubei Province is a pioneer in publicizing its establishment plan (bianzhi) and chaobian on government websites. Using this information, I tabulated the top 10 overstuffed bureaux in Daye County’s People’s Government, as shown

39. There are five sets of public administrative bodies (wutao banzi) in county governments in China (see Zhong, 2003, p. 51). They are party committee, people’s congress, people’s government, and people’s political consultative conference, and the disciplinary inspection
Table 4.26: Chaobian in Daye County

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of actual employees (②)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Level of expansion (persons) (②-①)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Level of expansion (%) ((②-①)/①)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Establishment plan (①)</td>
<td>29</td>
<td>16</td>
<td>9</td>
<td>5</td>
<td>60</td>
<td>15</td>
<td>20</td>
<td>20</td>
<td>9</td>
<td>9</td>
<td>19</td>
</tr>
<tr>
<td>Number of actual employees (②)</td>
<td>73</td>
<td>36</td>
<td>20</td>
<td>10</td>
<td>112</td>
<td>28</td>
<td>37</td>
<td>35</td>
<td>13</td>
<td>13</td>
<td>27</td>
</tr>
<tr>
<td>Level of expansion (persons) (②-①)</td>
<td>44</td>
<td>20</td>
<td>11</td>
<td>5</td>
<td>52</td>
<td>13</td>
<td>17</td>
<td>15</td>
<td>4</td>
<td>4</td>
<td>8.18</td>
</tr>
<tr>
<td>Level of expansion (%) ((②-①)/①)</td>
<td>151.72</td>
<td>125.00</td>
<td>122.22</td>
<td>100.00</td>
<td>86.67</td>
<td>86.67</td>
<td>85.00</td>
<td>75.00</td>
<td>44.44</td>
<td>42.11</td>
<td>91.88</td>
</tr>
</tbody>
</table>

Local Implementation: Remuneration in Fujian and Hubei Provinces

In total, Daye County had 78 administrative units and 545 public service units in 2009. Among them, 54 units belong to Daye County’s People’s Government. The Bureau of Land and Resources has the greatest enlargement in size; that is, the quota was 29 while the actual number of employees was 73, an expansion by 151.72 percent. Both the Bureau of Population and Family Planning and the Price Bureau increased their sizes by more than 120 percent. On average, the top 10 overstaffed bureaux employed more than 90 percent of staff than the figure stipulated by the establishment department.

A map of chaobian in Nanzhang County is presented here. In 2009, there were 59 government administrative units and 381 public service units in the locality. The level of expansion, measured by the share of actual employees relative to the establishment plan, was 79.30 percent on average, slightly lower than that in Daye. In detail, the Finance Bureau, responsible for carrying out government retrenchment in collaboration with the Establishment Committee, expands its staff size most seriously, in which the number of actual employees was 84, but the bianzhi was only 32. Besides the Finance Bureau, the Transportation Bureau increased its size by 100 percent, the Bureau of Civil Affairs by 80 percent, and the Bureau of Culture and Sports by 77.78 percent (see Table 4.27).

With reference to the extant literature and opinions of interviewees, I propose two explanations for micro-level bureaucratic expansion at the departmental level: one is resource-driven and the other is need-driven. Departments with important resources such as fiscal revenue, Zeng (2008) argues, are likely to expand. More resources indicate that departments are in a better position to reward their civil servants; and people tend to squeeze into these departments. This is the resource-driven cause of bureaucratic expansion. On other occasions, expansion may be driven by assuming more responsibilities; that is, individual departments have to add more manpower to handle new duties. In Daye and Nanzhang Counties, the Bureau of Land and Resources, Bureau of Housing Management, Finance Bureau, and Transportation Bureau have serious chaobian problems, which imply resource-driven expansions. Interestingly, many heavily expanded departments in the two counties of Hubei Province belong to “wet” function organizations whereby civil committee of the county. The majority of civil servants serve in the people’s government of the county.
Table 4.27: *Chaobian* in Nanzhang County

<table>
<thead>
<tr>
<th>Establishment plan (①)</th>
<th>Finance Bureau</th>
<th>Transportation Bureau</th>
<th>Bureau of Civil Affairs</th>
<th>Bureau of Culture and Sports</th>
<th>Economic Restructuring Office</th>
<th>Poverty Relief Office</th>
<th>Audit Bureau</th>
<th>Economic Services Bureau</th>
<th>Bureau of Environmental Protection</th>
<th>Bureau of Housing Management</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establishment plan (①)</td>
<td>32</td>
<td>15</td>
<td>15</td>
<td>9</td>
<td>6</td>
<td>6</td>
<td>19</td>
<td>20</td>
<td>10</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td>Number of actual employees (②)</td>
<td>84</td>
<td>30</td>
<td>27</td>
<td>16</td>
<td>10</td>
<td>10</td>
<td>31</td>
<td>32</td>
<td>16</td>
<td>25</td>
<td></td>
</tr>
<tr>
<td>Level of expansion (persons) (②-①)</td>
<td>52</td>
<td>15</td>
<td>12</td>
<td>7</td>
<td>4</td>
<td>4</td>
<td>12</td>
<td>12</td>
<td>6</td>
<td>9</td>
<td>13.3</td>
</tr>
<tr>
<td>Level of expansion (%) (\frac{(②-①)}{①})</td>
<td>162.50</td>
<td>100.00</td>
<td>80.00</td>
<td>77.78</td>
<td>66.67</td>
<td>66.67</td>
<td>63.16</td>
<td>60.00</td>
<td>60.00</td>
<td>56.25</td>
<td>79.30</td>
</tr>
</tbody>
</table>

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servants have more opportunities to get “rents from the public” (Burns & Wang, 2010, pp. 69–70; see also Wu, 2013). In theory, civil servants provide public services to the general public. However, in China, some government departments are more powerful than others. Civil servants in these departments can also benefit personally from exercising public power. Therefore, based on economic calculation, rent-seekers tend to join these departments in order to maximize their personal benefits.

It should be noted that not all overstuffed government departments have large resources. Interviewees in Hubei argued that:

Manpower is crucial for both bargaining for upper-level resources and attracting investment. Take attracting investment as an example: the strategy of “casting the net widely (guang sa wang)” is useful. We should attend not only to the Yangtze River Delta and the Pearl River Delta but also the Beijing-Tianjin-Hebei Region. Thus, the government needs more staff to handle this task (Interview note, PA-20090530).

Attracting investment is a case in point to illustrate the need-driven cause. My field work suggests that working teams for attracting investment enlarged from 10 groups to 20 groups within a very short period in Daye County, although the group size did not change significantly. Some departments might need more manpower to carry out new duties, as the official in Fujian argued: the quota of finance departments should be enlarged because local finance bureaux were asked to assume new responsibilities in the social security area (Interview Note, PA-20090111).

Bureaucratic expansion erodes the pay ability of the county governments. In the meantime, fiscal misallocation contributes substantially to the poor implementation of local civil service remuneration. As discussed in Chapter 1, the central government attempts to promote the transformation from “infrastructure finance” (jianshe caizheng) to “people’s livelihood-centered finance” (gonggong caizheng) in a bid to strengthen the government’s legitimacy. Nevertheless, local governments still stick to the old financial model with public resources being misallocated to enhance economic prosperity.

In some governments around the world, despite their meager budgetary revenues, substantial spending goes to attracting investment. Holliday (2000) accurately points out that all other policies are subordinate to economic policy in the “productivist” approach. It is epitomized as yi jingjijianshe wei zhongxin (taking economic development as a core task) in
Chinese. According to my field research, taking economic development as a core task entails two subsets of tasks: attracting investment and striving for government projects (zhengqu xiangmu). The former refers to the enhancement of local investment by inviting domestic or foreign enterprises to invest in the private sector, while the latter denotes bargaining for resources flowing from upper-level governments (see Interview note, PA-20090526-1). In recent years, local governments have called on cadres to pay equal attention to both tasks. For example, on 18 September 2008, the county head of the Daye County Government asked for a two-pronged strategy to develop the local economy. That is, the county government should seek more resources from upper-level governments while inviting private investment from overseas and coastal areas (see Fu, 2008).

Local governments wage all-out campaigns to attract investment (Smith, 2009, p. 58). All civil servants and government departments are required to contribute to inviting investment, although their officially stipulated responsibilities may have nothing to do with economic development. In 2008, the Daye County Government, for example, sent out ten teams to the coastal areas of China to contact potential investors and arrange visits to the county. The county government doubled the number of teams in 2009 in order to get more investment. But given that the number of civil servants had not increased substantially, sending out a large number of civil servants meant a lower capacity to provide public services to local people.

Fostering economic prosperity costs county governments huge sums. In addition to substantial tax breaks granted to enterprises, industrial parks add to the financial burden. The Daye County Government, for example, mobilized 224 million yuan in 2007 and 200 million yuan in 2008, just for the infrastructural construction of a new industrial park (one of six) in Daye County. In addition, county governments directly subsidized local enterprises to the tune of 145 million yuan between 2003 and 2006.40

The Nanzhang County Government is no exception. In its 2009 budget speech, the Finance Bureau claimed that it had spent 13.80 million yuan on building infrastructure in an industrial park and 68 million yuan on road construction in 2008. The above two projects cost a total of 81.80

40. Except for the above budgetary spending, there was 50 million yuan non-budgetary spending on technological upgrading in 2005.
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million yuan (81.22 percent of local budgetary revenue). In 2007, the county government spent 70 million yuan on infrastructure construction, which was 91.88 percent of the budgetary revenue for the same period.

The 2008 budget speech delivered in Lianjiang County states that attracting investment, construction of industrial parks, and urban basic infrastructure cost 321 million yuan in 2007 (Interview note, PA-20090111). Meanwhile, the local budgetary revenue in Lianjiang County was only 494 million yuan in 2007 and 322 million yuan in 2006.

As noted in Chapter 1, civil service pay reforms are associated with both legitimacy change and income distribution in China. The State Council asserted in 2002 that public sector remuneration, pensions for retired personnel, and basic allowances for laid-off (xiagang) workers should be made a top priority of local public spending. Related official documents and leadership speeches argue that public sector remuneration should be guaranteed. Only with the full implementation of civil service remuneration can other spending on economic development be undertaken. As noted, the Ministry of Finance coined the term “people’s livelihood-centered finance” in preference to “infrastructure finance”. It means that as a development state relying on public investment in infrastructure, the Chinese government should spend more money on civil service remuneration and other welfare programs that benefit the general public. Empirical evidence suggests that civil service remuneration is still second to infrastructure financing in the Chinese public sector, which partially explains the poor implementation of civil service pay reforms at the grassroots level.

DISCUSSION

As elaborated in Chapter 3, the central government intends to drive down serious wage disparities across the board in China. In doing so, the central government has improved civil service remuneration around the country while asking rich localities and government departments to cut back their overpayments. But an unintended consequence occurs as lower governments, striving to meet increasing expenditure demands,

41. Some may argue, in people’s livelihood-centered finance, welfare programs related to education, health care, and social security, should be emphasized. Nevertheless, in the official documents, public sector remuneration has been placed as a priority.
cannot pay civil servants at the level as stipulated by the central remuneration policy.

Local leaders continually disregard civil service remuneration at the grassroots level. On the one hand, they promote bureaucratic expansion in a bid to profit from it and to consolidate patron–client relationships. On the other hand, they are obsessed with GDP-oriented fiscal allocation, which aims at a good economic development and growth of fiscal resources.

There are some deleterious consequences of pay arrears. When civil servants are paid unreasonably low wages, they tend to become corrupt. Bureaucratic expansion makes the situation worse. As expenditure demands increase, local governments have to pay much lower rates to civil servants; thus civil servants are likely to become more predatory. As shown in Chapter 8, the historical experience in China suggests that low pay caused rampant corruption while bureaucratic expansion aggravated the situation.

The implementation of the central remuneration policy is by no means successful on many fronts. Furthermore, the central government seems to use an undesirable method to strengthen its authority. As shown in Chapter 5, a recentralization of civil service pay remuneration has occurred in recent years, which may not in fact improve civil service remuneration.
Setting pay is central to a remuneration regime. The pendulum of pay setting in the Chinese public sector has swung back to centralized and rigid one since 2006. After twenty years of pay setting decentralization, centralizing the system echoed what happened with fiscal management – an increasingly tighter control over government spending around the country. Pay setting centralization, against an international backdrop of decentralization, may generate some negative consequences for public sector motivation.

This chapter begins with an investigation into the driving forces behind pay setting decentralization, as well as into its advantages and disadvantages, followed by a discussion of the roles played by the central government. The second section discusses pay determination in pre-reform China, while the third one examines the decentralization versus the recentralization of pay setting. The fourth one reveals the benefits and perils of a centralized pay setting.

PAY DECENTRALIZATION IN THE WESTERN CONTEXT

Due to an intensified market competition, the private sector has for a long time around the world decentralized pay setting to line managers or directors of small units. This successful practice in the private sector has diffused to the public sector; thereby many countries adopt some forms of pay setting decentralization (Rexed et al. 2007).

Pay setting decentralization in the public sector, in general, has been promoted by the idea of cost saving and competition with the private sector for human resources (Bender & Elliott, 2003). The first reason for decentralization is to overcome the weakness of pay structure in the public sector, where experienced and skilled labor are compensated with less pay comparatively, while the least skilled labor is remunerated with
higher pay (Katz & Krueger, 1993). This phenomenon is also termed a “double imbalance”, where both the top and bottom of the labor force are not compensated fairly (Schager, 1993), or a “pay compression”, meaning an unreasonably small pay gap between senior and junior civil servants (Katz & Krueger, 1993).

The second reason for pay setting decentralization is to accommodate organizational diversity. Bender and Elliott (2003) argue that public demand for better services presses for organizational diversities in the public sector. As a key instrument of human resource management in government, pay setting should be aligned with organizational diversity. For instance, the departments responsible for policy making and policy implementation have been separated in the central government of the United Kingdom to accommodate and enhance diversities in the output of different departments. The pay management thus is adjusted accordingly (Bender & Elliott, 2003).

The third reason for pay setting decentralization stems from macroeconomic pressures. In the 1980s, many governments were accused of escalating public spending. As a response, “the Conservative government of 1979 [in the United Kingdom] was elected on an explicit commitment to control public expenditure, reduce the size of the public sector, and undermine the capacity of public sector trade unions to exploit their ‘monopoly power’” (Bach & Winchester, 1994). In addition, many European countries tried to fulfill the criteria for membership of the European Monetary Union in the 1990s. These governments were pushed to initiate various cost containment programs, resulting in containing the pay bills, which constitute the largest item of recurrent government spending (Bender & Elliott, 2003). In the United States, the situation was comparable. Rising costs of public services led to criticism from the general public. Some accused the government of overpaying public employees, resulting in inflated public spending (Pounian & Fuller, 1996). More importantly, less revenue was available for providing public services (Pounian & Fuller, 1996).

The methods of pay setting decentralization vary across countries. Among them, a horizontal devolution requires that personnel managers inside work units assume responsibility for pay setting; and therefore the role of national personnel authorities will shift to generate recommendations instead of making decisions. For example, the national
A Decentralized Versus a Centralized Pay Setting

personnel authority takes charge of pay adjustments for all departments at the central level, traditionally. After pay setting decentralization occurs, the national personnel authority will only make recommendations concerning pay management for other departments. The alternative approach is vertical devolution in which local governments rather than the central government frame their pay packages. By the same token, the roles of the central government will alter. Nevertheless, whatever pay setting models are finally adopted, flexible and downward pay determination has emerged in many OECD countries (Maguire, 1993).

The existing literature also examines the perceived merits when pay setting is decentralized. They are mainly as follows: (1) recognizing the heterogeneity of public services; (2) clarifying organizational goals; (3) encouraging innovation; and, (4) realigning pay (Rexed et al., 2007).

(1) Recognizing the heterogeneity of public services can be understood in terms of organizational or individual dimensions. At the organizational level, the remuneration policy made by personnel specialists of work units will allow them to choose suitable pay structures and scales. At the individual level, managers will remunerate their individual staff with different pay packages within a given work unit. For instance, it is usually a tough issue for public sector employers to recruit and retain the people with high technological skills in short supply. Inasmuch as the private sector can offer relatively high payments for the talented, the public sector risks being a training school for the private sector. If the managers can come up with comparable salaries for these people within their discretion, the problem may be solved. Hence, Rexed et al. (2007) argue that a tailor-made compensation policy is a prominent merit of decentralized pay setting.

(2) The second advantage of pay setting decentralization is to clarify organizational goals. Rexed et al. (2007) state that decentralized pay setting may push managers to think hard about the special culture and goal of their own organization and about ways to compensate their staff. Hence, “This may lead them to better define those organizations goals” (Bender & Elliott, 2003, p.11). For example, as suggested by Gabris (1998), the manager of a fire-fighting department may prefer a compensation plan with greater equality to encourage teamwork.

structure may be a major benefit of decentralization” (p. 12). Imagine that pay structure and scale are controlled by the central personnel authority: a tiny change in pay structure may result in a series of costly adjustments nationwide. However, if the change in pay structure and scale is limited to one work unit, the switching cost may be relatively small. Bender and Elliott (2003) further argue that this will allow more experiments to take place from which the best practice in the pay structure of a government unit may be identified and passed on to other units after trial and error. That is how pay setting decentralization contributes to innovation in the human resource management of a government.

(4) Finally, realigning pay is also viewed as a virtue of pay setting decentralization. Bender and Elliott (2003) suggest that “Decentralized pay setting allows public sector organizations to pay at market rates.” Thus, a work unit could adjust its pay structure and scale to enhance the capacity of recruiting and retaining the talented (Rexed et al., 2007). In addition, if pay setting decentralization is executed effectively, the phenomenon of “double imbalance” may be mitigated since the pay rates of skilled and unskilled labor may rise and fall, respectively.

Rexed et al. (2007) report the perceived disadvantages of decentralized pay setting. First, decentralization could result in higher transaction costs. Simply put, more remuneration experts may be needed. In a centralized pay setting system, the major responsibilities of ministries and local governments are to implement rather than design compensation policies for their staff; thus their work is relatively simple. After decentralization occurs, ministries and local governments need to develop their own compensation policies; hence, more manpower may be required.

Second, decentralization could lead to opaque pay signals. In a centralized pay system, one or more sets of pay scales will be released by the central personnel department; the pay signal, like the price of labor in general, is clear and accessible to job hunters. Under a decentralized pay system, the pay package may be different in every department; thus, job hunters will need to acquire substantial remuneration information for different government units (Rexed et al., 2007).

Third, in some extreme cases, remuneration could be distorted under the condition of decentralized pay determination. Rexed et al. (2007) remark that:
Decentralization could expose the employer to the exploitation of monopolistic behavior when a union is the sole “seller” of labor in the local market. Under these circumstances, the union could seek to set the rate of pay above the labor market clearing rate. On the other hand, when an organization is the sole buyer of a particular skill in a local market, opportunities for monopolistic behavior exist and pay may be driven down (p.32).

In reality, only a limited number of countries adopt either an extremely centralized or completely decentralized pay setting system. Decentralization does not mean that the central government has nothing to do with the formulation of civil service pay. The central government, Rexed et al. (2007) suggest, should be responsible for, to name just a few, (1) developing the parameters of pay structure design and (2) collecting pay statistical data, which would facilitate the localities in conducting pay comparisons. The literature produced by the OECD (1997) takes the United Kingdom as an example which well exhibits how the central government has exerted its influence in the case of pay setting decentralization. First, some groups of civil servants were explicitly excluded from pay setting decentralization. The remuneration of senior civil servants, judiciary staff, and some teachers was decided by independent pay review bodies instead of the managers of workplaces. Second, the state set a ceiling for the running cost budget, to rein in the total pay cost of a given government unit. Third, the state was still responsible for coordinating pay setting and developing the criteria for the compensation of civil servants. In general, pay setting in the public sector should generally follow the criteria: “better value for money from the pay bill; better budgetary control of pay costs; improved flexibility in the pay system; an effective link between pay and performance” (OECD, 1997, p. 85).

