

Holz, Carsten A.

**Working Paper**

## Wage determination in China during the reform period

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Carsten A. Holz

## Wage determination in China during the reform period



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## Abbreviations

bn	Billion
CPI	Consumer price index
FIEs	Foreign-invested enterprises
FM	Finance Ministry
GDP	Gross Domestic Product
HRSSM	Human Resources and Social Security Ministry
LM	Labor Ministry
LSSM	Labor and Social Security Ministry
mio	Million
NBS	National Bureau of Statistics
NPC	National People’s Congress
SASAC	State Asset Supervision and Administration Commission
SC	State Council
SOEs	State-owned enterprises
SOSCEs	State-owned and state-controlled enterprises
SPC	State Planning Commission
ULC	Unit Labor Costs

Carsten A. Holz

## Wage determination in China during the reform period

### Abstract

The purpose of this paper is to ascertain how wages are being determined in China during the reform period. The paper focuses on the development of the regulatory framework since 1978 and proceeds by examining official regulations regarding labor market institutions and wage setting, and by evaluating their potential implications for actual wage setting.

**JEL codes:** J3, J30, J31, J4, J41, J45, M5, M52, M54, M55, P2, P23

**Keywords:** wage determination, labor market institutions, minimum wages, wage classification system, wage level and structure, labor contracts, collective bargaining, public sector wages, wage-performance link

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This paper is the result of a project on wage determination in China begun as Visiting Researcher at the Bank of Finland Institute for Economies in Transition (BOFIT) in June 2013.

I am very grateful to BOFIT for hosting me, and to participants at a BOFIT seminar for discussions that shaped the project. Participants at the 5<sup>th</sup> International Symposium on Human Capital and the Labor Market in Beijing on 15 December 2013 provided further feedback. The project was motivated by earlier work on labor market institutions for the joint project with Aaron Mehrotra “Wage and price dynamics in Mainland China – Are there implications for global inflation?”

# 1 Introduction

Chinese wages are a major determinant of the competitiveness of Chinese products abroad. Studies suggest that as wages in China rise, countries such as Indonesia, Vietnam, and Bangladesh benefit by increasingly taking up China's market share of low-end manufacturing imports in the United States, a share that is reported to have peaked and to now be declining.<sup>1</sup> One source predicts widespread factory closures or reductions of production in Guangdong factories following minimum wage increases. Counterarguments run that China's infrastructure and mass of workers ensure that China will remain a major producer of low-end manufacturing exports. Cheaper workers could perhaps be found elsewhere – with China's minimum wage levels four times greater than in other places in South and South East Asia – but not the scale of the labor force that is available in China.<sup>2</sup> Wage rises may also cause price rises domestically, which in turn could influence future wage agreements. The outcome is a wage-inflation spiral that is of immediate relevance to monetary policy.

The issue of competitiveness is typically expressed in terms of unit labor costs (ULC), i.e., wages relative to real labor productivity.<sup>3</sup> Figure 1 summarizes the economy-wide development of ULC with a breakdown into the numerator (wages) and the denominator (real labor productivity). Comparing trends, the rapid increase in ULC in the first half