CENTRALIZED PAY IN THE MAO PERIOD

The 1956 remuneration regime adopted a tight central control over wage policy nationwide. Shortly after the founding of the PRC in 1949, the central government’s top priority was to consolidate its power and remove the remaining Nationalist forces from Mainland China. Economic affairs were largely devolved to local governments. As Harding (1981) points out “Basic social, economic, and organizational
policies were set by the central government in Peking, but the regional authorities were given substantial leeway in adjusting policies to meet local conditions, determining the pace at which they would be carried out, and supplementing them with programs designed to solve specific local problems” (p.67). Decentralization generated great benefits in promoting economic development; nonetheless, as noted, the negative aspects of decentralization soon outweighed the gains. Regional leaders were able to challenge central authorities on various fronts. More importantly, with advice from Russia, the Chinese central government installed large-scale state-owned industrial projects over the country in order to exploit economies of scale. To do that, the central government should be able to transfer resources from one area to another in a bid to maintain a balanced and fast development. But increasing resistance from local governments made the central plan very difficult to carry out. In addition to financial resources, manpower for central administrative capacity was siphoned off by local governments. Harding (1981) reports that “For one thing, the regional governments were increasingly seen as a drain on scarce human and material resources. They and their Party bureaus were staffed by cadres whose services often could have been better employed in the central economic ministries, in local governments, or in industrial enterprises” (p.67).

The central government took four steps to centralize its economic, administrative, and fiscal powers (Harding, 1981). First, the regional governments were reshuffled into administrative committees – which had limited autonomy over economic and fiscal policies in 1952. Second, the central government issued guidelines to regulate the central–local relationship in 1953. Though local governments could adjust the central policy to local conditions, local governments’ interpretations could not deviate from the principles set by the central government. Third, state-owned enterprises, vital to the country’s economic development at the time, were under the control of the various line ministries in 1953. Local governments were granted a limited role in decision-making in economic affairs related to these enterprises. Fourth, administrative committees were abolished finally in 1954. The first Constitution of the PRC promulgated in 1954 gave the central government veto power over any decisions made by local governments (Harding, 1981). Article 49 of the Constitution stated that “The State Council of the Central
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Figure 5.1: Pay determination and pay levels of government employees, 1956–current

![Diagram showing pay determination and pay levels]

Source: Compiled by the author.

Note: The X-axis denotes pay level in a relative sense. For example, it is relatively high compared with state-owned enterprise compensation in the 1956 pay system. The Y-axis illustrates pay setting patterns in China.

Government has the power to modify or revoke a decision made by any local governments”. Thus, the remuneration policy developed by local governments could be modified and revoked by the central government.

Remuneration policy was important to the new regime. Effective remuneration could motivate cadres and improve the administrative capacity of the government. The central government was aware of the importance of this policy. Thus public sector remuneration was highly centralized when the first remuneration regime was kicked off in 1956.

As shown in Figure 5.1, the 1956 remuneration system was in the heyday of the history of the PRC with regard to pay centralization in the public sector.
The central government issued a single pay table for government employees across the board. Based on a classification of government employees into 30 salary grades, employees’ wages were linked directly to the grades. The first to third salary grades were given to the top government officials such as Premier and Vice-Premiers, while service workers, such as janitors, were placed in the lowest grades, from the 25th to the 30th. In addition, the country was further divided into 11 salary districts in accordance with different local living costs. Officials of the same rank in the same salary district earned the same amount of money.

Centralization proved to be futile in practice, a reality which was not limited to the centralized personnel management system. Central planners found many negative aspects of excessive centralization on all administrative fronts. For example, the transferring of materials for industrial production was extremely sluggish and ineffective while economic performance got steadily worse. At the eighth Party Congress, held in September 1956, many Party heavyweights expressed their concern over excessive centralization. The then Chairman of the PRC Liu Shaoqi noted that:

During the past few years, some departments under the central authorities have taken on too many jobs and imposed too many or too rigid restrictions on local departments, ignoring special circumstances and conditions in the localities…. For much of the work of the state, such as that dealing with agriculture, small and medium-sized industries, local transport, local commerce, primary and secondary education, local health services, and local finance, the central authorities should simply establish general principles and policies and map out general plans, leaving the actual work to the local authorities to carry out in a manner suitable for a particular place and a particular time (Liu, 1984, p. 238).

When presenting the Second Five-Year Plan, the then Premier Zhou Enlai proposed a restoration of decentralization. Echoing the speech of Liu Shaoqi, Zhou argued that provincial governments should have autonomy in economic affairs, financial and personnel management, and material allocations in their jurisdictions. Senior advisors to the government in Beijing also proposed some solutions for addressing the problem of the central–local relationship. The technocrat and senior economist, Xue Muqiao, the director of the National Bureau of Statistics, recommended two principles governing Chinese intergovernmental relations
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to the central leadership; namely “echelon-by-echelon management” and “level-by-level responsibility” (Harding, 1981, p. 110). Under these principles, Xue suggested that major affairs such as investment allocation, pay setting, and the production and pricing of important goods should be still controlled by the central government. Other less important affairs should be decided by local governments, with the central government setting targets (Harding, 1981). The debate in 1956 actually led to decentralization reforms in September 1957. Though the central government imposed some limits on the autonomy of local governments, provincial governments in this period exerted a strong influence over the country’s economic and financial activities.

In general, provincial governments could later on adjust central targets in accordance with local conditions. Meanwhile, the central government tried to shrink central targets for local governments to implement. The 1957–58 decentralization further empowered provincial government leaders to manage state-owned enterprises all over the country (Harding, 1981). Provincial governments, instead of the central government, controlled almost all state-owned enterprises while retaining the financial surplus when they had submitted a certain amount of profits to the central government.

It should be noted that the pendulum swung with regard to decentralization versus centralization during the Mao period. For example, with regard to fiscal policy, decentralization was replaced by centralization, and then shortly later the system was decentralized again. Nevertheless, central control over wage policy remained almost unchanged. It meant that although fiscal and economic policies were decentralized, wage policy remained centralized.

Centralization did not prevent deviations from central requirements at the local level, however. The implementation of the remuneration regime in the public sector varied greatly at the grassroots level. Local governments developed numerous local remuneration schemes in practice. Though cadres in different localities earned similar formal wages, they received substantially different informal benefits. For example, public houses were provided for cadres. Despite being extremely low, the rents of public houses varied among localities and government departments. Some civil servants could get public houses at a price lower than cubes of sugar, while some could not. Benefits, such as child-care
centers and canteens, differed greatly across government departments and regions. Thus although a rigid centralized pay system was installed in 1956, local pay schemes flourished and cadres’ salaries and benefits were substantially different.

FROM DECENTRALIZATION TO RECENTRALIZATION
IN THE REFORM PERIOD

The early years of the post-Mao period witnessed a favorable political environment for institutional innovations and decentralized governance. “Throughout the 1980s, Beijing granted more and more discretion to local governments to manage trade and investment, joint ventures, social welfare, economic enterprises, ports, and many other functional areas” (Burns, 2001, pp. 431–432). Central leaders explicitly expressed the need to rectify excessive centralization and to rationalize the civil service system. As for the problems of centralized administration, Deng Xiaoping, the prominent leader at that time, stated that in 1980:

Our leading organs at various levels have taken charge of many matters which they should not and cannot handle, or cannot handle efficiently. These matters could have been easily handled by the enterprises, institutions, and communities at the grass-roots level, provided we have proper rules and regulations…. Difficulties have arisen from the custom of referring all these things to the leading organs and central departments of the Party and government: no one is so versatile that he can take on any number of complex and unfamiliar jobs. This can be said to be one of the main causes of the bureaucracy peculiar to us today (Deng, 1984, p. 310).

Consensus existed for decentralized management in the country. In addition, many central leaders also determined to rationalize the civil service system in China, which would pave the way for a decentralized pay regime. The then Premier Hua Guofeng argued in 1979 that the Chinese government needed a well-functioning cadre system wherein recruitment, reward, and retirement must be rationalized. Furthermore, the central leadership’s determination concerning labor retrenchment in the public sector had positive effects on decentralizing civil service remuneration and improving public sector pay. Deng Xiaoping proposed a substantial cut (by one-third) of cadres at the central level and larger than one-third of cadres in local governments (Harding, 1987). With a
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shrinking number of cadres, the government obviously had more financial resources for promoting a flexible and decentralized pay setting. As suggested by the Western experiences on pay setting decentralization, cutback management was, more often than not, associated with the decentralization of remuneration in the public sector. The Chinese experience suggested a similar pattern.

In addition to streamlining the bureaucracy, several wage increases across the board in the early years of the Post-Mao era provided a good basis for restructuring the remuneration regime. In 1979, for example, the central government decided to divert the money for investment in fixed assets to improving people's livelihoods. Therefore, a substantial wage increase was implemented that year (Xue, 2011, p. 123). Despite fiscal deficits incurred subsequently, several salary raises for employees of governments and state-owned enterprises removed the great obstacle to a decentralized wage management system whereby both rich and poor localities had enjoyed wage hikes.

Decentralized pay setting was first applied in the remuneration of state-owned enterprises. The CCP announced in 1984 that wages and bonuses would be linked to the performance of state-owned enterprises. Some even suggested that the national pay scale for public employees used for three decades should be abolished immediately. For example, the wages of employees would be associated with taxes or sales generated by a given state-owned enterprise (Harding, 1987, p. 119).

The public sector remuneration policy was formally launched in 1985. The Central Committee of the CCP and the State Council jointly issued the pay reform document about cadre remuneration in government organizations and public service units. A single pay scale was formulated for government employees across the board. Despite the central government claiming its final say over remuneration, echelon-by-echelon decentralized management was implemented in public sector remuneration. Thus, local governments could develop their pay schemes under the guidelines from the center. More importantly, individual public service units could have their remuneration schemes with the endorsement of higher authorities.

Against this backdrop, the 1985 pay system moved to the lower left quarter shown in Figure 5.1. Policy implementation nonetheless went in another direction. Despite a decentralized pay policy, local governments
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did not really utilize the autonomy of pay setting. Almost all government units still followed the central government’s moves on public sector remuneration. For example, most local governments implemented the national pay scale and pay rate tightly. An unintended consequence appeared as senior and junior civil servants were still compensated almost identically. Good performers had a wage comparable with bad ones. Egalitarianism in remuneration still prevailed across the country.

The research group, jointly convened by the Ministry of Personnel and the Chinese Academy of Social Sciences in the early 1990s, proposed more substantial decentralization in public sector remuneration for the following considerations: efficiency enhancement, talent recruitment, and public sector retrenchment. With a low wage for senior cadres, talent recruitment was a serious challenge facing the government, while a brain drain was widespread. Xiahai (literally “jumping into the sea”) was an important phenomenon in the 1980s and 1990s. Many government officials quit government jobs to join the private sector. Some surveys suggested a high percentage of government officials wanted to “jump” (30 percent and 20 percent in two surveys, respectively) (Li, 1998). Xiahai was caused by many factors but rigid and low civil service remuneration was an important one.

The research group within the bureaucracy argued that when local governments enjoy high autonomy in salary distribution, they can better motivate their employees in order to retain talent and improve public services (Research Unit on Civil Service Pay Reform, 1993). The group proposed that a wage index – associated with the local inflation level, the growth rate of government revenue, and the average growth rate of local state-owned enterprises – should be introduced in order to facilitate local remuneration management.

Pay setting was severely decentralized in the 1993 remuneration reform to the public sector. The 1993 remuneration system introduced a cost-of-living allowance, which varied across regions. Local governments could use their fiscal resources to improve civil service remuneration through adjusting the cost-of-living allowance. The 1993 pay document stated that the rate of the cost-of-living allowance should be made with reference to local living costs, economic developments, and the like. This new practice followed the idea proposed by the above research group about wage indexation. In addition, according to the above 1993
document, the remuneration of employees of state-owned enterprises should be taken into consideration in pay determination. The document implied that, on the one hand, civil servants could benefit from economic growth in the given region; on the other hand, local governments were offered substantial power to manage their compensations within their fiscal capacities. Therefore, the 1993 pay system was in the bottom left corner of Figure 5.1. When pay level increased in the late 1990s, the 1993 pay system moved to the bottom right quarter of the figure.

But then the equal pay policy introduced in 2006 brought decentralized pay setting to a halt in China. As noted in Chapter 3, excessive pay inequalities were widespread in the 1990s and early 2000s. Civil servants earned substantially different pay due to their employers’ (government departments) extractive capacity and individual departments’ remuneration packages. Nevertheless, an excessive pay gap among civil servants provided great disincentives to public employees around the country, which hampered the governments’ functions. Closing the substantial pay gap was the key target of the 2006 pay reform, as stated in the official document. In order to do so, the central government mandated that a strict pay management system should be installed by means of the equal pay policy. Higher authorities subsequently improved their monitoring capacity over remuneration in the public sector. More specifically, civil servants working in the same locality could earn comparable pay irrespective of their employers’ extractive capacity. In addition, the horizontal pay gap between the civil servants at the central and provincial governments and the grassroots public workers would be mitigated, based on several changes of pay structure.

In terms of pay management, the 2006 remuneration regime is comparable to the 1956 one, in which the central government imposed a centralized administrative system. Thus, as shown in Figure 5.1, the 2006 pay system is located in the top right corner. It is intriguing to note that civil service pay reforms in China have evolved in a cycle. In the 1956 pay system, the central government issued unified pay scales for state cadres nationwide. From 1985 to 1996, pay management was largely decentralized. After the five national pay raises between 1997 and 2005 as noted in Chapter 7, civil service compensation was much enhanced while leaving the inflated regional pay gap unresolved. Consequently, pay determination was recentralized in the 2006 pay system. However,
the political environment surrounding public sector remuneration in 2006 is quite different from that in 1956. Therefore, the extent of decentralization varies significantly as regards the 1956 and 2006 regimes. The 1956 pay regime was conducted under the Chinese planned economy; thus local deviations were strictly prohibited. Although the central government imposed a recentralized pay regime in 2006, some local autonomy is still available under the market-based economy, whereby the labor market can shape local remuneration practices.

ECHOING CHANGES IN FINANCIAL MANAGEMENT IN CHINA

The moves in public sector remuneration reflect the changes in financial management in China. Public sector pay is one of the largest recurrent expenditure items in almost all countries in the world. Thus, remuneration in the public sector is closely related to financial management. The swinging pendulum in pay setting actually mirrors the alterations in financial management in China.

The Chinese government adopted a decentralized fiscal system in the 1980s. Two factors determined this decentralization at the time. First, as the government retrieved its income from enterprises, improving local cadres’ enthusiasm to promote the development of local enterprises was crucial to the state’s survival. Letting local governments possess a large share of revenue increments rendered the whole country better off. When benefiting from promoting economic development, local governments would improve economic construction and make a big cake. The central government would get a slice of the cake, after all. Therefore, the economic structure mattered in shaping the fiscal system. Second, the central government had to decentralize its fiscal power because of the political and administrative environment. The Cultural Revolution in the 1960s and 1970s ruined the country’s administrative system, including financial authorities. The central government had no real authority over financial resources controlled by local authorities at that time. The Ministry of Finance thus had to adopt a decentralized fiscal system. Interestingly, the officials in the Ministry of Finance argued that decentralization was actually a means to tighten up rather than give up control over local governments, because the central government would know better about the real situation of local governments (Shirk, 1990). Fiscal decentralization in the 1980s, also termed as “playing to the provinces”,
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entailed a revenue-sharing system, in which local governments retained their revenues after a certain amount of money had been remitted to the central government based on *ex-ante* agreements.

Some scholars quoted Chinese fiscal decentralization as a perfect example of market-preserving federalism (Montinola, Qian, & Weingast, 1995). Even though China lacked free speech and public participation, the revenue-sharing system was a model of fiscal federalism, which was expected to be greatly beneficial to both economic development and public goods provision. But an unintended consequence of the revenue-sharing system emerged; the central government actually became the loser in fiscal decentralization. The center did not have enough financial resources to improve income redistribution.

Some statistics suggest the problematic intergovernmental fiscal relationship at that time. The ratio of government revenue to GDP and the ratio of central revenue to total revenue (the "two ratios") in China declined phenomenally after fiscal decentralization in the 1980s (Wang & Hu, 1994, 1999). Due to the close relationship between central fiscal capacity and macroeconomic management (including income redistribution), the World Bank (1995) also urged the Chinese central government to take action to change the status quo.

The excessive devolution of decision-making responsibility to lower levels of government has combined with insufficient enterprise and bank autonomy to impair central government control over the size of the deficit. ... some recentralization of administrative authority is necessary to stop the decline of government revenue, to bolster central government control over the scale of local government investment expenditures, and to restore budgetary discipline (p.24).

Against this backdrop, a significant reform of intergovernmental fiscal relations in China – the tax-sharing system (TSS) – was introduced in 1994. Distinguishing itself from the revenue-sharing system in the 1980s, the TSS guaranteed the central share of government revenue in two ways. First, the central government set up a national tax collection system, whereby the national tax bureau collected both central taxes and central–local sharing taxes. After that, central grants would be channeled to local governments in order to compensate their efforts in tax collection and providing public services. Second, the central government

1. For a criticism of this argument, please refer to Feng, Ljungwall, Guo, and Wu (2013).
claimed stable and easily collected taxes as the central or central–local sharing taxes (World Bank, 2002). With a tax bureau down to the lowest level and a lucrative source of taxes, the extractive capacity of the central government improved sharply after 1994. The “two ratios” have increased sharply after the TSS. As noted in Figure 5.2, the central share of government revenue jumped from 22% in 1993 to 55.70% in 1994, and has remained relatively stable since then.

As the central government becomes rich in today’s China, it imposes more and more central mandates on local governments (Gong & Wu, 2012a; Tsui & Wang, 2004). Among them, nationwide civil service pay rises are the most significant one. Zhou (2010) observes that:

What is distinctive about the Chinese bureaucracy in recent years includes both the growing scope of policy areas and the greater extent of centralization in resources and decision-making authority, as compared with other national governments or the Chinese government in the early years of reform (p.57).

The equal pay policy in 2006 was introduced under bulging central coffers and an assertive central government. Without a centralized fiscal system (most significantly on the revenue side) and an increasing fiscal capacity of the central government, the 2006 pay regime would not have been mandated.

DISCUSSION

There are many good reasons for the Chinese government to adopt
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pay setting decentralization. For example, the phenomenon of “double imbalance” prevails in public sector remuneration in China. As noted by Burns (2003b), on the one hand, pay compression, reducing the pay gap between senior civil servants and junior ones, has become more serious in recent decades, especially with regard to base pay. On the other hand, both higher-ups and rank-and-file civil servants are remunerated inequitably compared with those in the private sector. The distorted pay structure has caused negative consequences for public personnel management, as many senior civil servants are leaving to join the private sector, while junior civil service jobs attract numerous applications – in many cases, the application/place ratio is much higher than 50. Aligning pay setting decentralization with organizational diversity is also essential and needed in the Chinese public sector.

Furthermore, the Chinese government, especially in recent decades, has faced the growing pressure to provide high-quality public services and regulations in a market economy. Some government units are more suitable for installing a traditional remuneration system while others may need new remuneration schemes, such as broadband pay structures, wherein there are fewer numbers of salary grades. The top-down, hierarchical pay setting nonetheless prevents the government from performing well and adapting to a changing and challenging environment. In addition, recruiting highly skilled technicians is a daunting task, which requires a more flexible pay arrangement. For example, a higher-than-market clearing salary 2 will be valuable to attract and retain talent. Nevertheless, public sector remuneration in China entails only a single pay scale for all civil servants (including technicians and ordinary civil servants) and is not a higher-than-market clearing salary. This makes it difficult for government organizations to attract and retain the best persons, let alone enhance productivity.

Against the backdrop of fiscal centralization on the revenue side, pay determination has been recentralized in recent years. An excessive pay gap triggered the central intervention in public sector remuneration

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2. In order to understand the market-clearing salary, I explain the market-clearing price (the equilibrium price) first. It refers to the situation wherein “the quantity of the good that buyers are willing and able to buy exactly balances the quantity that sellers are willing and able to sell” (Mankiw, 2014, p. 77). Based on the efficiency wage hypothesis, employers pay their employees more than the market-clearing wage (price) to lower employee turnover and enhance productivity.
nationwide. But if the central government had not recentralized its revenue power and equipped itself with increasing fiscal capacity, it would be unlikely to have a centralized pay system, as local governments might simply have circumvented the centralized pay system. Simply put, governments in rich localities could still channel public money to their employees using different channels. As the survival of local governments increasingly hinges on transfers from the central government in today’s China, the center has leverage over local public finance and civil service remuneration. Thus, fiscal centralization is both a precondition and a root cause of recentralizing pay determination. Understanding the linkage between pay and fiscal management is helpful in appreciating the dynamics of the 2006 pay reform.

The evaluation of the impact of centralized pay setting has been mixed thus far. Pay setting centralization may enhance the capacity of the central government in controlling wage costs across the board and improving macroeconomic management. It is expected that public personnel management can be improved under both the centralized pay system and the equal pay policy.

Negative consequences of the centralized pay determination have emerged. For one thing, the current pay system provides disincentives to employees as the remuneration regime becomes more egalitarian. Good performers earn almost the same as poor performers. Hard-working staff receive the same compensation as others. More broadly, emphasizing egalitarianism reflects the public demand for an equalizing distribution of wealth in recent years. Bringing back egalitarianism into public sector remuneration nonetheless runs counter to the ethos of the growing market economy and the rationalizing of the civil service system.

A centralized pay setting may generate unintended consequences. Chinese local governments are sluggish in implementing some central policies while paying special attention to other policies aligned with local interests. (For selective policy implementation, see O’Brien & Li, 1999; Ahlers & Schubert, 2014) A centralized pay determination may not lead to wage cost containment in fact. Local governments may still use hidden revenues to line civil servants’ pockets while asking the central government to compensate their fiscal shortages in paying formal wages (Gong & Wu, 2012a). And there is no evidence suggesting that civil service compensation is particularly transparent or fair today (Chan & Ma, 2011).
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Addressing an excessive pay gap through installing a centralized pay determination and an equal pay is hitting the target but missing the point. Dealing with overpayments of some civil servants in resource-rich departments requires a rationalized personnel and financial management in the public sector in China. Public sector remuneration should be more transparent to both the general public and civil servants in other government units. Parallel to personnel management, financial management should be well regulated and transparent to the public. In addition, bureaucrats’ self-serving behaviors must be effectively restrained through introducing a responsible, accountable financial management system in China.
The Retreat From Performance-based Pay

Performance-based pay or performance pay refers to “a variety of systems linking pay to performance” (OECD, 2005, p. 10). The concept is not new to Chinese practitioners. As early as 1985, state-owned enterprises promoted a wage system linking pay to performance. “Performance-based pay” was also applied to the public sector in the same year. Though the rate of performance pay was constrained, the remuneration regime had the important function of linking the wage to individual performance. The situation has in recent years been reversed by the equal pay policy. At present, civil servants are compensated equally if they work in the same locality and have comparable seniority and position. The retreat from performance-based pay reflects the complexity of motivating civil servants in Communist China. The negative consequences of the retreat nonetheless are palpable. As good performance will not lead to good pay, reward can only come from promotion within the hierarchy. The historical experience in China suggests that an over-reliance on promotion to motivate civil servants results in unbridled organizational upgrading.

The first section of this chapter examines the debate surrounding performance-based rewards for public workers. The second section turns to discuss the general picture of performance pay, while the third section investigates the development and problems of performance-based pay in the public sector. The fourth section presents the reasons behind the retreat from performance-based pay in recent years.

THE DEBATE SURROUNDING PERFORMANCE-BASED PAY

Though its impact is controversial, many countries, especially OECD member countries, adopt some form of performance-based pay. Its theoretical base is grounded in “expectancy theory” and “reinforcement
theory” (Perry, Engbers, & Jun, 2009, p. 40). Expectancy theory assumes that people will make an effort to chase the goals they view important (Van Eerde & Thierry, 1996). It means two related things. Employees attach great importance to monetary reward. In addition, they believe that their efforts will lead to increased wages (Perry, Engbers, & Jun, 2009; Van Eerde & Thierry, 1996). Thus, employees will try their best to perform well and get their reward. Reinforcement theory suggests that there is a direct link between a motivational tool and the target behavior (Perry, Engbers, & Jun, 2009). It posits that employers can use remuneration to induce and reinforce good performance. The distinction between expectancy theory and reinforcement theory lies in the hypothetical effect of performance pay as the former emphasizes an interaction between employees and pay schemes while the latter sees a direct relationship between remuneration and performance.

Though the two theories of performance-based pay are not complex, the actual relationship between compensation and outcome is intricate. Based on an examination of existing research, Perry, Engbers, and Jun (2009) argue that there are many intermediate variables affecting the outcomes of performance pay schemes. As shown in Figure 6.1, employee and organization characteristics, environmental conditions, and the design of the pay system have an impact on intermediate factors such as job affect, perceived pay system, and job characteristics. The above factors jointly impact on outcomes. Therefore, even if a performance-based pay system is well designed from the standpoint of human resource management, the effect of motivating employees cannot be realized if some intermediate variables are not in place.

Perry et al. (2009), drawing on real world experience, provide some lessons for adopting pay-for-performance schemes. For example, a high level of trust within the organization, an effective performance evaluation system, and suitable public services are critical to a successful remuneration regime. Evidence suggests that performance pay in the education sector achieves limited benefits while incentive pay works well in the police force. Performance pay has a better effect on government performance when it is used at lower-level government units where employees have clear job responsibilities. In addition, there are three preconditions for an effective incentive pay system: (1) the task is clearly defined; (2) the employee’s output is measurable; (3) and the result
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Figure 6.1: Key variables affecting performance pay schemes

Source: Perry et al. (2009), p. 41.

can be directly linked to an employee's input (Bohnet & Eaton, 2003). Many jobs in the public sector are not well defined or team-based – requiring substantial collaboration and cooperation among colleagues. Furthermore, as expectancy theory suggests, an employee's perception of performance pay also matters significantly as regards the effectiveness of this remuneration practice. If an employee does not value monetary reward, performance-linked pay may not be instrumental in motivating the employee. The function of performance-linked pay in the public sector is more complex than it is in the private sector.

There are three factors that hinder performance-based pay from functioning well (Perry, Engbers, & Jun, 2009). The first is transparency in the public sector. Some evidence suggests that performance-based pay functions well in the private sector partly due to pay secrecy (Colella et al. 2007). If pay secrecy paves the way for a harmonious environment in the workplace, then good performers can perform much better under the protection of privacy. The second is budget constraints. As pay in the private sector can increase with enlarging profits, public sector remuner-
The Retreat From Performance-based Pay

Pay for Performance in China

The remuneration reform was one of the most momentous economic reforms in post-Mao China, where the market economy was being accepted gradually (Wei & Rowley, 2009). There was however, an unbalanced development in utilizing the performance-related pay scheme as between enterprises and government departments.

Enterprises enjoyed a full autonomy of pay determination when the pay system, previously controlled by the state, was decentralized to enterprise levels during the 1980s (Wei & Rowley, 2009). Joint ventures were among the first to introduce performance-related schemes in the mid-1980s (Warner, 1997). Since then, such rewards have been widely applied in Chinese enterprises. Wei and Rowley (2009), on the basis of a survey of enterprises in Shanghai, find that performance-related rewards are used extensively in various types of enterprises. Among three wage components, namely base pay, performance-linked pay, and fringe benefit, the share of pay for performance among the total was 30–40 percent for top management, 40–50 percent for sales and marketing positions, and 10–20 percent for professionals. Compared with the international experience, employers in the Chinese private sector are very aggressive in linking pay to performance.

The development of performance-based rewards in the public sector has evolved in a zigzag path over the past three decades. When the political environment was conducive to administrative innovation, which meant successfully borrowing good practices from the private sector, performance-oriented rewards were employed in the public sector in a bid to improve government performance. But when the
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central government needed to tackle the excessive pay gap among civil servants and restore so called “redistributive justice” in China in recent years, performance-related pay was denounced as a loophole for wage mismanagement in local government. Thus the macro-environment has affected the implementation of performance-based pay among civil servants. The Chinese experience suggests that introducing good practices into public management can be futile, as a well-functioning civil service system is not possible in a “transition” country.

**PERFORMANCE REWARDS IN THE CHINESE PUBLIC SECTOR**

Discussing performance rewards should start with an investigation of the performance evaluation system in China. Governing by numbers and developing numerical indicators have recently shown great progress in China. Various types of performance rewards have been developed against this backdrop.

*Performance Evaluation in the Public Sector*

The Chinese government has attached great importance to performance evaluation since the 1980s. Nevertheless, it was not until the early 1990s that indicators for measuring a cadre’s performance became more substantial and quantitative (Whiting, 2004, 2006).

Ordinary civil servants are evaluated annually. Morale, capability, diligence, and achievement are four indicators for performance evaluation for all civil servants (Liu & Dong, 2012). The above indicators do not deviate substantially from international practice. Nevertheless, supervisors and public personnel managers always complain of the lack of a clarification concerning these indicators from high authorities. Too often, the implementation is sloppy in practice. Nearly no one gets unfavorable ratings in the end (Wang, 2012).

Another important part of the performance evaluation system in the Chinese public sector is the “objective responsibility system” (mubiao zerenzhi) – which mainly applies to leading cadres (Burns & Zhou, 2010). In this system, individual targets are developed by higher authorities for subordinate governments to implement; thereby the subordinates must be held accountable to their behaviors. Subordinate governments, further, assign responsibilities to individual government departments whereby government employees (especially those leading cadres) have
The Retreat From Performance-based Pay

the final responsibility to complete specific tasks. Gao (2007) aptly summarizes: “Accountability was distributed to everyone in the form of concrete performance tasks, including cadres at the lowest ranks in the organizations. As a result, a net of performance targets was formed within local governments at various levels where every cadre had a specific task to fulfill and was held responsible for his/her accomplishment of these targets” (p.103). This means that all civil servants and governments in China have been linked up to the performance evaluation system. Thus, compared with decentralized performance evaluation systems in many developed countries, performance evaluation and its indicators have been framed within the administrative system in China in a top-down fashion.

The composition of indicators of the objective responsibility system has changed over the past two decades. Economic achievement, such as GDP growth and gross value of industrial output, was one of the most important factors in determining a cadre’s performance in the early period of the economic reform (Whiting, 2006). Social indicators have also been accorded greater importance in evaluating the performance of civil servants over recent years. The central government seems aware of the negative consequences of an over-emphasis on economic development, thus promoting an adjustment to the composition of performance indicators in the beginning of the 21st century. According to the Outline of the Eleventh Five-Year Program for National Economic and Social Development, unveiled in 2005, more indicators related to social development rather than economic development have been promoted. An annex to the Outline classifies all indicators into two types: anticipative targets (yuqixing zhibiao) and binding targets (yueshuxing zhibiao). Expected targets such as GDP, urbanization, and education are desirable goals. Failing to fulfill them will not invite punishment. Binding targets must be accomplished as prescribed by higher authorities. Coverage by an urban basic pension insurance system and by a new rural cooperative medical system are those binding targets.

Responding to the guidelines from the central government, local governments have modified their targets for performance evaluation gradually. Prefecture-level cities in Fujian Province, for example, have developed several indicators related to a harmonious society (hexie shehui), sustainable economic development, and diligent and clean government in recent years (Wu & Yan, 2008, p. 27). The “scientific
development” concept, requiring a balanced development between economic and social aspects, coined by Hu Jintao – the president of the PRC – in 2003, has become a core indicator of cadre performance in several provinces, such as Guangxi and Zhejiang Provinces (Wu & Yang, 2009, p. 153). But though the composition of performance indicators has evolved, local governments still seek GDP growth enthusiastically in practice. Good performance in some targets such as GDP growth and revenue generation still leads to substantial rewards, including monetary benefits.

The implementation of the civil service performance evaluation system suffers from several constraints, thereby tarnishing the impact of performance evaluation on civil service motivation in China. For example, as noted by Liu and Dong (2012), evaluators such as line managers and personnel managers do not have sufficient skills in rating civil servants. Especially when facing increasingly complex environments, untrained evaluators choose either to make everyone happy by inflating rates or to annoy most civil servants by arbitrarily deciding their rates. On most occasions, evaluators act to please everyone in the department. Almost all civil servants receive good evaluations eventually. This tarnishes the system of performance evaluation.

Routine pay for performance
Pay for performance was introduced in the 1985 remuneration regime in the public sector. According to the 1985 central pay regulation, performance-related pay rewarded those with outstanding performance. This wage item was funded from savings in operating budgets of local governments; evidence suggested a substantial amount of money being distributed to good performers at that time.

Routine pay for performance was documented in the literature. In a coastal county close to Shanghai City in 1995, civil servants at the grassroots level earned 17,500 yuan in addition to their base salary, due to outstanding performance, while those with lowest performance only received 6,000 yuan. The average annual wage nationwide was only 5,500 yuan in the same year; thus excellent performers could get more than 5 times performance-based pay than the average base pay across the board (Whiting, 2004). According to Yan (1995), local cadres’ performance-based pay amounted to 80 percent of their wages, based on their performance in 1991. The size of performance-based rewards
The Retreat From Performance-based Pay

was by no means small during the early period of the economic reform. Recent years have seen substantial rewards for civil servants, though the amount of pay for performance is not as high as that in the early 1980s. The Changchun prefectural government in Jilin Province, for example, offered performance-based rewards to individual government departments based on *ex ante* agreements. Individual departments also signed “contracts” with all civil servants stating the criteria for receiving extra pay for performance. In 2003, every civil servant in the education bureau of the Changchun government received 1,800 yuan as a reward for good performance (Burns & Wang, 2010).

Recent field research suggests that routine pay for performance varies substantially in different localities and government units. In addition, the perception of linking pay to performance differs greatly across the region. When asked about whether pay was linked to their performance, some civil servants were very skeptical of this type of remuneration; others much positive. The result is so mixed that a conclusive argument is hard to make from the field research (see Wang, 2012).

**Project-based pay for performance**

Local governments in recent years have increasingly employed performance-based pay to reward cadres with good performance in some specific projects, namely key infrastructure construction, attracting investment, and revenue collection. It means that not all civil servants with good performance records can be rewarded with increased pay. Only those excelling in completing specific projects can be rewarded.

**Linking pay to key construction projects**

Gao (2007) reports that in order to promote key construction projects, the Xi’an prefectural government in Shaanxi Province allocated 500,000 yuan as monetary reward for good performers in 2006. When the money arrived in county governments, they distributed it to individual government departments, with employees being reward takers. In addition, the lower governments under the jurisdiction of the Xi’an prefectural government promised to offer 3,000 yuan to every government department for the successful accomplishment of assigned projects, while an extra 5,000 yuan was given to ten departments with outstanding performance. During the same period, the monthly salary of civil servants in the region was lower than 2,000 yuan.
As local governments are keen to promote infrastructure development, various kinds of pay scheme have been offered to align civil service motivation with government priorities. My field research in China’s local state generally reveals that governments in poorer areas tend to give relatively higher rewards for state workers, who contribute to key construction projects.

Linking pay to revenue collection

Local governments also reward good performers in revenue collection. My field research between 2008 and 2010 suggests that some provinces have kicked off schemes linking revenue collection to performance-based pay. For example, in Guangdong Province, the governor of the provincial government signed a formal “contract” with the head of the provincial tax department every three years. The contract in Guangdong Province – made in 1999 and extended in 2002, 2005, and 2008 – indicated a retention rate of tax collection for compensating the efforts of tax officers. The retention rate here refers to the percentage of tax revenue being kept by tax departments to improve the fringe benefits of their employees.

During an interview with a senior official in the Guangdong Provincial Local Tax Bureau in 2008, I was told that the document was in direct violation of the 2006 equal pay policy, as tax officers would get extra pay in addition to their formal wage (interview note, PA-20080321). The equal pay policy requires that civil servants should not receive extra pay due to their job responsibilities. Civil servants of similar rank and seniority in any government department in a city should earn the same. Therefore, I raised the question whether the provincial government will still give tax officers special treatments with regard to civil service remuneration. Tax officials interviewed had confidence in maintaining their extra remuneration and obtaining their new “contract”. Tax officials in Fujian Province also enjoyed special compensation through these sorts of contracts, basically serving to bind the provincial government and the provincial tax bureau to some targets, guaranteeing the special pay for performance for tax officials.

According to the above official document of Guangdong Province, the retention rate of tax collection should be 3 percent, 2.8 percent, and 2.6 percent of tax revenue at the provincial level in 2005, 2006, and 2007, respectively. It meant that the taxation bureaux would retain 2.6 percent to 3 percent of tax revenue they collected for their own disposal. In addition, the retention rate would increase to 3.8 percent if the...
provincial tax bureau collected higher-than-expected revenue. As with other types of pay for performance, the sum rewarded to the provincial taxation bureau would be distributed to improve the remuneration of civil servants working in the bureau. Given the substantial amount of tax revenue in China’s local government, even a 2 percent retention rate means a lot of money being offered to individual civil servants.

In Hu County of Shaanxi Province, Gao (2007) reports that township governments can retain as much as 15 percent of the revenue they collect if their performance on tax collection is satisfactory. The money will be further distributed to individual civil servants as a reward for their efforts in tax collection.

Linking pay to attracting investment
Local governments also employ performance-related rewards to promote foreign and domestic investment. As with other developing countries, attracting investment is a high priority of local governments in China in a bid to promote the local economy and public revenue. Executives at the grassroots level view attracting investment as the No. 1 project requiring the full attention of local cadres. Good performers in attracting investment receive handsome compensation for their efforts. In a county in Hubei Province, the county executive interviewed said that:

The county government will continue to view attracting investment as the No. 1 project and the “first-in-command” (yibashou) project. …We should strengthen performance appraisals and implement the reward and punishment system for attracting investment (interview note, PA-20090527).

Rewards for attracting both foreign and domestic investment ranged from 60,000 to 150,000 yuan per person. Civil servants could get more than that when they successfully invited very large investments. For example, people who introduced a manufacturing project with fixed assets investment amounting to 100–200 million yuan would earn a reward of 200,000 yuan. According to China Statistical Yearbook 2011, civil servants in China only earned 38,242 yuan on average per person across the board in 2010.

In another county in Hubei Province, there was a sophisticated system of reward and punishment in attracting investment imposed on both government organizations and civil servants. The financial reward
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to civil servants was 0.1 percent if the fixed assets investment of the project ranged from 5 million to 10 million yuan, 0.2 percent at a range between 10 million and 50 million yuan, and 0.3 percent when the investment exceeded 50 million yuan. The reward normally varied from 5,000 yuan to 300,000 yuan. The lowest amount of 5,000 yuan equaled the annual base salary of most civil servants in the locality.

In sum, performance-related pay varies greatly among different regions and types of public services in China. The amount of performance-related pay is nevertheless not low at all. In some cases, especially for rewarding efforts in attracting investment, performance-related pay can be several times base salary. In the meantime, the OECD (2005) reports that performance-related pay as a ratio of base salary is usually less than 10 percent for non-managerial positions and 20 percent for managerial positions in OECD member countries. The Chinese case shows that good performers can earn as much as 100 percent of their base pay.

DISPUTES OVER PAY FOR PERFORMANCE

Project-based performance pay, as a type of high-powered incentives (Whiting, 2004), nonetheless has many negative consequences. Civil servants may seek short-term interests rather than long-term ones. For example, many local government units are keen to promote economic investments; therefore environmental degradation due to having heavily polluting industries is largely overlooked. An executive of the county government argued that enterprises with the possibility of generating good revenue for the government, albeit having a negative environmental impact, are more than welcome to locate in his county (Interview note, PA-20090104). Government officials are supposed to strike a balance between short-term revenue generation and long-term sustainable economic development. But when the government blindly links civil service pay with promoting GDP growth without consideration of the negative consequences, this can be disastrous.

In addition, project-based performance pay makes colleagues compete with each other, which dampens the morale of public servants eventually. When public services become complex and challenging,

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1. Cooke (2012), in a study of human resource management in the private sector, identifies a similar problem in a large private enterprise in China. Employees were reluctant to help each other when high-powered incentives were introduced.
collaboration among colleagues is increasingly important in ensuring high-quality services. Performance-based pay schemes at the grassroots level, Whiting (2004) reports, favored only a few top performers and leading cadres. Most civil servants were unhappy about their declining relative pay level because only a small fraction of them got good pay. Those who received good pay in past years also might be upset when their performance was no longer rated as outstanding.

Routine performance-related pay has another problem. Though four rating categories exist in the Chinese performance appraisal system – outstanding, competent, basic competent, and incompetent – real evaluations are highly skewed toward top ratings. Less than 0.3 percent of civil servants across the board got the rating of “incompetent” while more than 99 percent received the rating of “outstanding or competent” (Burns & Wang, 2010; Wang, 2012). Burns and Wang (2010) contend that the Chinese government has adopted a de facto two-rating system (outstanding or competent) in civil service appraisal. Against this backdrop, performance-based remuneration hardly works when everyone receives the same amount of incentive pay.

Apart from the above problems, favoritism in allocating ratings and determining performance-related pay is also evident in China. As noted by O’Donnel and O’Brien (2000), many employees reported the scenario regarding favoritism in pay-for-performance schemes in developed countries. Based on my field interviews on the remuneration policy at the grassroots level in Chinese local governments, favoritism and other related problems prevail and upset ordinary civil servants seriously. For example, some managers use hearsay to make judgments on employees’ performance and decide their pay. In some cases, managers allocate substantial good ratings exclusively to “special” sections or their “supporters”.