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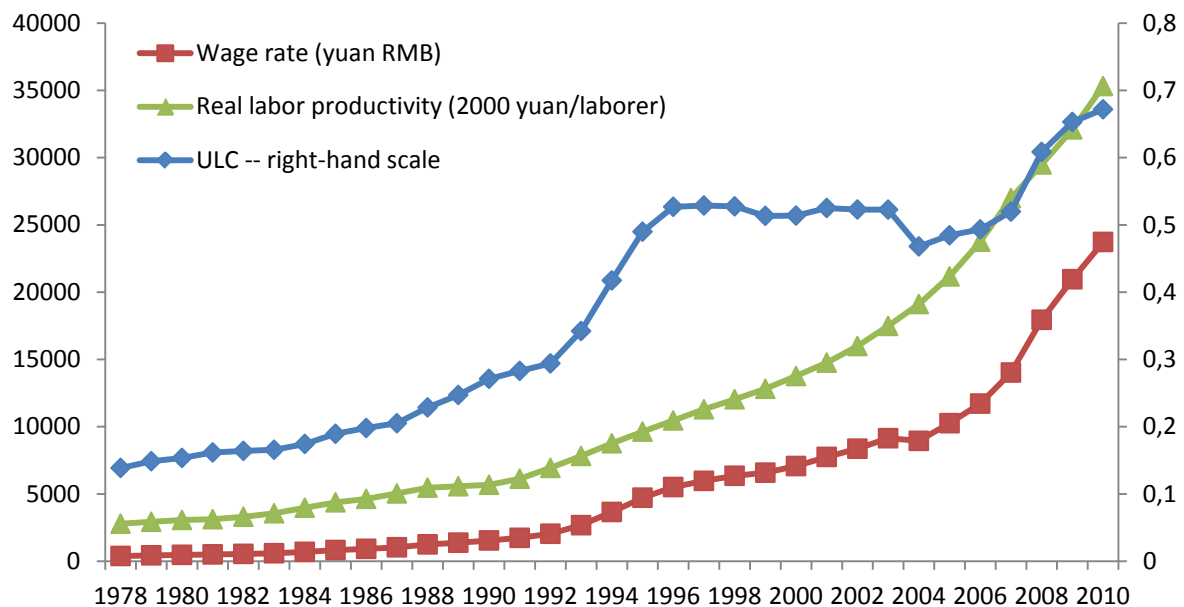
<sup>1</sup> According to a survey by the American Chamber of Commerce in Shanghai released in early 2011, 85 of the companies that responded believed that rising (labor) costs are hurting China's competitiveness compared with other developing countries. The source does not state how many companies responded, and does not identify the precise report. ("China Ups Minimum Wage As Inflation Persists," 27 January 2011, The China Post, <http://www.chinapost.com.tw/print/289231.htm>, accessed 17 December 2013)

<sup>2</sup> See, for example, "China Labour Costs Soar As Wages Rise 22%," 25 October 2011, Financial Times; "China Minimum Wage Up by 21.7% Despite Economic Cooling," 25 October 2011, BBC, <http://www.bbc.co.uk/news/business-15456509>, accessed 8 December 2011; "Minimum Wage Hike Coming to Guangdong, the World's Factory," 10 November 2011, Global Post, <http://boingboing.net/2011/11/10/minimum-wage-hike-coming-to-gu.html>. A news item in the Financial Times (3 June 2013) titled "China Plans Multimillion Ethiopia Investment" reports on plans by Huajian, one of China's largest shoe exporters, for a multimillion dollar factory expansion in Ethiopia as "a sign that Chinese manufacturers are starting to move to Africa to benefit from preferential trade tariffs and lower labour costs." The company opened its first factory in Addis Adaba a year earlier. In the academic literature, Banister and fellow researchers in a number of publications document the rise in Chinese labor costs and compare them to U.S. labor costs (Banister, 2004; Lett and Banister, 2009; Banister and Cook 2010). Yang, Chen and Monarch (2010) conclude that China's manufacturing wage has already converged to that of Asian emerging markets, but that China still enjoys enormous labor cost advantages over its neighboring developed economies.

<sup>3</sup> Ceglowski and Golub (2011) ask if China still has a labor cost advantage and conclude that China's ULC have been rising since 2003 but remain low relative to those in most other countries. Depending on data source, in purchasing power parity terms, China's manufacturing ULC were 33 percent of U.S. ULC in 2009 or 68 percent in 2008.

of the 1990s appears driven by a rapid increase in the wage rate; conversely, when the increases in the wage rate abate in the second half of the 1990s and the first half of the 2000s, ULC are flat. The slight fall in ULC in 2004 is due to a fall in wages, which in turn is due to a statistical break.<sup>4</sup> After 2004, wages again rise faster than real labor productivity, and ULC thus pick up.<sup>5</sup> Real labor productivity follows a steady trend over time. It is wages whose growth rates fluctuate significantly and thus lead to the variability in ULC over time, rendering wage determination of particular interest for China's competitiveness.