Favoritism is not new to the Chinese government. In the early 1950s, many government employees complained of favoritism within the Chinese bureaucracy. Some managers were accused of being biased in favor of their friends or relatives in the workplaces. Some were criticized because of enthusiastically promoting their favorites. Local leaders

2. There was a similar situation for the Senior Executive Service in the US in the late 1980s (OECD, 1993).
3. Cooke (2012) also finds the problem of favoritism and managers’ subjective judgment on employees’ performance in the Chinese private sector.
therefore condemned public employees for their favoritism and nepotism (Harding, 1981). During the early period of economic reform, the then supreme leader Deng Xiaoping complained that:

Bureaucracy remains a major and widespread problem in the political life of our Party and state. Its harmful manifestations include the following: standing high above the masses; abusing power; ... suppressing democracy; deceiving superiors and subordinates; being arbitrary and despotic; practicing favoritism; offering bribes; participating in corrupt practices in violation of the law; and so on. (Deng, 1984, p. 310, emphasis added by the author).

Despite of some improvements in recent years, the Chinese performance appraisal system, as Bao, Wang, and Shi (2007) observe, is still laden with both subjectivism and favoritism. On the one hand, some managers complain about the lack of clarification from higher authorities about performance evaluation; these same managers, on the other hand, may abuse power to channel public money to their favorites.

THE RETREAT FROM PERFORMANCE-RELATED PAY

Performance-related pay does not exist on paper after 2006. The 2006 pay regime disallows variable remuneration being related to civil servants’ performance. There are three main components of civil service pay according to the 2006 pay regulation. The base pay is related to position and seniority while cost-of-living allowances reflect the variation of living costs around the country. Bonus, supposed to be tightly associated with performance, nonetheless equals the December base salary. Thus, the variable pay in the 2006 pay regime is invariant in reality. It should be noted that many local governments still circumvent the central policy by sticking to various performance-related reward schemes for promoting investments and the alike.

The retreat from variable pay to civil servants was due to an excessive pay gap among civil servants, which was caused by several macro- and micro-factors. At the macro-level, marketization benefited coastal areas as they could attract foreign investments and readily borrow successful experience in running businesses from Hong Kong and Taiwan, economically advanced areas in the Greater China region; civil servants working in coastal areas tended to have better pay. The domestic policy – the coastal development policy – had aggravated the advantage of these are-
The Retreat From Performance-based Pay

as as against the inland areas. Governments in coastal areas were allowed to develop pro-market policies and improve people’s living standards. At the micro level, the government’s “ability to pay” varied among the regions due to variations in revenue generation capacity. Governments with richer revenue sources on average had a greater capacity to overpay their employees. Civil servants also earned substantially different salaries even within the same coastal city.

Individual government departments featured in determining civil servants’ pay levels in a given city. Departments handling license issuing and land trade approvals often overpaid their employees as they had extra revenue to improve the fringe benefits of their employees. However, some government departments could not even pay their civil servants at the remuneration level as stipulated by the central government, due to limited income.

There are many environmental and organizational hurdles confronting pay for performance in China.

(1) First, a formal authorization for performance-related rewards by the budget agency is lacking. The 1985 pay regime introduced the performance-related pay scheme to the public sector. However, the successor – the 1993 pay regime – gave up using the practice of performance-related pay. A variation of performance-related pay nonetheless was still endorsed in reality. The central government was reluctant to state explicitly the share of performance-related pay against base pay. In the 2006 pay regime, performance-related pay lacks institutional support as the central pay document does not allow for the link between pay and performance. This means that there is no formal authorization for performance-related rewards from the central government.

Without such authorization, the budget of the pay-for-performance scheme depends essentially on local leaders’ preferences. Some leaders may promote performance pay for civil servants enthusiastically in order to improve civil service performance, though not necessarily enhancing public services. But some local leaders may be skeptical of the effect of linking pay to performance. More importantly, not promoting performance pay involves less risk, for example being punished by higher authorities for violating remuneration regulation. The amount of performance-related pay varies greatly around China. In some localities and government units, the sum of performance-related pay is several times
over base salary, while in others there is still remuneration irrespective of performance.

(2) Second, the expectation of fiscal responsibility has recently grown among the general public in China; thus large sums of money for rewarding performance may cause public anger. The general public is increasingly skeptical about the self-serving behavior of state workers in China. For example, during the drafting of the first Civil Service Law in China, congresspersons at the national level raised serious concerns about excessive overpayments to civil servants in some government departments. Some of them contended that civil servants working in the same locality should earn the same, as long as their seniority and job difficulty were comparable (Hou, 2007, pp.171–172). That is in part why the equal pay policy was introduced in 2006. Anger over wage mismanagement in the public sector has increased in recent years. Many criticize a handsome remuneration system for red-collar jobs (civil servants). Any rumor about hefty remunerations offered to good performers among civil servants may not only trigger jealousy among their fellows but also may spark anger among the general public.

A related issue is that administrative spending, of which public sector wages claim the largest share, has become a controversial issue among ordinary Chinese people. As noted in Table 6.1, administrative spending was 851.42 billion yuan in 2007 and 933.72 billion yuan in 2010. In spite of declining in total in recent years, the absolute amount of administrative spending is very eye-catching. Many Chinese press for a public disclosure of the outlay of administrative spending, as people are worried that some public money has been wasted instead of being spent in the public interest.

(3) Third, an official egalitarian culture further hinders the development of pay-for-performance. This culture has its roots in both Chinese tradition and socialist ideology, with the latter strengthening and penetrating egalitarianism in society everywhere. This culture actually led to a denouncing of the principle of “pay according to work performed”, as such performance would enlarge the pay gap between civil servants during the early period of the PRC. Many early CCP veterans disliked the idea of a pay disparity derived from work performance and position. They argued for a direct supply system wherein the state distributed daily necessities to citizens who worked for the state. Reformist leaders
The Retreat From Performance-based Pay

Table 6.1: Administrative spending in China, 2007–2010

<table>
<thead>
<tr>
<th>Year</th>
<th>Total expenditure (billion yuan)</th>
<th>Administrative spending (billion yuan)</th>
<th>Share of administrative spending (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>4978.14</td>
<td>851.42</td>
<td>17.10</td>
</tr>
<tr>
<td>2008</td>
<td>6259.27</td>
<td>979.59</td>
<td>15.65</td>
</tr>
<tr>
<td>2009</td>
<td>7629.99</td>
<td>916.42</td>
<td>12.01</td>
</tr>
<tr>
<td>2010</td>
<td>8987.42</td>
<td>933.72</td>
<td>10.39</td>
</tr>
</tbody>
</table>


had to explain to the general public that the supply system suggested by such Marxism was not compatible with the Post-Revolution Chinese situation. These leaders, later on, contended that the socialist commodity economy must allow for the functions of a wage system and of varied pay (Wages, welfare and social insurance in contemporary China, 1987). Nevertheless, an egalitarian culture has never quite faded away in China, even against the backdrop of periodic clarifications on this issue by the government. In recent years, in response to the excessive pay gap between civil servants, many argue that an egalitarian remuneration system is more suitable to the civil service system in socialist China.

(4) Fourth, favoritism prevails among the Chinese bureaucracy. Thus, performance-related pay is vulnerable to the abuse of power by management and not accepted by many ordinary public employees. Favoritism is so widespread in the Chinese bureaucracy that the Chinese leadership has criticized it on numerous occasions. Denouncing favoritism among the Chinese cadres, Deng Xiaoping, the then Chinese paramount leader, emphasized that remuneration must be linked closely with employees' performance and actual contribution (Deng, 1984). Despite such criticism, both favoritism and nepotism have become growing problems in today’s China.

CONCLUSION

The Chinese pay-for-performance case, albeit intricate, is intriguing for two reasons. First, despite not being encouraged by the central government, local governments introduce some performance-linked rewards in reality. Compared with Western practices, the amount of this pay component is substantial, even aggressively so. Though a high-powered
incentive may be beneficial to fulfill government targets, the negative consequences of this practice are manifest.

Second, instead of remedying this situation, the central government has resorted to abolishing performance-related remuneration. The move was caused by many factors including the local mismanagement of pay schemes. Nevertheless, this retreat from performance-based pay may lead to negative effects such as unrealistic egalitarian culture among civil servants.

The Chinese government should learn from the experiences of civil service remuneration in Western countries. Modifying performance-related rewards may be the smart solution. The practice of linking pay to performance has proved helpful in motivating civil servants in many countries.
Civil Service Pay Levels

Pay level is a hotly-debated topic within and outside China. In recent years, red-collar jobs, referring to civil servants in China, have been highly sought after in the job market. Many suppose that in addition to job security, handsome civil service pay plays a major role in making civil service jobs so prized. Little research literature has explored the issue. The research questions in this study are: what is the level of civil service compensation compared with those of other job categories? Why has the Chinese government sought to increase civil service pay since the late 1990s? What were the dynamics and complexities of several nationwide pay rises?

This chapter starts with a review of the “rational low wage policy”, which dominated public sector remuneration for several decades. The second and third sections investigate the pay levels after the first wage regime was introduced in China. The fourth section attempts to untangle the current pay level of civil servants.

THE RATIONAL LOW WAGE POLICY

The policy of a “rational low wage” dominated the Chinese civil service remuneration for over 40 years. Introducing this policy in 1957, Deng Xiaoping, the then General Secretary of the CCP, argued that:

There should not be too large a gap between workers’ and peasants’ lives, and between urban and rural lives. In enhancing living standards, we must take into account the conditions of a good majority of the nation. For the time being, therefore, we must adhere to a rational low wage system and do our best to let everyone have a meal to eat (as cited in Takahara, 1992, p. 44).

Chan and Ma (2011) point out that as “an encompassing state”, the Chinese government should look after the welfare of both civil servants and ordinary people (p.296). As having “a meal to eat” was an overriding

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concern at the time, the compensation of state cadres should not be too high compared with other people such as peasants. The compensation of civil servants was therefore deliberately kept low by the central leadership during the early period of the PRC. Although the first pay scale for civil servants set a relatively high salary for state cadres, it was soon cut back by the ideology of egalitarianism held by the CCP. In the meantime, people were encouraged to maintain low consumption levels in order to save money for public investment to promote economic development. Cooke (2005) observes that, “For half a century, the state has largely maintained a high-employment, low-wage, low-consumption pattern of the economy” (p.294). Though civil service pay has increased substantially in recent years, Cooke’s observation is still valid with regard to the general situation in China.

The cadres’ salary system was inherited from the guerrilla period after 1949. Non-cash remuneration was the main source of a cadre’s income. This meant that the state was responsible for distributing daily necessities to public workers. Based on the suggestions of Soviet experts, the early liberated areas adopted a salary system with substantial pay disparities between senior and junior cadres. This practice attracted heavy criticism at the time. Some experts and public officials were slammed for advocating a material reward system for civil servants. Mao Zedong, the prominent central leader at the time, joined in to condemn substantial pay differentials and high pay for senior cadres in some regions. This political fight eventually led to the defeat of open-minded reformers. Before the first remuneration regime was introduced in China, the “rational low wage policy” had taken root and developed.

The first salary system in the PRC, introduced in June 1956, had two components. First, the salary of administrative personnel (xingzheng ganbu) was divided into 30 grades. For example, a section head cadre (kezhang) might hold a salary grade ranging from the 14th to the 18th. Each salary grade corresponded to a fixed sum. Second, the whole country was divided into 11 salary zones according to living costs in the locality. The 11th salary zone, in Northwest China, represented the highest living costs; thus, the same ranking personnel earned 30 percent higher than those who worked in the 1st salary zone, mainly in Southwest China (see Table 7.1).
Table 7.1: Government pay scales (yuan/month), 1956

<table>
<thead>
<tr>
<th>Grade</th>
<th>1st Salary District</th>
<th>6th Salary District</th>
<th>11th Salary District</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>560</td>
<td>644</td>
<td>728</td>
</tr>
<tr>
<td>2</td>
<td>505</td>
<td>581</td>
<td>656.5</td>
</tr>
<tr>
<td>3</td>
<td>450</td>
<td>517.5</td>
<td>585</td>
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<tr>
<td>4</td>
<td>400</td>
<td>460</td>
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<tr>
<td>5</td>
<td>360</td>
<td>414</td>
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<td>6</td>
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<td>322</td>
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<td>8</td>
<td>250</td>
<td>287.5</td>
<td>325</td>
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<td>9</td>
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<tr>
<td>13</td>
<td>135</td>
<td>155.5</td>
<td>175.5</td>
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<tr>
<td>14</td>
<td>120</td>
<td>138</td>
<td>156</td>
</tr>
<tr>
<td>15</td>
<td>108</td>
<td>124</td>
<td>140.5</td>
</tr>
<tr>
<td>16</td>
<td>96</td>
<td>110.5</td>
<td>125.5</td>
</tr>
<tr>
<td>17</td>
<td>86</td>
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<td>87.5</td>
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<td>78</td>
<td>88.5</td>
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<td>20</td>
<td>61</td>
<td>70</td>
<td>79.5</td>
</tr>
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<td>21</td>
<td>54</td>
<td>62</td>
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<td>48.5</td>
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<td>28</td>
<td>24</td>
<td>27.5</td>
<td>31</td>
</tr>
<tr>
<td>29</td>
<td>22</td>
<td>25.5</td>
<td>28.5</td>
</tr>
<tr>
<td>30</td>
<td>20</td>
<td>23</td>
<td>26</td>
</tr>
</tbody>
</table>

Source: Adapted from Shi & Wu, 1993, p.206.
LOW PAY IN THE 1956 PAY REGIME

Low pay can be confirmed by several sources.

(1) First, the income distributed to individuals was low in general. Scholars use the labor share of national income to assess the effectiveness and fairness of income distribution (Gollin, 2002; Prados de la Escosura & Rosés, 2003). For example, labor remuneration as a percentage of national income in the United States remained roughly stable at between 65 to 75 percent from 1935 to 1990 (Gollin, 2002). In a cross-country study (including the United States, the Netherlands, Japan, and France) this share ranged from two-thirds to four-fifths of national income (Prados de la Escosura & Rosés, 2003).

The labor share of national income was quite small in China as compared with the international data. The ratio of labor remuneration to national income declined between 1960 and 1975. As Li (1992) argues, the gap relating to the share of wage between China and the United States broadened from 16 percent to 31 percent from 1960 to 1970. Notwithstanding the increase in China’s wage share in the post-Mao era, the difference between China and the United States remained noticeable (Figure 7.1).

(2) Second, for nearly three decades, the nominal average salary of cadres and enterprise employees1 doubled from 1956 to 1985, but the real salary increased only 21 percent (Table 7.2). From 1958 to 1977, nominal wages in China were surprisingly lower than those of 1956 (see column 1 of Table 7.2). In terms of real pay, the purchasing power of employee salaries was only 70 to 88 percent of the 1956 level from 1958 through 1978. It was not until 1983 that the real pay rate recovered to the 1956 level and there was a real pay raise of 21 percent between 1983 and 1985.

PAY LEVEL DETERIORATION AFTER 1985

The central government introduced a new pay system in 1985. One of the policy goals of the 1985 pay regime was to rectify the situation of low pay among civil servants. The new pay system soon encountered difficulties in reality. Worse still, pay levels deteriorated.

1 The average salary of state organs before 1978 was not covered by labor statistical yearbooks. The Ministry of Personnel and the Chinese Academy of Social Sciences report that, prior to 1978, public sector pay was slightly higher than the average (Liu, 1993). According to the assumption that it was a relatively homogeneous society in terms of income in the pre-reform era, pay differentials between state organs and others would not be high.
**Civil Service Pay Levels**

Table 7.2: Average employee salary (yuan/year), 1956–85

<table>
<thead>
<tr>
<th>Year</th>
<th>Average Employee Salary</th>
<th>Salary Indices (1956)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>nominal</td>
<td>real</td>
</tr>
<tr>
<td>1956</td>
<td>601</td>
<td>100</td>
</tr>
<tr>
<td>1957</td>
<td>624</td>
<td>103.83</td>
</tr>
<tr>
<td>1958</td>
<td>536</td>
<td>89.18</td>
</tr>
<tr>
<td>1959</td>
<td>512</td>
<td>85.19</td>
</tr>
<tr>
<td>1960</td>
<td>511</td>
<td>85.02</td>
</tr>
<tr>
<td>1961</td>
<td>510</td>
<td>84.86</td>
</tr>
<tr>
<td>1962</td>
<td>551</td>
<td>91.68</td>
</tr>
<tr>
<td>1963</td>
<td>576</td>
<td>95.84</td>
</tr>
<tr>
<td>1964</td>
<td>586</td>
<td>97.5</td>
</tr>
<tr>
<td>1965</td>
<td>590</td>
<td>98.17</td>
</tr>
<tr>
<td>1966</td>
<td>583</td>
<td>97</td>
</tr>
<tr>
<td>1967</td>
<td>587</td>
<td>97.67</td>
</tr>
<tr>
<td>1968</td>
<td>577</td>
<td>96.01</td>
</tr>
<tr>
<td>1969</td>
<td>575</td>
<td>95.67</td>
</tr>
<tr>
<td>1970</td>
<td>561</td>
<td>93.34</td>
</tr>
<tr>
<td>1971</td>
<td>560</td>
<td>93.18</td>
</tr>
<tr>
<td>1972</td>
<td>588</td>
<td>97.84</td>
</tr>
<tr>
<td>1973</td>
<td>587</td>
<td>97.67</td>
</tr>
<tr>
<td>1974</td>
<td>584</td>
<td>97.17</td>
</tr>
<tr>
<td>1975</td>
<td>580</td>
<td>96.51</td>
</tr>
<tr>
<td>1976</td>
<td>575</td>
<td>95.67</td>
</tr>
<tr>
<td>1977</td>
<td>576</td>
<td>95.84</td>
</tr>
<tr>
<td>1978</td>
<td>615</td>
<td>102.33</td>
</tr>
<tr>
<td>1979</td>
<td>668</td>
<td>111.15</td>
</tr>
<tr>
<td>1980</td>
<td>762</td>
<td>126.79</td>
</tr>
<tr>
<td>1981</td>
<td>772</td>
<td>128.45</td>
</tr>
<tr>
<td>1982</td>
<td>798</td>
<td>132.78</td>
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<tr>
<td>1983</td>
<td>826</td>
<td>137.44</td>
</tr>
<tr>
<td>1984</td>
<td>974</td>
<td>162.06</td>
</tr>
<tr>
<td>1985</td>
<td>1,148</td>
<td>191.01</td>
</tr>
</tbody>
</table>

Source: Adapted from Li, 1991, pp. 317–318.

Note: Real salary is nominal salary deflated by consumer price index in which 1956 is set as the base year (base = 100).
First, the ratio of the total wage bill to gross national income declined. The ratio reached its peak in 1986 and then kept falling from then to 1993 (Figure 7.2). The declining salary share in the gross national income had a practical implication. As the national income and GDP increased sharply after the advent of reform, what individuals got, measured by salaries, became less, which suggested a problematic income distribution system in China.

(1) First, the ratio of the total wage bill to gross national income declined. The ratio reached its peak in 1986 and then kept falling from then to 1993 (Figure 7.2). The declining salary share in the gross national income had a practical implication. As the national income and GDP increased sharply after the advent of reform, what individuals got, measured by salaries, became less, which suggested a problematic income distribution system in China.

Figure 7.2: Ratio of the total wage bill to gross national income (%), 1985–1993

Civil Service Pay Levels

(2) Second, the gap between the nominal and the real wage was still large. Notwithstanding the notable increase in nominal wage, real wages were eroded by serious inflation. As Xu (1992) notes, the total national wage bill rose by 16.4 percent whereas the real wage bill increased by only 5.2 percent from 1986 to 1990. Therefore, the annual growth gap between the nominal and the real wage bill was 11.2 percent during the period. As compared with the wage bill in total, average salaries increased much more slowly in both nominal and real terms. The nominal average salary of employees increased by 13.3 percent; but the real one rose by only 2.6 percent between 1986 and 1990. For public sector pay, given that 1985 is a base year, the gap between nominal and real annual salary was 82 yuan in 1986, 704 yuan in 1989, and 1,823 yuan in 1993 (see Figure 7.3). Notably, the growth rate of real wages in 1988 and 1989 was negative.

The fact that increasing the nominal salary led to both higher inflation and lower purchasing power was epitomized as the “wage-price spiral” (gongzi jiage luoxuan) in China, which invited much scholarly debate after the 1985 pay reform (Dai, 1995). On the one hand, the price reform in 1985 led to a substantial increase in the living costs of the country. Pay raises were made explicitly to prevent the living standards of employees from falling. On the other hand, the pay raises were offset by inflation

Figure 7.3: Nominal and real salary of state organs and social organizations (yuan/year), 1985–93

![Graph showing nominal and real salary of state organs and social organizations from 1985 to 1993.](image)

since pay increases created a “demand-pull” inflation. For example, the increase in the price of daily necessities was 2.7 percent in 1984, but it reached 12 percent in 1985. The Consumer Price Index (CPI) increased by 18.8 percent in 1988 and 18 percent in 1989. Among other factors, pay raises led to the inflation. As a result, the general public was enraged. When the National Peoples’ Congress convened in Beijing in 1985, its secretariat received 10,000 letters and phone calls with complaints about inflation and related issues (Takahara, 1992, p. 167).

(3) Third, the pay level of civil servants was lower, as compared with the compensation in state-owned enterprises. When state-owned enterprise reform was underway in the 1980s, remuneration decision-making was delegated to enterprise managers. The bonus ceiling was lifted high

2. At the time, there was another phenomenon, as illustrated by a popular saying: “Selling boiled eggs is better than building nuclear missiles. Working with a razor is better than working with a scalpel” (zaodaodan buru mai chayedan, nashoushudao buruna titoudao) (Cooke, 2005, p. 295). As noted by the World Bank (1988), “One consistent pattern among African countries and several other developing countries around the world is the decline from the mid-1970s to the mid-1980s both in real compensation levels, whether cash or fringe benefits, and in pay differentials between skilled and unskilled workers” (p.115).

Table 7.3: Pay gaps between government officials and state-owned enterprise employees, 1989

|                    | Government agencies (yuan/year) | State-owned enterprises (yuan/year) | Government agencies (1.00) | Pay ratio 
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bureau Head</td>
<td>3,284</td>
<td>3,802</td>
<td>1.00</td>
<td>1.16</td>
</tr>
<tr>
<td>Bureau Deputy</td>
<td>3,104</td>
<td>3,757</td>
<td>1.00</td>
<td>1.21</td>
</tr>
<tr>
<td>Division Head</td>
<td>2,752</td>
<td>3,508</td>
<td>1.00</td>
<td>1.27</td>
</tr>
<tr>
<td>Division Deputy</td>
<td>2,478</td>
<td>3,460</td>
<td>1.00</td>
<td>1.40</td>
</tr>
<tr>
<td>Section Head</td>
<td>2,289</td>
<td>3,129</td>
<td>1.00</td>
<td>1.37</td>
</tr>
<tr>
<td>Section Deputy</td>
<td>2,155</td>
<td>2,974</td>
<td>1.00</td>
<td>1.38</td>
</tr>
<tr>
<td>Section Member</td>
<td>1,923</td>
<td>2,902</td>
<td>1.00</td>
<td>1.51</td>
</tr>
<tr>
<td>Clerk</td>
<td>1,882</td>
<td>2,610</td>
<td>1.00</td>
<td>1.39</td>
</tr>
<tr>
<td>Average</td>
<td>2,117</td>
<td>2,720</td>
<td>1.00</td>
<td>1.28</td>
</tr>
</tbody>
</table>


Note: Figures in the last column are pay ratios of SOE managers to government officials, given the pay of state organs is 1.00.
Civil Service Pay Levels

in 1984, and thereby salaries in enterprises increased rapidly in the late 1980s. Thus, the gap between state cadres and state-owned enterprise employees broadened dramatically. The salary growth rate in state organs, Xu (1992) reports, was only 55 percent of that in enterprises between 1986 and 1990. Furthermore, a comparison between the pay levels of new employees in state organs and state-owned enterprises illustrates the remuneration gap as well. University graduates in state organs got more than 5.49 percent starting salary than their counterparts in state-owned enterprises in 1957. Nevertheless, the situation later became reversed. Newentrants with university degrees in state organs received 37 percent less than those in state-owned enterprises in 1990 (Xu et al., 1993). In 1990, the Ministry of Personnel conducted a survey and found that the salary gap between state organs and state-owned enterprises in 1989 was 979 yuan for a section member, and 518 yuan for a bureau head (see Table 7.3).

Thus, even though the 1985 pay reform aimed to rectify the deficiencies of the 1956 one, the period 1985–1993 witnessed deterioration in public sector compensation. The 1985 pay system lasted only eight years.

PAY LEVEL IMPROVEMENT AFTER 1997

The situation was reversed in the late 1990s. The pay rate of civil servants rose due to a number of pay rises from 1997. As shown in Table 7.4, the

<table>
<thead>
<tr>
<th>Effective date</th>
<th>Item(s)</th>
<th>Increments (yuan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 1, 1997</td>
<td>Subsistence salary</td>
<td>90 → 110</td>
</tr>
<tr>
<td>July 1, 1999</td>
<td>Subsistence salary + grade salary</td>
<td>580→900 (the highest rank); 165→265 (the lowest rank)</td>
</tr>
<tr>
<td></td>
<td>Position salary</td>
<td>some</td>
</tr>
<tr>
<td>January 1, 2001</td>
<td>Subsistence salary + grade salary</td>
<td>900→1,396 (the highest rank); 265→345 (the lowest rank)</td>
</tr>
<tr>
<td>October 1, 2001</td>
<td>Position salary</td>
<td>480→850 (the highest rank); 50→110 (the lowest rank)</td>
</tr>
<tr>
<td>July 1, 2003</td>
<td>Position salary</td>
<td>850→1,150 (the highest rank); 110→130 (the lowest rank)</td>
</tr>
<tr>
<td>July 1, 2006</td>
<td>Position salary</td>
<td>1,350 (the highest rank), 380 (the lowest rank)</td>
</tr>
</tbody>
</table>

pay enhancements were by no means small. For example, there were pay rises for both subsistence salary and grade salary in 1999. Civil servants with the highest rank increased their salaries from 580 yuan per month to 900 yuan per month in addition to some increases in position salary. Much more substantial pay increases happened in 2001. Civil servants with the highest rank got a pay rise from 900 yuan to 1,396 yuan for both subsistence salary and grade salary in January 2001, and received another pay rise in October 2001. Pay rises continued to happen in 2003 and 2006.

There are a variety of reasons underpinning the pay raises from 1997. (1) First, pay rises were driven by pressure from the private sector. Hussain and Stern (2008) note:

A general phenomenon in transition economies is a shift in the share of national income to salaries and wages. This begins in the nongovernment sector with the phasing out of centralized wage determination, a process that began in China in the mid-1980s. The widening wedge between government and nongovernment wages and salaries forced the government to follow suit. (p. 25).

Retaining talent and competing with the private sector for human resources is a continuous challenge facing the Chinese government. Civil service remuneration lagged far behind the private sector not only in pay level but also in pay structure. Evidence suggests that civil service wages were much lower than those in the private sector in the late 1980s and early 1990s. In addition, when performance-related rewards were used extensively in the private sector, the public sector continued to adopt a rigid state-dominated wage system, though some civil servants received substantial pay. Thus improving public sector pay from the late 1990s was an important step towards a well-functioning wage system, which will enhance the government’s ability to attract and retain talent.

(2) Second, pay increments helped to improve macroeconomic management in China. The Chinese experienced several unprecedented crises in the mid-1990s, in the context of a turbulent Asian economy. The restructuring of state-owned enterprises, for example, was a huge challenge facing the Chinese government during this period. A fragile economy required a prompt and appropriate government policy to tackle internal and external economic threats at the time. The 1997–1998 Asian Financial Crisis made the Chinese situation worse. Nevertheless,
it prompted the Chinese government to adopt a proactive fiscal policy in 1997 whereby public spending was the core of this Keynesian-style policy. Increasing the number of civil servants was conducive to boosting domestic consumption; therefore, civil service pay enhancements had been promoted within a relatively short period. For example, the Ministry of Finance reports that pay rises and related spending increased the GDP by 0.44 percent in 2000 (Ministry of Finance General Office, 2001).

(3) Third, increased remuneration served corruption control, as many studies suggest that low public sector wages are positively associated with corruption in many countries (Rijckegehem & Weder 2001). Zhu Rongji, the then Premier of the PRC, argued in 2000 that although the Chinese government could not afford high salaries for civil servants, salary increments should be employed to deter corruption (Takung Pao, 11 January 2000, cited in Gong and Wu, 2012a, p. 319). He told the media that “My current monthly salary is 2,000 yuan; it will increase to 3,400 yuan in 2001 and 4,000 yuan in 2002” (Takung Pao, 11 January 2000). Although the correlation between civil service wages and corruption is much more complex than expected, the Chinese leadership seem to endorse the idea of employing pay increments to deter corruption (Yang, 2004).

It should be noted that the 2006 pay rises were part of the equal pay policy introduced in 2006. The 2006 pay regime intended to rectify the situation of the coexistence of the overpayment and underpayment of civil service pay among different regions across the country. The central government made it unequivocally clear that overpayments should be curtailed while substantial pay rises were tilted towards those with poor remuneration previously. The central government also transferred a large amount of central grants to enhance the “ability to pay” of some poor local governments. In the meantime, rich localities and government departments were actually required to take a pay cut, since the remuneration level of these units were much higher than pay rates after the national pay rises.

Civil service pay has been enhanced since the late 1990s. It can be measured by the following two features.

(1) First, the average annual salary of state organs has increased steadily. The annual salary of state organ employees was 3,382 yuan in
1993 and rose to 20,828 yuan in 2005. As can be seen, the civil service pay rate in 2005 was six times more than that in 1993. If we use 1993 as a base year, the annual real salary in 2005 was 3.6-fold over that in 1993. Furthermore, a comparison between civil service pay and GDP per capita shows civil service remuneration improving (see Figure 7.4). The ratio of the annual real salary of state organs to real GDP per capita was 1.13 in 1993, 0.89 in 1994 and 0.93 in 1995. The low levels in 1994 and 1995 reflected the impact of high inflation on real income in those two years. But the ratio kept increasing after 1998 and hit the highest point at 2.36 in 2005.

(2) Second, compared with other jobs, civil service compensation increased substantially from 1995. There were 16 categories of occupation between 1993 and 2002 and 19 categories after 2003 listed in the China Labor Statistical Yearbooks. The relative salary ranking of civil servants fluctuated from 1993 through 2005. However, the relative ranking of civil service compensation has grown slightly from 1995 onward. For example, civil service salary ranked 12th out of 16 job categories in 1995 while it jumped to 8th in 2002. When the total job categories increased to 19, its absolute ranking remained 10th between 2003 and 2005.

Figure 7.4: Comparison between civil service pay and GDP per capita (yuan), 1993–2005


Note: Real salary is nominal salary deflated by the consumer price index while real GDP per capita is deflated by the index of GDP per capita. For both cases, 1993 is set to be the base year where the CPI and the index of GDP per capita are equal to 100.
Civil Service Pay Levels

Table 7.5: Ratios of civil service pay to salaries of manufacturing and education sectors (%), 1993–2005

<table>
<thead>
<tr>
<th>Year</th>
<th>Civil Service/Manufacturing</th>
<th>Civil Service/Education</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>1.05</td>
<td>1.07</td>
</tr>
<tr>
<td>1994</td>
<td>1.16</td>
<td>1.01</td>
</tr>
<tr>
<td>1995</td>
<td>1.07</td>
<td>1.02</td>
</tr>
<tr>
<td>1996</td>
<td>1.12</td>
<td>1.03</td>
</tr>
<tr>
<td>1997</td>
<td>1.18</td>
<td>1.03</td>
</tr>
<tr>
<td>1998</td>
<td>1.10</td>
<td>1.04</td>
</tr>
<tr>
<td>1999</td>
<td>1.15</td>
<td>1.05</td>
</tr>
<tr>
<td>2000</td>
<td>1.15</td>
<td>1.06</td>
</tr>
<tr>
<td>2001</td>
<td>1.24</td>
<td>1.06</td>
</tr>
<tr>
<td>2002</td>
<td>1.27</td>
<td>1.05</td>
</tr>
<tr>
<td>2003</td>
<td>1.24</td>
<td>1.08</td>
</tr>
<tr>
<td>2004</td>
<td>1.25</td>
<td>1.08</td>
</tr>
<tr>
<td>2005</td>
<td>1.30</td>
<td>1.11</td>
</tr>
</tbody>
</table>


A comparison between civil service pay and the salaries of the manufacturing and education sectors was also made. As shown in Table 7.5, civil service pay from 1993 through 2005 exceeded pay in both the manufacturing and education sectors. Even though the ratio of civil service pay to manufacturing remuneration fluctuated between 1993 and 2005, the pay gap broadened substantially. That is, the ratio was 1.05 in 1993, 1.15 in 1999 and 1.30 in 2005. Although the Compulsory Education Law in China stipulates that “The average salary of teachers shall not be lower than the average pay of civil servants in the same localities”, compensation in the education sector was lower than that of the civil service in the period 1993 to 2005.

LOW PAY OR HIGH PAY

This section evaluates the current pay level in the Chinese public sector. Some argue that civil service salaries are still low compared with other jobs while many contend that the pay level is too high in the public sector. Several comparisons thus are conducted in order to investigate the public sector pay level. Civil service pay ranks middle among all
sectors in the country. In addition to formal pay, this section discusses the informal compensation offered to civil servants. When taking informal compensation into consideration, the pay level of civil servants is impressive.

**FORMAL PAY FOR CIVIL SERVANTS**

I compare the civil service pay and GDP per capita in the country. As shown in Figure 7.5, the gap between the average salary of civil servants and GDP per capita in real terms has broadened over the years. Since 1999, the real income of civil servants has surpassed the country’s GDP per capita (Gong & Wu, 2012b). After that, the gap enlarged substantially. The real average salary of civil servants was 3 times GDP per capita in 2010.

As shown in Table 7.6, civil service pay was relatively stable between 2003 and 2010. Among the 19 sectors, civil service remuneration ranked 10th over these years. As noted, the civil service salary ranked 12th out of 16 sectors in 1995. The rankings had risen after 1997 and remained

Figure 7.5: Comparison between civil service pay and GDP per capita (yuan), 2003–2010

![Figure 7.5: Comparison between civil service pay and GDP per capita (yuan), 2003–2010](image)

Source: China Statistical Yearbook 2011.

Note: Real salary is nominal salary deflated by the consumer price index while real GDP per capita was deflated by the index of GDP per capita. For both cases, 1993 is set to be the base year where CPI and the index of GDP per capita are equal to 100.
Table 7.6: Average salary among 19 sectors in China (yuan), 2003–2010

<table>
<thead>
<tr>
<th>Year</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<tbody>
<tr>
<td>Total</td>
<td>13969</td>
<td>15920</td>
<td>18200</td>
<td>20856</td>
<td>24721</td>
<td>28898</td>
<td>32244</td>
<td>36539</td>
</tr>
<tr>
<td>Agriculture, Forestry, and Fishery</td>
<td>6884</td>
<td>7497</td>
<td>8207</td>
<td>9269</td>
<td>10847</td>
<td>12560</td>
<td>14356</td>
<td>16717</td>
</tr>
<tr>
<td>Mining</td>
<td>13627</td>
<td>16774</td>
<td>20449</td>
<td>24125</td>
<td>28185</td>
<td>34233</td>
<td>38038</td>
<td>44196</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>12671</td>
<td>14251</td>
<td>15934</td>
<td>18225</td>
<td>21144</td>
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<td>43435</td>
<td>47700</td>
<td>54906</td>
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(continued next page)
Table 7.6: Average salary among 19 sectors in China (yuan), 2003–2010 (continued)

<table>
<thead>
<tr>
<th>Year</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<td>Health, social security, and social welfare</td>
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<td>Culture, sports, and entertainment</td>
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<td>30430</td>
<td>34158</td>
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<td>Public sector</td>
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<td>32296</td>
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<td>38242</td>
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</table>

Source: China Statistical Yearbook, 2011
Civil Service Pay Levels

Figure 7.6: Relative public sector pay level, 2003–2010

Source: China Statistical Yearbook, 2011.
Note: The relative pay level equals civil service pay divided by the average pay in all job categories.

Civil Service Pay Levels

stable after that. Based on the data, civil service pay ranked middle in the all job categories. The impact of the pay rises after 1997 was manifest.

The relative pay level (see Figure 7.6), as measured by the average civil service pay divided by the average pay in all job categories, indicates that the civil service is generally well paid. It should be noted that civil service pay reached its peak in 2007. After that, the relative pay level declined steadily. It is probably due to the Chinese civil service pay determination system wherein a top-down approach is applied. When the central government kicked off the substantial pay rise in 2006, the pay level of the public sector increased substantially in 2007. Nevertheless, when the central government did not require pay rises in 2009 and 2010, relative civil service pay declined against the backdrop of increasing salary increases in all other sectors in these two years.

Perhaps more importantly, as shown in Table 7.7, the pay rises over the decade in question were not eroded by inflation. After the onset of economic reform, pay rises were significantly offset by serious inflation; therefore, pay rises did not denote an increased purchase power in reality. During the 1980s, “demand-pull” inflation plagued the Chinese
Governing Civil Service Pay in China

Table 7.7: Civil service pay level, 2003–2010

<table>
<thead>
<tr>
<th>Year</th>
<th>Civil service pay (real terms, yuan)</th>
<th>Growth rate of civil service pay (real terms, %)</th>
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<td>9797.159</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>10707.56</td>
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<td>2006</td>
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<td>2007</td>
<td>15345.49</td>
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<tr>
<td>2008</td>
<td>16875.94</td>
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</tr>
<tr>
<td>2009</td>
<td>18589.36</td>
<td>10.15</td>
</tr>
<tr>
<td>2010</td>
<td>19480.95</td>
<td>4.80</td>
</tr>
</tbody>
</table>

Source: China Statistical Yearbook 2011.

economy and macroeconomic management. Though policy makers intended to improve civil service remuneration, nationwide pay rises aggravated the inflation problem in the country; pay rises in turn led to declining real pay levels. The political leadership at that time had just started to learn to utilize market-based incentives to motivate public workers, and so experiments in civil servant motivation were inadequate and rudimentary. More seriously, macroeconomic mismanagement resulted in serious inflation, which in turn rendered the civil service remuneration reform ineffective. Over the decade, the Chinese bureaucracy performed very well in managing nationwide pay rises for public employees while maintaining an acceptable inflation level. In general, the growth rate of civil service pay in real terms increased over 9 percent except in the year 2010.

**SUBSTANTIAL BENEFITS IN ADDITION TO CASH WAGES**

Fringe benefits play a leading role in Chinese public service remuneration. The scope and size of extra benefits for civil servants in addition to formal pay are much higher than their Western counterparts. Su and Yang (2008), on the basis of a survey over 26,000 civil servants around 11 provinces in 2004 and 2005, reveal that substantial benefits were offered to civil servants in the country.

Benefits varied among different tiers of government. A survey of civil servants in Jiangsu Province shows that, when asked about what main benefits were offered to them, about 45.7 percent of civil servants at
Civil Service Pay Levels

the county level answered that those were bonuses.\(^3\) In the meantime, only 3 percent of civil servants at the provincial level and 23 percent of civil servants at the municipal level had the same answer (Shi, 2008). It implied that civil servants at the county level enjoyed high bonuses.

With a top-down civil service pay management system, many may wonder how local governments make extra benefits possible. Anecdotal evidence suggests that local governments grasp various opportunities to enlarge their own benefits. Local auditors report that governments at the grassroots level utilize many ways to grab public money for private gain (Pan & Li, 2004). Some governments manipulated project-based performance pay to line their pockets. For example, public officials received substantial rewards for their work in attracting investments. Nevertheless, too often, investments never happened in reality. Some local governments diverted public money for special uses such as science grants and awards to enrich public servants while some of them pocketed revenues that should have been submitted to higher authorities.

Su and Yang (2008) report that benefits were 100 percent to 200 percent of formal salary in the public sector in rich, coastal areas. The ratio was between 30 percent and 40 percent in relatively poor regions in central and western China. Some senior public personnel management experts had a similar estimation on the size of fringe benefits (Interview note, PA-20090615). I make my calculation drawing on Su and Yang’s (2008) research by adding up the formal and the informal pay. Even using the lowest estimation with benefits being 30 percent of formal salary, the ranks of civil servant salary would jump from 10\(^{th}\) to 4\(^{th}\) among the 19 sectors between 2003 and 2010. This is an important finding for the study of civil service pay in China. It means that despite the low wage policy in place, civil servants in China have in fact been well and fairly compensated. In recent years, red-collar jobs have been the most sought after. As for civil service examinations at the central government level, about 1.41 million candidates competed for 16,000 public jobs in 2010 (Xinhua, 6 December 2010). The application/place ratio was astonishingly high at 88. Good pay for civil servants plus job security probably explains why the national civil service examination is so attractive in today’s China.