Figure 1 Unit labor costs and their decomposition



Wages are labor remuneration in the income approach to the calculation of GDP (summed provincial labor remuneration as share of summed provincial income approach GDP, times national production approach GDP), divided by the number of laborers. The 2008 value of ULC is based on the arithmetic mean of the 2007 and 2009 ULC share of (summed provincial) labor remuneration divided by (summed provincial) income GDP. A statistical break occurs in the labor remuneration series and thereby in ULC in 2004 and in 2009.

Sources: *Statistical Yearbook* (numerous issues for the income data, and the 2011 issue for the production approach data (pp. 44 and 47)), *GDP 1952–1995*, and *GDP 1952–2004*. The number of laborers (used in the derivation of the wage rate and of real labor productivity) of the years since 1990 is from the *Statistical Yearbook 2011*, for the years prior to 1990 from Holz (2008b).

<sup>4</sup> The wage data are calculated as economy-wide labor remuneration (one of the components of income approach GDP, or national income) divided by the number of laborers. Income components were redefined in 2004 (causing a fall in labor remuneration) and in 2009 (then contributing to a rise in labor remuneration) (Bai and Qian, 2010, and Qian, 2013).

<sup>5</sup> A re-definition of labor remuneration between 2007 and 2009 and missing data for 2008 are handled, somewhat imprecisely, by assuming the 2008 share of labor remuneration in income GDP to be the arithmetic mean of the 2007 and 2009 values.

Wage rate determination in China is also relevant in other contexts, such as the use of the Cobb-Douglas production function to analyze developments in the Chinese economy. Growth accounting based on the Cobb-Douglas production function needs to assume perfect competition in order to replace output elasticities by factor shares. But if labor isn't paid its marginal product, i.e., if wages aren't market determined (or, just possibly, state-determined at the level of the marginal product value), growth accounting cannot be applied to China.<sup>6</sup>

Since Bian's (1994) monograph on wages and inequality in China, the topic of wage determination seems to have disappeared from researchers' radar screens. A comprehensive institutional analysis of wage determination in China during the reform period is as yet missing. What exists is research on specific wage issues, addressed in the following section, as well as overviews of labor market institutions. The overview literature includes recent literature (for example, Meng, 2012; Cai, Park and Zhao, 2008; Naughton, 2007; Yueh, 2004) and an earlier, lengthier treatment by Meng (2000).

A range of literature discusses Chinese wage findings without, however, delving into the possibly underlying institutional details. For example, Knight and Ding (2012), based on household survey data of 1988, 1995 and 2002, find considerable wage segmentation in China by province, by type of ownership, and by profitability of enterprise. Could the impact of locality, ownership type, and profitability possibly be the result not of market forces but of state regulation? Another example is Ge and Yang (2014), who provide a summary overview of wage changes by decomposing urban household survey data of the years 1992–2007. In one decomposition, 80 percent of the 202 percent increase in average real wages during this period is attributable to higher pay for basic labor, rising returns to human capital, and increases in the state-sector wage premium.<sup>7</sup> Could the higher pay for basic labor and the state-sector wage premium possibly be driven by state regulation?

In the broader, macroeconomic literature on China, wage formation is typically not a topic of interest. The process of aggregate wage formation may appear far too complex to take into consideration. Wages may implicitly be assumed to be market-determined, or an assumption may be made that wages in state-owned enterprises are higher than in private enterprises.

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<sup>6</sup> Groshen (1990) further points to the importance of understanding wage determination for understanding income distribution, poverty, consumer spending, and the perpetuation of inflation.

<sup>7</sup> Within the aggregate production function framework they find that capital accumulation, export expansion, and skill-biased technological change are the primary forces behind the recent wage explosion.



Of key interest in this paper is specifically this complex process of wage formation: how are aggregate wages being set in China? To that end, the paper delves into the institutional framework of wage determination in China. It proceeds by examining official regulations on labor market institutions and wage setting, and by evaluating their potential implications for actual wage setting. The aggregate wage level is the outcome of a great multitude of institutional and possibly other factors. This paper attempts to capture the key institutional features that shape the aggregate wage level in China.