\(^3\) According to the 2006 pay regime, the bonus should be equal to the December base salary. The payment, under the guise of bonus, is an extra benefit in addition to formal pay.
DISCUSSION

Changes in the civil service pay level reflect politico-economic changes in China. The central leadership promoted a low wage level on purpose from the beginning for three reasons.

(1) First, the central policy on the relationship between production and income distribution tilted the balance in favor of economic development and the improvement of production capacity (Wages, welfare and social insurance in contemporary China, 1987). It was projected that not until the year 2000 could the Chinese people have a decent life. Both production and capital accumulation thus were the top priorities for the country, while income distribution was largely ignored. It was believed that as the generated wealth had to be channeled into the production line, wages should be suppressed in the early years of economic development. It was not until the 1990s that the above understanding was challenged. Occasionally, some conservative leaders in China still talk about economic development taking precedence and public sector pay being secondary.

(2) Second, a low tolerance of ANY urban-rural remuneration gap rendered civil service pay low for years. It was argued that wage increments in the urban areas should not happen without a simultaneous improvement of the income of rural peasants (see Deng, 1984). Substantial wage gaps between rural peasants and urban-based civil servants exist in some developing countries. But in China urban-based civil servants being compensated much better than peasants was not acceptable. As an encompassing state (Chan & Ma, 2011), the Chinese government also strove to reduce wage disparities between urban and rural areas, because ideological concerns dominated. And income inequality might lead to social unrest.

(3) Third, the low wage policy was conducive to high employment. With a sharply growing population in the early period of the PRC, high employment was viewed as being fundamental to social stability. As several million people were newly employed in the urban areas every year, a low wage policy was instrumental in maintaining a high employment rate; otherwise, the wage bill would be a huge burden for a fiscally weak, new regime (Wages, welfare and social insurance in contemporary China, 1987). A low wage policy went hand-in-hand with a high employment policy.
Macro socioeconomic factors have led to substantial pay increments and the retreat from the rational low wage policy in recent years. The Financial Crisis of 1997–1998 generated pressure for the Chinese government to rethink its fiscal policy and its civil service remuneration policy. It realized that civil service pay rises could serve to promote a Keynesian-style economic stimulus, which contributed to weathering the crisis. In addition, high pay in the public sector might serve to attract talent. The government’s wage policy had not been effective in recruiting and retaining the talent, while the thriving private sector did much better in this regard.

More importantly, public sector pay rises were and are a part of a bid to improve the legitimacy of the ruling Party. The grand slogans such as “the scientific development concept” and “the harmonious society” promoted by the Hu–Wen administration (huwen tizhi) between 2003 and 2013 point to a reconciliation between economic development and income distribution. Economic growth through suppressing wages in both the public and private sectors is now viewed as unacceptable by both civil servants and the general public. Public sector pay rises serve to protect the interests of civil servants, who are the bone of the government. What remains to be seen is how the Chinese government reconciles conflicting interests, arising from the three decades’ economic reform, between state workers, urban wage earners, and rural peasants. Improving civil service pay is only a small part of the income distribution reform.
The relationship between civil service pay and corruption alleviation is an intriguing but underexplored topic. A widely held view is that when civil service pay is comparatively low, public officials will be tempted into corrupt behaviors in order to compensate their perceived withheld desserts. Thus, some governments use high pay to ensure a clean civil service. Rahman (1986) notes that: “The government [in Singapore] believed that an efficient bureaucratic system is one in which the officers are well paid so the temptation to resort to bribes would be reduced” (p.151). In fact, employing good civil service pay to improve government integrity is not new to the Chinese. This chapter explores the historical background to utilizing good civil service remuneration to ensure a clean government in China. It is found that though in both ancient and modern China some policy makers were well aware of the importance of appropriate civil service compensation, the complexities and dilemmas embedded in implementing this policy were daunting. In today’s China, some Chinese traditional philosophies, coupled with a socialist ideology, encourage the introduction of good practices in modern public administration.

The chapter proceeds as follows. It first presents theories about the relationship between civil service pay and corruption. The second section examines the practice of good pay in ensuring government integrity prior to 1949, while the third section discusses the complex situation of applying increased pay to deter corruption in the history of the PRC. A final discussion serves to link up the various debates in both ancient and modern China.

THEORIES EXPLAINING CIVIL SERVICE PAY AND CORRUPTION CONTROL

Cross-national evidence suggests that bureaucrats may act predatorily when their wages are kept unreasonably low (Wei, 1999). In ancient
Pay and Corruption: Past, Present, and Prospects

China, rulers offered an extra benefit (yanglian yin) to bureaucrats to prevent corruption (Klitgaard, 1987). There are some theories related to the relationship between increased pay and corruption reduction. The “efficiency wage” hypothesis coined by Becker and Stigler (1974) is one of the most influential theories. Paying a higher than market clearing salary, it hypothesizes, is instrumental for corruption control. It is argued that public officials are mainly motivated by the maximization of personnel interests. As such, they calculate the benefits from corruption and costs of being punished eventually. Thus, the government should pay a “capitulation wage” to civil servants in a bid to maintain a clean civil service (Rijckegehm & Weder, 2001).

Some empirical research suggests that good compensation helped to reduce corruption in Sweden between 1870 and 1970 (see Tanzi, 1998). Goel and Rich (1989) in a survey of the US observe that high compensation for public servants can prevent officials from taking bribes. Rijckeghem and Weder (2001), drawing on cross-national panel data, develop a test of the relationship between public sector pay and corruption. It is found that public sector pay is negatively and significantly associated with corruption. That is, high pay can play a crucial role in ensuring a clean government.

Public officials, being human beings, compare their own lives with others. Thus, some literature suggests that corruption control will only succeed when public servants earn a relatively high salary in comparison with other wage-earners. That is the “fair-wage” hypothesis. A perception of a “fair” income matters a lot in practice. “The ‘fair wage’ can be determined through comparing the wages of peers within or outside the place of employment, social expectations, the market wage, subsistence requirements, the status of civil servants etc.” (Mahmood, 2005, p. 70). A perception of pay unfairness can result in corruption. More importantly, the general public may share the feeling with civil servants; thus they show sympathy towards corrupt officials, which complicates a government’s anti-corruption efforts (Abbink, 2005).

Supplementing the “fair-wage” hypothesis, Gong and Wu (2012b) call attention to some sociological studies which shed light on the causes of corruption. This is the “relative deprivation” hypothesis. As noted by Giddens (1972), relative deprivation is associated with much social deviances in the real world. When people feel deprived of what they
perceive they should receive, they may respond in unhealthy ways to compensate their perceived losses. Real-world examples suggest that the above assumption can be tested empirically. Huang and Snell (2003), in a study of the moral atmosphere in state-owned enterprises in China, reveal that a perception of material deprivation makes the managers of state-owned enterprises vulnerable to corruption and other unethical behaviors.

Scholars and practitioners are now paying growing attention to the negative impact of pay inequality on corruption. Good public sector pay relative to the private sector, as Quah (2003) notes, is essential for effective anti-corruption efforts in many countries. The Singapore government, among others, promotes an effective mechanism of corruption control whereby a civil service salary is, by and large, higher than one in the private sector.

It should be noted that though the negative consequences of external pay inequality in the public and private sectors has been detected, the impact of internal pay inequality on anti-corruption remains little understood. External pay inequality (public–private wage disparities) receives much scholarly attention. The perception of pay unfairness, Mahmood (2005) points out, is determined by the comparison among peers “within or outside the place of employment” (p.70). I suggest that the perceived unfairness or deprivation is greater when a comparison is made with colleagues in the same place of employment. People tend to have an interest in comparing their own salaries with their colleagues, as they not only compete for promotion but also better pay. When they feel unfairly treated, frustration and deprivation may lead to corruption.

Internal pay inequality can be disastrous in the Chinese context. Drawing on ethnographic field work in China, Agelasto (1996) reveals that cellularism and personal relationships among colleagues complicate public sector motivation and corruption control in China. On the one hand, colleagues seem to have closer personal relationships than their Western counterparts; thus a comparison about remuneration is possible. On the other hand, close personal relationships do not necessarily mean that perceived unfairness and jealousies are lower in Chinese workplaces. Comparing wages within the workplace, coupled with perceived unfairness, more often than not poses a greater threat to public sector integrity in China than elsewhere (Wu, 2012).
With regard to the policy implications of the relevant theories, they point to different anti-corruption strategies. Under the “efficiency wage” hypothesis, the government should provide a good salary for civil servants. Meanwhile, an increase in the probability of the detection of corruption and the punishment of corrupt behavior will work to reduce corruption as well. Nevertheless, addressing the problems inherent in the “fair-wage” scheme requires a comprehensive reform of both the civil service pay system and the corruption control approach. Civil service salaries should be set at a good rate but in a fair fashion. Corruption control should not be handled only through enhancing law enforcement. A well-structured and transparent civil service system is a prerequisite to maintaining an honest and clean service.

The “relative deprivation” hypothesis also points to the importance of a fair wage system, especially within the place of employment. From the perspective of modern human resource management, differentiating remuneration between senior executives and rank-and-file civil servants may reap some benefits in terms of rewarding accumulated contribution and motivating junior civil servants. But a substantial internal pay gap has a negative impact on civil service management and a government’s anti-corruption efforts. It is acute in the Chinese context. Soon after the founding of the PRC, the government channeled sizable fringe benefits to senior cadres. Therefore, cadres tended to view promotion as vital to their careers. If they got promoted to higher positions, it meant that they could receive both higher formal pay and substantial cash-based or non-cash-based extra pay. However, there is always a limited chance of promotion in practice. Roughly 92 percent of civil servants hold the ranks of section head and below. Comparing salaries and fringe benefits between those occupying senior positions with rank-and-file civil servants can result in frustration, which can shape cadres’ behaviors negatively.

More importantly, the situation turns serious when a country’s labor market is rigid. The “efficiency wage” hypothesis has been developed against the background of rather flexible labor markets in developed countries. If civil servants readily shift to the private sector, paying a higher than market clearing salary to civil servants is instrumental in improving civil service morale. A rigid labor market, by contrast, limits the possibility of transfers of labor between the public sector and the
private sector. Substantial internal pay inequality therefore can be devastating as, even though civil servants might feel upset and deprived, they cannot readily join the private sector for a while and come back later on. Transfers between government departments are not easy in China.

The policy-makers of the equal pay policy in today’s China seem well aware of the importance of internal pay equality. Senior officials in public personnel management have reiterated the necessity of correcting pay disparities across government departments since the 1990s. But as will be seen later, this policy’s implementation nonetheless runs in a different direction.

**YANGLIAN YIN AND THE PRACTICE OF GOOD PAY TO REDUCE CORRUPTION**

*Yanglian yin* (literally “money to nourish incorruptness”) (see Klitgaard, 1987; Zhong, 2003) was an important practice for a clean government in ancient China. The Emperor Yong Zheng of the Qing Dynasty promoted the system to improve both the fiscal responsibility and the corruption control of local governments in 1723. Leading local officials were offered an extra payment amounting 10 to 100 times their regular remuneration.

Mr. Tian Wenjing, the Governor of Henan and Shandong Provinces and the proponent of “*yanglian yin*” and “*huohao guigong*” (regulating surcharges by local governments), reported to Emperor Yong Zheng that some clean public officials had to get involved in corruption as they encountered extremely difficult situations when performing their public duties. When everyone was implicated in corruption, then the governing system should be reviewed thoroughly. Mr. Tian saw “the link between adequate salaries and the ability of officials to carry out their responsibilities honestly and efficiently”, thus promoting high pay for ensuring civil service integrity (Zelin, 1984, p. 131). He discussed this with Emperor Yong Zheng and promoted the system of “*yanglian yin*” wholeheartedly in his jurisdiction. The Henan model of alleviating corruption through improving public sector remuneration became famous at that time. In addition to formal taxes, local officials collected surcharges (*huohao*) on farming. The rate of surcharges originally was up to magistrates at the municipal and county levels. Many magistrates used surcharges to fund their daily public expenses and to provide
bribes to their superiors. Nevertheless, the Henan model of “yanglian yin” prescribed a flat rate of surcharges and asked local officials to remit all their collections to the provincial government coffers. Magistrates then received money for their daily expenses from higher authorities. Therefore, the Henan model prevented local governments from collecting extra surcharges because they needed to return all revenues to higher authorities. In the meantime, the money returned to magistrates ensured that local officials received adequate pay to sustain their families and run public enterprises.

In parallel to the Henan model, the Hubei one also attracted great attention nationwide. The Hubei model was a surcharge-sharing system whereby 68 percent of surcharges collected by magistrates were remitted to higher authorities. The remaining 32 percent of surcharges were retained by magistrates as “yanglian yin”, which was used for public affairs and their own family spending. Compared with the Henan model, the Hubei one still implicitly encouraged magistrates to collect more surcharges than they were supposed to, with local governments still having a nefarious stake in the collection of surcharges.

Utilizing the “yanglian yin” system, the Emperor promoted a decentralized system of corruption control. But the implementation of “yanglian yin” varied greatly among local governments. Some adopted the Henan or Hubei models, with others mixing them up in order to adapt to their own situations. The “yanglian yin” system did not achieve its goals in the end, but modern public administration does have something to learn from this system of ancient China. It has some modern elements of corruption control: the government attempts to alleviate corruption through enhancing the fiscal responsibility of local governments. In today’s developing countries, many governments collect surcharges in addition to formal taxes in a bid to meet expenditure needs. Some public officials nonetheless profit from the system. When local governments’ expenditure needs are guaranteed, civil service salaries are adequate, and corruption tends to level off.

In addition to the “yanglian yin” system, reducing corruption through increased civil service remuneration emerged occasionally in ancient China. But civil service pay remained very low in general due to ideological concerns. According to the Rites of Zhou (zhouli, one of the classics of Confucianism), civil service salary serves to compensate the loss
from agricultural production (luyi daigeng) when a person decides to join the civil service in an agrarian society. Emperors in ancient China, by and large, respected the pay principle set by the Rites of Zhou. The implementation of this principle nonetheless encountered difficulties for two reasons. First, bureaucratic expansion occurred frequently in ancient China and eroded the fiscal capacity of the government, making adequate pay impossible to carry out. Wang Anshi, a politician of the Song Dynasty, advocated the practice of “shengguan yifeng”, whereby the government introduced increased remuneration for public servants while public sector retrenchment was conducted. But instead, serious bureaucratic expansion rather than civil service retrenchment occurred during this period (Yang, 2006).1 Second, inflation ate away public sector pay increments. Similar to what happened in China in the 1980s, public sector pay increments always resulted in inflation in the economy. Some public officials in the Song Dynasty argued that their salaries had been eroded by half even though they had not committed any crimes (a criminal offense often led to a reduction in civil service pay in ancient China (Yang, 2006)).

The late Qing (China’s last imperial dynasty) period saw an increasingly heated debate over the linkage between civil service pay and corruption control, due to the importation of Western public administration theories and practices. During this period, many “best practices” concerning civil service management from Western countries poured into China. Some prominent politicians and philosophers contended that, rather than being corrupt inherently, public officials were led into corruption because the government was promoting a bad system, especially in fiscal matters. Thus they argued that the government should be responsible for covering all public expenses related to public affairs. This meant that government officials should not rely on bribes and illegal collections from farmers to support their daily public work. They suggested that the Chinese government should learn from the Japanese experience in introducing a modern civil service pay system to reduce corruption. In 1906, five years before the collapse of the Qing Dynasty, the Qing government set up a government department in charge of sur-

1. As we shall see, Zhu Rongji, the former premier of the PRC, also promoted a two-pronged strategy of civil service reform in the late 1990s. On the one hand, he launched a large-scale civil service retrenchment across the board; on the other, he attempted to improve civil service pay without harming the fiscal capacity of the government.
veying public officials’ salaries. The Qing government announced that expenses related to public affairs should be paid by the state treasury. This practice was, to some extent, similar to the “yanglian yin” system promoted by the Emperor Yong Zheng. However, the late Qing government was not able to implement this system before it collapsed.

A military uprising overthrew the Qing government in 1911. The provisional government of the Republic of China (ROC) was introduced in 1912, and Sun Yat-sen, a prominent revolutionary in the late Qing period, was elected as the first president of the ROC. A prolonged period of political and economic turmoil followed. Nevertheless, the debate over civil service management and, in particular, civil service remuneration did not halt during this time. For example, Liang Qichao, a reformist and philosopher in the late Qing Dynasty and early the ROC, criticized high remuneration for public officials. He viewed civil servants as unproductive labor. If high pay were introduced to reward public officials, society would be corrupt and uncompetitive (Yang, 2006). The argument advocated by Liang Qichao exactly epitomized the pay principle of the Rites of Zhou.

In the warlord period of 1912–1928 the Chinese government promoted high pay for civil servants. Although one administration overthrew another administration regularly, civil service management imported from the West had started to take root in China. Many open-minded reformists advocated high civil service salaries to ensure civil service integrity, which could buffer the negative impact of the wars on society.

The lowest paid public servants could afford a family with five members during this period (Yang, 2006). Drawing on some nationwide household surveys on income and expenditure, the government tried to promote good living conditions in a bid to foster a stable and clean civil service. Pay differentials were substantial – even larger than those in the PRC, as the idea of “privileging high-ranking officials (zhonggaoguan boxiaoli)” dominated. But since many civil wars occurred during this period, the high pay system was frustrated by inflation and poor economic conditions.

Not until the Nationalist Government of the ROC (1927–1948) was a modern civil service system introduced. Over half of the ministers in this government were foreign-educated returners (Yang, 2006). Numerous good practices taken from Western public administration were introduced into China. For example, the government separated
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management by political appointees from that by ordinary civil servants. Also funds for the remuneration in both work and retirement of civil service personnel were guaranteed by the government.

Civil servant pay during this period was generally handsome – the average expenditure of a lowest-ranked civil servant was double that of an ordinary worker (Yang, 2006). According to the Rites of Zhou, civil service pay works to guarantee civil servants’ family expenditure needs when civil servants stop being involved in agricultural production. Public administrators in the Nationalist Government argued that civil service pay served to promote both the personal integrity and the incorruptness of public officials. Thus civil service remuneration should be high enough for civil servants to have a decent life. Excessive pay differentials nonetheless were condemned at the time, which suggested a social demand for equality and distributive justice. Evidence suggests that a rationalization of civil service remuneration was associated with a clean government at that time (Yang, 2006).

Civil service pay suffered after warfare began against the Japanese in 1937. Serious inflation made an every-three-month salary review late and ineffective. Local governments had to provide cost-of-living allowances for civil servants. But too often salary adjustments and cost-of-living allowances could not catch up with hyperinflation. Worse yet, high military expenditure led to widespread civil service pay arrears. When civil servants did not receive their salaries on time, they resorted to using their power for private gain. It is reported that corruption, especial grand corruption among high-ranking officials, was rampant at that time (Yang, 2006).

**Using Adequate Pay to Improve Government Integrity in the PRC**

From its beginning, the PRC has been governed by the ideology of Marxism–Leninism. During his rule over the Soviet Union, Lenin and his party were plagued with pre-revolutionary bureaucracy and petty corruption. He turned to “rationalize” the civil service system during his administration, though he never succeeded in eradicating corruption (Harding, 1981). Lenin’s preoccupation with rationalizing his bureaucracy deeply shaped the governing style of the Chinese Communist Party.

Alleviating corruption through increased civil service pay never became a core public administration issue in the Mao period in China.
A mass campaign against corruption was the main method of corruption control at that time. Gao Gang, the head of the early liberated Northeast People’s Government, launched a campaign aimed at reducing both corruption and administrative waste in 1951, soon after the founding of the PRC. Most of the state’s cadres, due to a lack of management skills, wasted substantial financial resources when the new government was in dire need of various resources to consolidate power. They also gave in to temptation now that they unexpectedly had the power to manage the economy, allocate human and material resources, and regulate commercial activities. Small-scale corruption mushroomed across the country. Zhou Enlai, the then premier of the PRC government, wished to reorganize the administrative system to improve public sector efficiency and reduce corruption. But Chairman Mao was enthusiastic about promoting a campaign style of anti-corruption and anti-waste within the bureaucracy. The Three-Anti Campaign (against corruption, waste, and bureaucracy) saw many high-ranking and grassroots cadres lose their jobs or even end in jails.

The Socialist Education Campaign was another high watermark of anti-corruption in the Mao period. Most ordinary people and grassroots cadres have a bad memory of the Great Leap Forward in the late 1950s and early 1960s, as they suffered from unprecedented food shortages; numerous people died in a great famine. Partly as self-protection behavior, local cadres increasingly paid attention to material benefits for themselves and their family. Some of them abused public power for personal gains (Harding, 1981). As an outcome of the Socialist Education Campaign, many cadres received brutal punishment for their wrongdoing or incorrect political stance.

Harding (1981), in a review of governance before the economic reform and right after the reform, points out that “the Chinese have done a creditable job in controlling outright graft” (p.356). Various international surveys on corruption in China also suggest that the government was relatively clean during the early period of economic reform, which implies that corruption control was effective in the Mao era. However, Wedeman (2000) argues that campaign-style corruption control is not able to deter large-scale corruption. Some large-scale corruption happened but this was not detected during the Mao period.

Corruption has grown to operate on a larger scale since the late 1980s. Forms and characteristics of corruption have become increasingly com-
plex and multifaceted (Gong, 1997). Transparency International – a Berlin-based, independent, corruption-monitoring organization – has published a global ranking of perception of corruption for decades. As shown in Figure 8.1, the perceived level of corruption was less serious in the mid-1980s. It nonetheless became very worrisome between 1995 and 1997 as the score changed from 4.73 in 1992 to 2.88 in 1997.

Zengke He (2000) provides three explanations for the acceleration of corruption in post-Mao China. First, a dual economic system with a combination of a planned economy and a market economy created huge opportunities for corrupt officials to profit. In many cases, for example, insiders in the public sector could obtain materials at a price far lower than the market value. It was noticed that public officials made profits through utilizing various opportunities related to their public positions. Second, regulatory power wielded by government officials led to substantial corruption. The growth of regulatory policies for the market-oriented economy aimed at leveling the playing field in transitional China. But an unintended consequence was that it generated space for bureaucratic manipulation. Corruption surged. Third, the decline of the Marxist–Leninist ideology and “ethical education” in the public sector resulted in an intensification of corruption. As noted by Professor He, ethical education for public sector officials has lost effectiveness since

Figure 8.1: Corruption perception index of China, 1985–2011

![Corruption Perception Index](image)

Source: Transparency International (TI), various years.

Note: Lower score indicates a high perceived level of corruption.
the economic reform. Corrupt individuals now feel less moral pressure from society, which contributes to rampant corruption in China.

A civil service remuneration regime was a part of the planned economy, which maintained a low-wage regime and paid little attention to the alleviation of corruption. This regime profoundly shaped the civil service reform both before and after the economic reform. Though a market-oriented economy has been promoted since the early 1990s, the old orthodox view of civil service pay in China is substantially distinct from the Western one in two ways. First, the Chinese government prioritizes production over income distribution; civil service remuneration, viewed as a counterforce to advancing production, is tarnished and compressed. The Chinese government has some characteristics of a developmental state wherein economic development is a crucial tool for the ruler to maintain legitimacy. In the planned economy of China, income distribution was inferior to production, as wealth generated went back to improve the production capacity of state- or collective-owned enterprises.

Chen Yun, a central heavyweight with the portfolio of economic management, argued in 1982 that “We should attempt to improve people’s livelihood. It is of great importance to let people have a meal to eat. Eating, consumption, nonetheless must be contained. Production is crucial to our nation. There is no hope for the country when people eat up all resources” (Li, 1991, p. 312). The central leadership in China viewed production and consumption as a zero-sum game wherein substantial consumption would lead to a declining capacity to produce. Production thus came first, wage remuneration and other consumption activities second.

Second, civil service remuneration is constrained by an encompassing state. The Chinese government pays attention to the issue of “letting everyone have a meal to eat” (Takahara, 1992, p. 44), though some reformists are skeptical of “everybody eating from the same big pot” (Chew, 1990a). Under the framework of an encompassing state, civil servants cannot earn a substantially high salary as against other urban employees; meanwhile, the gap between civil service pay and the income of rural peasants should not be great. In addition, social stability is also an important concern. The Central Committee of the CCP in 1957 stated unambiguously that the gap between rural and urban lives should not exceed a certain limit. Otherwise, migration from rural to urban areas would ensue. However, urban areas fell short of resources to sustain a large population (Li,
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1991, p. 312). Thus, as noted in Chapter 7, for a long period the model of “high-employment, low-wage, and low-consumption” dominated in China. Though the advocates of low-consumption have faded away in recent years, since the country needs to boost consumption for economic growth, the encompassing state still hinders the development of a well-functioning civil service pay system (Cooke, 2005, p. 294).

Rooted in the early period of the PRC, civil service remuneration, ridden with many political and ideological concerns, has not played a role in improving both civil service motivation and government integrity. Though some rectifications have been made since the late 1990s, civil service pay in China has a long way to go toward true rationalization, though public opinion about the positive impact of adequate pay on corruption reduction has been around since the early 1990s.

Singapore, as a model country of corruption control in Asia, has spread its successful experiences to China. When Lee Kuan Yew, the founding father of modern Singapore, visited China in 1992, he was invited to talk about Singapore’s experiences and lessons in both public goods provision and civil service governance. He told the Chinese about the role of high civil service pay in alleviating corruption in his country. According to the People’s Daily, Lee argued that “Civil servants in Singapore earn a good salary; thus corrupt officials will risk losing their jobs and handsome pensions” (People’s Daily 29 August 1992, p. 6). It stirred a great debate in the country about remuneration in the public sector and corruption control.

Intriguingly, when discussing the Singaporean experience, the Chinese do not use the term “using high pay in ensuring a clean government” (gaoxin yanglian) but “using adequate pay in ensuring a clean government” (yixin yanglian). This reflects both an ideological and a practical concern that civil service pay cannot be too high, in order to meet political demands. In addition, the fiscal capacity of the Chinese government at that time could not pay a high salary to cadres (the term of civil servant was officially endorsed in 1993).

The People’s Daily, the CCP’s mouthpiece, published the first commentary on improving public sector salary in ensuring a clean government soon after Lee’s visit. It was argued that sufficient compensation was a precondition for preventing corruption. More importantly, the author cited the Singaporean case when drawing a distinction between an
adequate and a high wage. Whilst cadre remuneration was not expected to catch up with high earners in the private sector, a fair wage offering government officials a decent living should be put in place in a bid to prevent them from involving themselves in corruption (Liu, 1992).

Then in 1995 another article appeared in the *People’s Daily*. It observed that as both economic development and living conditions continued to improve in the country, many were arguing for the introduction of the Singaporean practice for corruption control in China. The article cautioned, however, that a high salary by itself would not effectively prevent corruption, because some greedy persons might still try to grab more money illegally. The author cited an old Chinese saying: “Greedy persons want more than they need after they get rich while self-disciplined people are happy even they are poor (lianzhe changyu wuqiu tanzhe changyu buzhu)”. The commentary concluded by urging the government to promote the way of a frugal life among civil servants (Wu, 1995).

Whilst sharing a caution about material reward, the 1992 and 1995 commentaries in the *People’s Daily* both endorsed the role of adequate civil service compensation as a precondition of minimizing corruption in modern China. Zhu Rongji, a heavyweight in the Chinese government, also argued that public employees should be given an adequate and fair, but not high, compensation. This distinction between adequate and high pay shows that there is still an egalitarian sentiment born of the Marxist–Leninist ideology. Civil servants should not be remunerated substantially higher than other job earners. But there are strong demands for pay rises in the public sector, not only for corruption control but also to realize a modern civil service system in China.

A turning point came in 1997 when the first pay rise for civil servants across the board came (Ministry of Personnel & Ministry of Finance, 1997). Six nationwide civil service pay rises between 1997 and 2006 were due to several factors, such as macroeconomic control and addressing pay inequality among the regions. In addition to such factors, using pay increments to reduce corruption is now also a crucial driving factor for pay rises in the Chinese public sector. The then Premier Zhu Rongji promised to double the salary of civil servants within three years (Singtao Daily, 6 March 2001). Modeled on anti-corruption experiences in both Hong Kong and Singapore, the premier seemed to be learning from the Emperor Yong Zheng, who had promoted the “yanglian yin” system in
the Qing Dynasty. More significantly, Zhu Rongji’s successor – Wen Jiabao (in office between 2003 and 2013) – introduced a reform parallel to the “huohao guigong” in the Qing Dynasty, whereby surcharges on the rural sector were regulated by the central government.²

The *People’s Daily*, later on, published some bolder, more articulated commentaries on the relationship between civil service pay and corruption. A party chief with a portfolio in corruption control in Shanxi Province argued for reforms, to improve the effectiveness of reducing corruption. He pointed out that the Chinese government should have in place a system of increased civil service pay, to safeguard a clean government. Thus civil service pay must rise in line with economic development. In addition, pay should be made adequate in order to attract and retain talent (Jin, 2003). In the same year, a senior cadre in the central government also wrote to the *People’s Daily* arguing for a system with adequate pay for alleviating corruption. He said that the central government should address the low pay of civil servants and state cadres in order to foster a clean and effective government (Peng, 2003).

In sum, the Chinese leadership has started to attach great importance to the role of civil service pay in alleviating corruption. Neither civil servants nor ordinary people object to adequate pay for corruption control. In 2009, Wen Wei Po, a Hong Kong-based pro-Beijing newspaper, published a piece on Tian Wenjing, who had endorsed a good pay for making civil servants honest and efficient in the Qing Dynasty. The piece discussed the role of Tian Wenjing in promoting “yanglian yin” and a clean government. It argued that when Governor Tian was awarded an extra yanglian yin amounting to 10,000 taels by the Emperor Yong Zheng, Tian declined to accept the payment, saying he already had good salary (Wu, 2009). The above piece concerning the link between public sector remuneration and corruption echoes some Chinese sayings. For example, “The gentlemen are concerned about justice, while the petty men are preoccupied with profits (*junzizhongyi xiaorenzhongli*).” This reflects the impact of Confucianism on modern civil service management in China, by stressing that public officials should pay more attention to justice than to material benefit. In addition, the state’s Socialist ideology contributes to the situation as it attaches importance to self-sacrifice and the like. In the early period of the PRC, asceticism, self-sacrifice, and

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² Eventually rural agricultural taxes were abolished in 2006 (see Kennedy, 2007; Li, 2008).
detachment from material world were rather emphasized. Even today the Chinese leadership still tend to pay lip service to these qualities.

The idea of “privileging high-ranking officials” in fact dominated in both ancient and modern China. This meant that senior officials should be respected and well compensated, with rank-and-file officials being educated to maintain a humble life with meager pay. The bureaucratic hierarchy itself was expected to play an instrumental role in motivating talented youths and gentlemen (junzi), and discouraging petty men (xiaoren) who cared about material interests, to join the government. In many inspirational stories from ancient China, senior officials were depicted as gentlemen who were concerned with spiritual rather than physical matters. Nevertheless the state compensated them by offering them substantial material benefits to improve their lives, while junior officials, the petty men seeking physical comforts, were punished.

Socialist China has complicated the above issue, as egalitarianism was a part of the Marxist–Leninist ideology. The CCP nonetheless inherited some governing techniques from those of ancient China, by in practice maintaining a hierarchical society. Therefore, if informal compensation such as cars or houses for senior officials is taken into consideration, civil service compensation today is highly in favor of senior public officials. Wu (2012), in a survey of extra benefits for senior state workers, reveals that internal pay inequality is very serious in China. The income gap between senior and junior civil servants has not been narrowed but widened in recent years.

**WORSENING CORRUPTION DESPITE INCREASED REMUNERATION**

The Chinese government has latterly made great efforts to improve public sector remuneration. The pay level has increased substantially. On a conservative estimation, real civil service pay now ranks 4th out of 19 job categories. Civil service compensation has become high both in absolute and relative terms. Coupled with substantial extra benefits, leading cadres earn a good salary while leading a good life.

Statistics on corruption in China nonetheless suggest a disappointing trend: many senior officials have been investigated and prosecuted for corruption since the mid-1990s (Gong & Wu, 2012b). For each corruption case, the sums involved have risen sharply over time (Yang, 2004). A survey on corruption severity in China among private entrepreneurs
between 2006 and 2007 reveals an alarming situation. 17.6 percent of private entrepreneurs stated that “hardly anyone [public official] is involved” in corruption, 63.1 percent of the respondents agreed that

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Figure 8.2a: Growth of “grand” corruption cases (%), 1998–2008

Source: Gong and Wu, 2012b, p. 198.

Note: Narrowly defined corruption includes graft, bribery, embezzlement, and misappropriation while broadly defined corruption includes all the above plus other types of power abuse such as nepotism, privilege seeking, and dereliction of duty.

Figure 8.2b: Growth of “major” corruption cases (%), 1998–2008

Source: Gong and Wu, 2012b, p. 199.
“some officials are corrupt”, while 19.0 percent of them thought that “most officials are corrupt” (Chen & Dickson, 2008, p. 796). China has suffered a surge of corruption in recent years (Johnston & Hao, 1995).

Furthermore, according to the China Procuratorial Yearbook, the number of “grand cases” (da an) of bribery, embezzlement, and the like in proportion to all prosecuted cases rose from 32 percent to 67 percent during the period 1998–2008, and “major cases” (yao an) increased from 4.9 percent to 7.4 percent in the same period (see Figures 8.2a, b). “Grand case” means that the case involves a vast amount of money. Currently, it refers to at least 50,000 yuan for bribery. “Major case” denotes the corruption case involving high-ranking officials (above the county level).

A newly-available large-scale dataset suggests a similar trend. This dataset covers all the corruption cases detected by the government and reported by the China Procuratorial Daily (jiancha ribao) between 2000 and 2009. In general, they reveal a steady increase in corruption cases over the period. The number of high-profile corruption cases, on average, was 251 in the period 2000 to 2004, whilst it increased to 310 between 2005 and 2009 (Gong & Wu, 2012c).

Figure 8.3: Number of reported corruption cases, 2000–2009

Source: Adapted from Gong and Wu, 2012c, p. 207.
Increasing pay to ensure a clean civil service seems to be a rather technical issue. It epitomizes the development of the Chinese bureaucracy and civil service governance. The Chinese government has waged an unrelenting war against corruption. Nevertheless, many issues pertinent to the association between civil service pay and corruption control remain ambiguous and inconclusive.

In the early period of the PRC, ordinary citizens surprisingly put up with the slogan “working for no pay” when most of them needed to make money for their families. Ordinary people suffered from both low pay and low consumption. They “voluntarily” advocated giving up material returns on their labor, which suggested that the controlling power of socialist ideology was omnipresent and formidable. Though people have gradually changed their minds in the post-Mao period, the attack on good pay for civil servants is still present today.

Internal pay inequality persisted for a long time over Chinese history. Egalitarianism paradoxically coexists with serious pay inequality in the PRC today, which makes the effectiveness of both corruption control and civil service motivation difficult. The practice of “privileging high-ranking officials” existed for more than a thousand year in China. Most public officials were viewed as magistrates’ personal secretaries or personal servants (Zhong, 2003). Thus the remuneration of public officials, up to magistrates, was always low. Privileging those appointed by emperors was the norm in ancient China. Learning from the Western, modern public administration, many foreign-educated returners to the ROC promoted an effective system of public personnel remuneration for low-ranking officials. But though good pay for civil servants was introduced, internal pay inequality remained serious.

Originally, it seemed that internal pay inequality could be addressed readily in Socialist China where a proletarian dictatorship prevailed. Under the orthodoxy of the Marxist–Leninist ideology, the social statuses of high- and low-ranking officials were comparable – all were “comrades”. It should be noted that internal pay inequality was serious as early as the founding of the PRC. Substantial extra benefits were provided to senior cadres to compensate their efforts in building a modern socialist country. This has become unbridled since the introduction of the market economy, as many public officials abuse their power to seize power.
“market opportunities” to enrich themselves (Gong, 2006). It appears that senior officials increase their personal gains while increasingly ignoring the remuneration of low-ranking civil servants. This leads to bad public governance at the grassroots level.

Why does better remuneration not lead to corruption alleviation in the country? Civil service pay is but one dimension of the intricate set of factors leading to corruption. Thus, we cannot expect increased civil service pay to deter corruption immediately after the pay increments. The probability of being caught for corruption is still very low in China. As Guo (2008) points out the latency period (the time lag between the commission and the detection of corruption) of corruption cases has grown in recent years. Guo generated databases A and B based on corrupt officials’ administrative rankings. In the period 1980 to 1988, the latency period, on average, was 1.80 years for database A and 2.19 years for database B. The period increased to 6.44 and 5.00 years, respectively, during the period 1998 to 2002 (Guo, 2008). The severity of the penalty for corruption, based on various accounts, seems not to be high in China. Therefore corrupt officials are emboldened to profit from wielding power.
A healthy civil service remuneration regime is central to facilitating any government agency to realizing its mission by recruiting and motivating civil servants effectively. Civil service pay is of significance to anti-corruption efforts, especially in the developing countries. Compensation is also important in maintaining a good government size and a good fiscal capacity by adjusting civil service pay according to the demand for and the supply of public services. A well-functioning civil service remuneration regime is instrumental in state-building and providing a high-quality public service. In China, developing a good civil service pay system was and is compounded by central–local fiscal relations, legitimacy change, ideological concerns, and a disjunction between state and non-state actors in making public decisions.

Central–local fiscal relations have an impact on civil service remuneration. Fiscal decentralization contributes greatly to post-Mao China's economic growth (Montinola, Qian, & Weingast, 1995). This decentralization also leads to a great variation of fiscal capacity at the local level. Thus the outcomes of various central policies depend on local governments’ actions or inactions. Although all of Chinese civil servants are defined as national civil servants, who take similar entrance examinations and have comparable job descriptions, they are compensated very differently. Like other recurrent spending such as social welfare provisions (Duckett & Carrillo, 2011), civil service compensation largely hinges on the fiscal capacity of local governments in China.

Viewed through the lens of fiscal decentralization, it is not surprising to observe the changes in civil service remuneration since the outset of the economic reform. Since local governments were encouraged to take the lead in both economic development and revenue generation, civil service remuneration was decentralized to local authorities at that time. Performance-related pay was introduced for the first time
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in 1985 to stimulate administrative innovation and improve government efficiency. This aimed to enhance bureaucratic capacity in order to promote economic growth. The second civil service pay regime, kicked off before the 1994 tax-sharing reform – which changed the "landscape" of central–local fiscal relations fundamentally – continued to decentralize remuneration power to local authorities. Several consequences followed. When base salaries were largely comparable across the board, performance-related pay, for example, was enthusiastically embraced as a high-powered incentive to civil servants for promoting economic development. Excellent performers in promoting economic development, such as attracting high investment, earned as much as 100 percent of their base salaries. The embrace of performance-related rewards had both positive and negative consequences. On the one hand, local governments could realize their goals such as having a high GDP growth rate. Revenue generation increased. On the other hand, this Chinese-style performance pay regime made colleagues compete with each other. Worse, civil servants sought to fulfill the tasks rewards were attached to while overlooking other essential public services.

The negative public reaction caused by performance-related pay was much less serious than that caused by the omnipresent pay disparities around the country. As a main source of public discontent, the pay gaps between civil servants captured the attention of both Party heavyweights and congresspersons in China. Some civil servants, especially those at the higher levels of government, were overpaid, but many civil servants at the grassroots level were not remunerated as stipulated by the central government. Pay arrears were widespread. Two of the most significant contributing factors to remuneration variation were the diverse fiscal capacity of local governments and dysfunctional central–local fiscal relations.

Without addressing the problem of central–local fiscal relations, it is impossible to have a well-functioning remuneration system in the Chinese public sector. The 2006 equal pay policy recentralizes pay setting across the board, with performance-related pay coming to a screeching halt. The central government’s determination to centralize pay setting has been backed up by two factors. First, the central coffer has been increasingly affluent since the 1994 tax-sharing reform, whereby the central government claims lucrative and easily-collected
taxes. Relatively poor local governments are left with a combination of stagnant revenue and an astonishing growth of expenditure needs. Thus, the central government can leverage financial resources to require local compliance with central policies. Second, legitimacy change with an emphasis on both welfare spending and public sector remuneration mitigates the resistance of several pay enhancements and paves the way for centralized pay determination. The ideology of the rational low wage dominated for several decades in China. It was not until the late 1990s that this ideology was lifted (though this is not indicated in official discourse). The debate about civil service remuneration still is going on; there has been a growing consensus about pay increments in recent years. The above two factors contribute to both aggressive civil service pay rises starting in 1997 and a significant recentralization of remuneration power in the public sector.

Civil service remuneration in the West often captures the headlines. By contrast, compensation in the public sector in China has remained only known to public personnel managers for decades. Pay setting, ruling out the possibility of bargaining between trade unions and employers, rests with the executive branch of the Chinese government. Like the organizational departments of the Party, the personnel departments of the government in China are one of most mysterious departments.