Section C describes the evolution of the labor contract system, which frames the possible choices for wage determination. Section D defines wages and introduces the traditional wage classification system and its key reform stages. Section E traces the evolution of the traditional wage plan system. Sections F and G discuss changes in wage-setting institutions for enterprises vs. state organs and administrative units. Section H elaborates on minimum wage regulations.

## 2 Related literature

A large literature addresses microeconomic aspects of wage determination, i.e., the determination of wages for specific types of jobs or workers. This includes inquiries into the impact of education and other personal characteristics on wages, the impact of enterprise profitability on wages, and non-labor market innovations and their impact on wages. Literature on the macroeconomic aspects of wage determination, i.e., the factors that affect aggregate trends in wage levels, appears to be largely absent; the one aspect that has been covered is the question of if the Lewis turning point has been reached in China.

The impact of education levels and other personal characteristics (such as age, migrant worker or urban household registration status, gender and Party membership) on wage levels is typically measured in Mincerian regressions. Several dozen research papers explore this topic for China and are summarized, among others, in Naughton (2007) and Cai, Park, and Zhao (2008). Thus, for example, returns to an additional year of schooling in China were below world average through the late 1990s, but starting in 1999 reached levels above the world average. The primary purpose of such analysis is to determine the cause of wage differentials, more than to determine the general wage level. An increasing aggregate level of education combined with positive returns to education implies rising labor costs, but that is typically not the topic of Mincerian regressions.

Knight and Li (2005) contrast the efficiency wage theory with a theory of profit-sharing, and then proceed to estimate wage functions with dummy variables for loss-making and for profitable enterprises in 1995 and 1999.<sup>8</sup> Standardizing for worker characteristics, workers in profitable enterprises in 1995 earned 21 percent more than those in loss-making enterprises, and in 1999 41 percent more. In 1995, the component ‘other income’ (especially bonuses) was most sensitive to profitability, but by 1999 it was basic income that was most sensitive. The authors surmise that this may in part be due to loss-making enterprises being unable to pay even contracted wages. Knight and Li treat profit-sharing as a manager’s choice. They do not delve into the labor market regulations that show profit-sharing to occur on government orders. Similarly, by the late 1990s bonuses – on government orders – had been successfully folded into basic wages and it is thus not astonishing that by 1999 basic income (more than disappearing bonuses) was sensitive to profit.

Various institutional changes unrelated to the labor market impact on wages. For example, reforms to the household registration system – a cause of labor market segmentation – that facilitate the acquisition for rural citizens of an urban household registration will likely lead to higher wages. While urban workers with urban household registration may not hold the same occupations as migrant workers do in urban areas, one study finds that the returns to education are much higher for urban workers with urban household registration than for urban workers with migrant worker status (Lu and Song, 2006).

Another aspect is market access. De Sousa and Poncet (2007), using a dataset of 29 provinces in the years 1995–2004, find that most of the wage increases experienced by Chinese provinces correspond to a national phenomenon, in their view possibly pertaining to productivity growth and price rises. The impact of province-specific forces, such as improved access to markets and intensified gross internal migration, though statistically and economically significant, is of less importance. On the other hand, Hering and Poncet (2010), based on a 1995 survey, find that a significant fraction of the inter-individual dif-

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<sup>8</sup> According to the efficiency wage theory, managers pay employees more than the market-clearing wage in order to increase their productivity (through less shirking, minimizing turnover, adverse selection, etc.), which then pays for the higher wages. In contrast, the profit-sharing hypothesis suggests that managers simply share profits with workers. Knight and Li argue that in the early stages of Chinese SOE reform there was little managerial authority and it was therefore pointless to pay efficiency wages as a disciplinary device. On the other hand, relating wages to profits may have provided a group incentive to laborers. Later, managers acquired more autonomy and the efficiency wage theory may have become more relevant.

ferences in returns to labor can be explained by the proximity to markets. This also implies that the national average wage may depend on the geographic distribution of laborers.