**KEY FINDINGS**

In addition to the relationship between fiscal decentralization and civil service pay, we have following six findings.

1. First, four civil service pay reforms in the PRC were driven by both micro- and macro-factors. Civil service pay, as in most countries, serves public sector motivations. But although some in the Chinese leadership recognized the importance of civil service pay, many others, especially Party conservatives, preferred using non-wage instruments to motivate cadres. The misunderstanding of the role of civil service remuneration was widespread; thus ordinary wage earners welcomed a slogan like “working for no pay” and even demanded abolishing the pay system, which was depicted as the root of the erosion of proletarian enthusiasm. Egalitarianism and informal remuneration coexisted before the early 1990s. Though criticism of cash-based remuneration itself faded away in the 1990s when the Chinese government embraced
the market economy, the sensitiveness of income distribution has not declined.

Macro factors also matter. As a part of macroeconomic management, the public sector wage bill is critical to the success of both public sector cost containment and fiscal management. In some developed countries, the public sector pay bill constitutes more than 50 percent of public recurrent spending (55 percent in the United Kingdom, see Elliott et al, 2005). The share was 60–80 percent for county governments in China.

Though formal civil service pay was low before the early 1990s, grade creeping and the upgrading of government departments’ positions posed a great threat to civil service pay management and, more broadly, fiscal management. The decentralization of civil service pay management since 1993 seemed to diversify the risk caused by an increased pay bill through holding local governments accountable for their wage management. In the meantime, fiscal decentralization, which gave leeway to local governments in managing public money, facilitated local fiscal profligacy in practice. While some civil servants strove to keep their heads above water, overpayment to other civil servants was pervasive around the country. It put great pressure on macroeconomic management, as the wage bill was the largest item of recurrent spending in the public sector.

(2) Second, the equal pay policy was introduced in 2006, which had a significant bearing on civil servant motivation in the coming years. The impact of the equal pay policy on civil service performance remains an open question. The policy is not related to equal compensation between men and women, but to equal remuneration between civil servants. As stipulated by the central government, civil servants with similar seniorities and positions should earn the same in any city, and the regional pay gap between civil servants pay should be reduced substantially.

Human resource management practices suggest that proper pay differentials between senior and junior civil servants are instrumental for an effective motivation system in the public sector. However, an excessive pay gap generates a disincentive for civil servants to perform better. The worldwide financial crisis from 2008 revealed huge pay disparities between senior positions and junior ones, even in the private sector, and this attracted heavy criticism. In China, hostile sentiments toward pay disparities within the bureaucracy had existed for a long time, which was
complicated by the Communist ideology. When a technical issue turned into a political one, the civil service pay gap was viewed as a hurdle to the social harmony between civil servants and ordinary people, between urban and rural citizens. Also, pay disparities were handled in a top-down fashion with little attention paid to the negative consequences of the reemergence of egalitarianism in public sector remuneration.

The implementation of public sector remuneration involves a very intricate situation in China’s local government. Civil service pay, on average, has been improved. Nevertheless, pay arrears are widespread, because civil servants at the county level are compensated at a rate lower than the pay levels stipulated by the central government. The 2006 equal pay policy aimed to address horizontal pay disparities between government departments in different regions. But vertical pay disparities between the tiers of government have continued to expand, as central and provincial governments by and large enjoy pay rises, with lower governments such as county governments being unable to compensate all civil servants in their jurisdictions as stipulated. Worse still, pay arrears are juxtaposed with widespread bureaucratic expansion, as local leaders can profit from an expanded public employment.

The implementation problem has profound implications for local public finance, as expenditure needs, especially civil service pay and social spending, soar over time. The central mandate on public sector remuneration aggravates the fiscal difficulties at the local level. Also, pay arrears have a woeful impact on civil service motivation. Simply put, low pay may lead to increasing corruption at the grassroots level.

(3) Third, Chinese public sector pay has been recentralized over the past decade. The current pay system, against an international backdrop of decentralized pay, has swung back to the system before the onset of economic reform in 1978. In an ever-changing and globalizing society, the Chinese government has many good reasons to adopt a decentralized pay system, whereby local governments and government departments could develop their pay schemes with the central government being responsible for overall management. For instance, civil servant motivation, administrative reform, and transparency enhancement – all of them are imperative in China – require a flexible and decentralized pay system. Such a decentralized pay setting could encourage administrative innovations and clarify organizational goals. The central government
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has resorted to the restoration of centralized management in its attempt to curb excessive pay disparities. I argue that this is hitting the target but missing the point. Though pay disparities may be reduced, pay setting centralization has a significant, negative, impact on civil service motivation and on civil service governance at large.

It should be noted that reducing excessive pay disparities by the central government does not lead to the desired goal. Though the equal pay policy curtails some formal pay disparities, informal compensation still grows in an unbridled fashion. Perhaps more importantly, vertical pay gaps within the bureaucracy with senior cadres being offered substantial extra benefits have continued to grow. As suggested by some anti-corruption theories, internal pay inequalities do no good to government integrity (Wu, 2012).

The root cause of excessive pay disparities among civil servants and of local fiscal prolificacy is the dysfunctional fiscal management system in China. On the one hand, local governments have no power to create or impose new taxes at the local level. Rather, the central government monopolizes the power of taxation. Local governments, on the other hand, enjoy substantial leeway in using public money. Therefore, self-serving behavior such as pay increments for civil servants were and are widespread in China’s local government. The solution to this ill-functioning fiscal management lies in a restructuring of the central–local fiscal relationship and in an improvement of the local administrative system.

(4) Fourth, “performance-related pay”, linking remuneration to performance, has suffered a great setback in recent years in China. The Chinese government started to introduce performance-related remuneration in 1985. With the encouragement of the central government, a variety of pay-for-performance schemes were promoted by local governments. There were two types of these schemes: routine pay for performance and project-based pay for performance. The former refers to the system connecting civil service pay to civil servant performance in conducting routine work. The latter links up civil service remuneration with such things like the achievements of attracting investment, collecting government taxes, and accomplishing key construction projects in the promotion of economic development. The amount of project-based pay for performance is quite eye-catching in China today. The share of performance-related pay in the total wage ranges from 10 percent to 20
percent in OECD member countries. By contrast, in China excellent performers in accomplishing some important tasks can receive performance-related pay as high as 100 percent of their base pay.

This Chinese performance-linked pay scheme is not immune from criticism. Assuming that favoritism prevails in the government, good pay for rewarding performance may be employed for advancing favoritism and nepotism. Substantial compensation for accomplishing tasks also causes resentment, because the general public tends to think that civil servants should do their jobs without extra compensation. Perhaps more importantly, similar to the situation in some neighboring countries (see the Korean experience, Kim (2002)), China’s traditional egalitarian culture has a negative impact on the development of pay-for-performance.

The abrupt recent retreat from performance-related pay due to the equal pay policy has led to two unexpected consequences. First, though the central government requires abolishing performance-related pay and advancing “equal pay for equal work” around the country, local governments still have to motivate their civil servants by tempting incentives in order to accomplish important tasks, such as attracting investment, which are actually blessed by the central government. Performance-related pay still exists in disguised forms in reality and will continue to do so in an unregulated fashion. Second, a remuneration system which cannot identify and reward good performance stunts the development of an efficient and effective administrative state in China. For a country aspiring for modernization, the improvement of public administration and governance is imperative. Pay-for-performance, in a sensitively moderated form, is a crucial tool to motivate civil servants around the world. The Chinese government’s retreat from pay-for-performance may not be a smart move.

(5) Fifth, the pay level of civil servants has increased gradually over the past 15 years. Pay level is an oft-debated topic in China because it is related to income distribution but also to the costs of public service delivery. Two factors bear heavily on civil service pay level. First, both the Communist ideology and traditional culture matter. As an encompassing state (Chan & Ma, 2011), the Chinese government was and still is striving to “let everyone have a meal to eat” (Takahara, 1992, p. 44). Thus civil service pay should not be set high compared with other wage earners. The pay gap between urban public workers and
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rural peasants also should not be large. But maintaining a small pay gap between wage earners in urban areas and peasants in rural areas is not easy. Nevertheless, under an encompassing state, policy makers fix the pay levels of different job categories before improving civil service compensation – although in reality this may not be actualized or may be circumvented by local governments. Second, balancing production and income distribution often leads to an overemphasis on production, with the income of public workers being restrained. Increasing production capacity has been the top priority of the Chinese government since the planned economy began. The reasons behind this are complex and multifaceted. It was once projected that the Chinese citizen could have a decent life only after 2000. Before that, wealth accumulation rather than wealth distribution had to be the top priority. A heavy emphasis thus was put on economic development for several decades after the founding of the PRC.

This model of development, with an overwhelming emphasis on wealth generation, resulted in great public discontent. People needed tangible benefits rather than empty concepts and a GDP growth with declining benefits for ordinary citizens. In the Hu–Wen regime (2003–13), the central government introduced the concepts of both “scientific development” and “the harmonious society”. The rationale behind these concepts was that the rule by the Communist Party should have at its heart welfare enhancement not economic growth. The new legitimacy model that appeared in the late 1990s attempted to bring social justice back in. An assertive role for the state in income distribution has been emphasized in recent years. In terms of public spending, the central government calls for a priority given to public sector remuneration, pensions for retired personnel, and basic allowances for workers laid-off from state-owned enterprises. Though the new legitimacy model places great weight on benefits for public officials and retired workers, this change bids farewell to the previous ideology-laden public sector remuneration.

(6) Sixth, civil service remuneration can be examined through a historical perspective. Concerning civil service pay and corruption control, there are some intriguing similarities and differences in public sector management between ancient and modern China. The traditional theory states that civil service pay only serves to release public officials from agricultural production. Thus, civil service pay should be comparable
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with peasant income. This pay parity principle dominated in ancient China though some Emperors improved the salaries of public officials in a bid to meet social demands.

Magistrates needed to involve themselves in public businesses to sustain their own living standards. Low pay put public officials in a dilemma: to provide minimum public services while living frugally; or to promote public services ambitiously while extracting resources illegally from ordinary people. Some officials were corrupt not only because of greed. The “yanglian yin” and the like were practiced by the Emperor Yong Zheng and other rulers. The amount of “yanglian yin” could be 100 times over the normal pay magistrates received. “Yanglian yin” actually covered public spending on the part of public personnel, for entertainments, and for public infrastructures.

This study suggests that both bureaucratic expansion and serious inflation diluted the policy of using adequate pay to ensure a clean civil service. Thus, though some high pay for public workers occurred in ancient China, low pay was the norm in pre-20th-century China. During the several decades of turmoil in the first half of the 20th century, many reformists, some of whom had trained in Western countries, promoted an “appropriate” pay system for a modern civil service system in China. However, changing the low wage mind-set and system proved to be more difficult than expected.

Low pay revived in the early period of the PRC. Its socialist ideology, coupled with Chinese tradition, put a high pay system under attack and gave rise to the rational low wage policy, which lasted for several decades. The 1990s saw some new thinking on civil service pay and corruption control. This study provides some “thick” understanding of civil service management in China through investigating pay and its role in corruption reduction from a historical perspective. The linkage between historical memory and modern practice should be explored further. This study suggests that building a modern civil service remuneration system in China will be more challenging than some expect.

THEORETICAL IMPLICATIONS

Many assume that the making and implementing of civil service remuneration are black box secrets, entirely controlled by both bureaucrats

1. Some local officials still face this dilemma today.
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and Party cadres in China. It is thought that decision-making by the Chinese government, especially related to the functioning of the bureaucracy, tends to be conducted in a top-down, centralized, and mechanistic manner. Civil service remuneration is a good “touchstone” for this. Little is known about the inner bureaucracy of China, especially in the fields of public finance and civil service remuneration. An executive-led model has governed public sector compensation in China for several decades. Nevertheless, this study reveals that in fact no formal control system can dominate public sector pay regimes in China. Various players including non-state players interact to create trade-offs touching on several important issues, such as remuneration level, the priority of public spending, and income distribution over the whole.

The delegation issue, as an integral part of governance theory, has been tested in the area of Chinese public sector remuneration. In the early period of the economic reform, the central government almost devolved all powers to local governments, as the central leadership believed that more decentralization led to more responsibility and better performance. But because the wage bill was a macroeconomic management indicator, the central government remained cautious towards a full decentralization of public sector remuneration. Nevertheless, except for some important issues such as pay structure, local governments enjoyed substantial, de facto autonomy in public sector remuneration at that time. A minister in charge of civil service management in the PRC then recalled that a number of Western-style practices in cadre/civil service management were introduced into China after the onset of economic reform (Hou, 2007). Performance-related pay was one of them. Local governments introduced some good practices to improve civil service motivation. Though some local governments displayed self-serving behavior, in general they abided by the regulations on civil service remuneration in the 1980s.

The situation became greatly complicated after the national government formally announced market reforms in the early 1990s. Chasing profits became a dominant concern of both the business sector and the public sector. Government-controlled competitive economic entities sprouted up alongside the country’s socialist ideology. Decentralized civil service remuneration was soon utilized by local governments, especially those with a good revenue-generation capacity, to enhance
employees’ benefits. Thus though civil servants performed similar functions in any given city, they were compensated substantially differently.

As people became increasingly annoyed by wage mismanagement in the public sector, income distribution/redistribution became a prominent concern among both the general public and decision-makers from the late 1990s. In many national surveys of perceptions of public policy, income distribution stood at the top of the serious concerns of the Chinese people (Wu, 2010). People were dissatisfied with poor compensation for peasants and factory workers and had hostile sentiments towards relatively well-compensated civil servants. The overpayment issue in some regions and some government departments came to the front of debate in People’s Congresses at various levels. These debates were viewed as an important platform for discussing top national concerns and setting the agenda for further administrative reforms. Ordinary people, some disgruntled civil servants, congresspersons, and senior public managers all came together to exert influence over the reforming of public sector remuneration.

In order to address the delegation issue, the central government retained its remuneration power. However, governance theory indicates that the recentralization of public sector remuneration may not be the right direction to take. Various actors can thwart the central policy, as appropriate public sector remuneration is always central to a well-functioning civil service system and a modern administrative state. State actors at the local level may develop some countermeasures while non-state actors may utilize official channels such as people’s congresses and alternative channels, including online platforms, to express their concerns. Increased pay differentials and performance-linked pay will still exist at the local level. Debate and disagreements around civil service remuneration and income distribution will not fade away in the near future. The future direction of these issues rests on interactions between central and local governments, senior officials and rank-and-file ones, civil servants and other wage earners. The Chinese experience attests to the intricacies of public governance in a transitional country.

POLICY IMPLICATIONS

This study has the following five policy implications.

(1) First, pay management should be devolved to local levels so as to
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match diversified living costs and management requirements in different localities. As noted by Migdal (1977), “Centralization and decentralization are not a zero-sum relationship. A shift towards decentralization does not entail an explicit denial of the elements of the macro-sociological model that emphasizes the need for political centralization” (p. 257). Hoggett (1991) also suggests that decentralization at the operational level may not lead to the decline of central control. On the contrary, the central government can enhance its capacity at the strategic level. For pay setting, local governments’ gains may not be central government’s losses. Combining the strengths of both central and local governments could be a win-win situation, because the central government is good at stabilizing macroeconomics while local governments are skilled in daily management. In addition, as suggested by governance theory, it is desirable to replace “control” with “influence” in terms of exercising power (Xue & Liou, 2012). The central government can still exert influence on local governments through fashioning macro plans in civil service management.

In the ideal remuneration system, the central government is responsible for macro-management; namely setting the pay structure, nationwide, for civil servants, and prescribing the pay ceiling for government organizations. Local governments determine the pay rates in their jurisdictions. The approval from higher authorities on pay scales is not necessary if wage bills do not exceed an agreed limit.

(2) Second, the horizontal collaboration between public personnel departments and fiscal departments must be strengthened. Pay packages were not well integrated into the government budget for several decades after the founding of the PRC. Government departments in charge of public sector pay management and fiscal management did not work together, although remuneration is a fiscal issue by nature. It is only in recent years that bureaucrats in charge of pay and fiscal management have begun to work together in formulating pay policies. Nevertheless, disputes over the authority over public sector remuneration still occur. The Ministry of Personnel (now the State Administration of Civil Service) has been in charge of public sector remuneration for decades.

2. Both overspending on public sector remuneration and government deficits may pose a threat to macroeconomic stabilization. Thus, the central government may lay down the guidelines for fixing the ceiling of the wage bill.
But being the largest share of recurrent spending, public sector pay is actually endorsed and appropriated by fiscal departments. Fiscal departments have information about the number of government employees, detailed data related to actual public spending, and spending needs in a given year. Thus, it would be helpful to put the Ministry of Finance in charge of public sector remuneration. This change would also improve the budget control in general.

Public sector remuneration should be under the scrutiny of a politically appointed body, which could reflect state and non-state actors’ concerns about wages for public sector workers and about income distribution in the society at large. Drawing on a developed context (such as the United States), Pounian and Fuller (1996) point out that public sector remuneration in general requires an endorsement from politically appointed bodies such as legislative councils. In addition, with the rise of public sector labor unions in many countries – for example in the United States (Reilly, 2012) – the approval of legislative bodies would be essential to an effective civil service remuneration system.

(3) Third, formal pay differentials should be broadened while civil service remuneration should be monetized. In the Chinese situation, formal pay differentials are narrowed with local governments ironically coming up with various informal pay schemes to compensate employees, especially those holding leadership positions. The combination of narrow formal pay differentials and generous non-wage remuneration is a great impediment to a well-functioning public sector compensation system. International public sector remuneration practices suggest that narrowed pay differentials harm the government’s ability to recruit talent and motivate good performers. Meanwhile, informal pay schemes pose a real threat to pay management and even budget control in China. Pay differentials thus must be enlarged to incorporate the contribution of different employees, with different local pay schemes being monetized and transparent.

Excessive internal pay disparities should be curtailed. When asked whether leading cadres at various levels are living too well, many people would say yes. Pay differentials should be promoted in a bid to motivate civil servants, while extra benefits to senior cadres should be reduced. This would have fundamental and positive implications for corruption control in a transitional country.
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(4) Fourth, “performance-related pay” should be brought back. Well-regulated performance-related remuneration would be instrumental in motivating civil servants. It is too early to disconnect remuneration from civil service performance in China, where encouraging civil servants to work hard is still a big challenge. Both a modern civil service system and an administrative state are imperative to this transitional country. In addition to bringing back pay-for-performance, the Chinese government would of course have to carefully regulate the implementation of this modern compensation practice.

(5) Fifth, a comprehensive and fundamental reform of the fiscal system should be carried out in order to adjust the incentive mechanisms at work in local governments. Civil service pay is closely related to central-local fiscal relations in China. Thus the reform of the fiscal system is a prerequisite to a well-functioning civil service remuneration system. In the short run, the central government should limit the issue of new mandates such as civil service pay raises nationwide. Adjustments to the civil service pay level must be conducted by local governments in response to changing socioeconomic factors. At the same time, the fiscal discipline of local governments should be strengthened. A vicious circle has recently been formed. On the one hand, the central government encroaches on local autonomy through increasing central mandates. Civil service pay raises are one of those, with a significant impact on local governments. On the other hand, local governments increase their fiscal profligacy. Overpayments to civil servants cause great public anger. It is imperative to make both central and local governments responsible for their differentiated fiscal behaviors.

In the long run, the Chinese government should make clear the different roles and responsibilities between different tiers of government, and consider the resource constraints facing them. More broadly, as Cheung (2007) argues, “institutional guarantees” to local governments are crucial for managing well-functioning intergovernmental relations (p.259). Long-term and rule-based budget autonomy should be granted to local governments, while improving bottom-up monitoring and control.

THIS STUDY’S CONTRIBUTION AND LIMITATION

This study has made a contribution related to both public sector remuneration and public finance in China. This is the first attempt to
systematically review the civil service pay system in China. Public sector remuneration in China, despite its importance to the government fiscally and politically, is an under-researched area. Previous studies on public sector remuneration generally share a human resource management perspective. That is, grading systems, within-grade salary increases, and pay structure evolutions are the research foci. This study puts an emphasis not only on human resource management but also on broader aspects, such as the centralization and decentralization of pay determination, income generation and distribution in a transition economy, legitimacy enhancement, and different players’ struggle for resources and recognition in a developing country. Recent developments in administrative reform, regime legitimacy, income distribution, and using good pay to curb corruption in China have been investigated. This study can contribute to a better understanding of big issues such as intergovernmental relations and the political economy in China.

The most salient limitation to this study is that the heterogeneity of China’s administrative systems renders this study not applicable to the whole country, where some areas may have different remuneration practices, although the central government has in recent years recentralized pay setting.


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