Enterprise ownership forms and changes in the relative shares of different ownership forms in output may impact on wages. Thus, Liu, Xu and Liu (2004) find that wage-related standards are higher in foreign-invested enterprises (FIEs) whose home countries' standards are higher, after controlling for other influences. This is inconsistent with a 'race to the bottom,' downward wage pressure hypothesis; FIEs take the home country's standard as 'benchmark' in their choice of wage-related labor standards. The authors also review secondary literature that finds higher wages in FIEs than in state-owned enterprises (SOEs) and other non-SOE indigenous firms. FIEs generally complied better with the Chinese law on minimum wages and overtime wages. Non-overseas-Chinese FIEs (especially those from the EU and U.S.) provided higher wages than overseas Chinese FIEs. Appleton, Song, and Xia (2005), find a wage premium for working in a joint venture (but not for foreign direct investment per se).

Development economics has a long-standing research interest in rural-urban wage differentials in developing countries. In the Lewis model, an "unlimited" supply of labor from the (rural) subsistence economy allows the (urban) capitalist economy to grow for some time without the need to raise wages. In the Harris-Todaro model, rural-urban migration is driven by expected income differentials, which in turn are a function of rural-urban wage differentials, urban unemployment, and marginal productivity in agriculture (rural wages).<sup>9</sup> For the case of China, Li et al. (2012) note that wages are now rising in China, and several authors explicitly focus on the Lewis turning point (when a shortage of rural labor drives up wages): according to Zhang et al. (2011) and Cai and Du (2011), China has reached or exceeded the Lewis turning point, whereas according to Golley and Meng (2011), Ge and Yang (2011), and Das and N'Diaye (2013), it has not. Knight et al. (2011) have it both ways: simultaneous surplus labor in rural areas and rising rural migrant wages in urban areas. No consideration is given to the possibility that the observed "Lewis turning point" may simply reflect changes to state regulations on wages.

Absent throughout this literature on wages in China is any deeper interest in the institutional context in which wages are determined. Authors invariably appear to assume

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<sup>9</sup> Since these theories are not of core interest to this paper, the very large literature in this area is not referenced. For brief overviews of these theories see the entries in Wikipedia for "Arthur Lewis (economist)" (also the Fei-Ranis extension) and "Harris-Todaro model."

that aggregate wages are determined (implicitly: freely) by demand and supply. An occasional reference to rural-urban migration may be made, without, however, assigning institutional factors more than a contextual role. In sum, the literature examines the impact on wages of employee characteristics (such as level of education), employer characteristics (such as ownership form), and passive or indirect institutional factors (such as geography or the household registration system). What authors appear to ignore is the possibility of state-determined wages and state-regulated wages, for at least some if not a significant share of workers, and any impact this may have on the wages of the remaining workers. Authors appear equally uninterested in the impact of the state-determined minimum wages.<sup>10</sup>

That wages are not market-determined is widely accepted for “market” economies. For example, Groshen (1990) writes for the U.S. that the concept of the classical competitive market does not explain “many of the observed patterns of wages, such as wage variation across industries for apparently equivalent workers. Nor does it explain why employers perceive themselves as choosing a wage within a market-determined range of feasible wages, and how they make that choice” (p. 1).<sup>11</sup> Consequently, economic theories of wage determination include such deviations from perfect competition as rigid (or “sticky”) wages, or immediate adjustment of wages but slow adjustment of workers between jobs. Institutional analysis frequently focuses on the impact of unionization, and on decentralized vs. centralized wage setting (for example, Soskice, 1990). The absence of perfectly competitive markets is obvious in the case of minimum wage legislation (where research then focuses on the impact on employment).

The purpose of this paper is not to absolve between different theories of wage formation for the case of China, nor to quantify wage developments and explain them by employee or employer characteristics, but to fully grasp the institutional framework of

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<sup>10</sup> Chan (2003, 2005) treats minimum wages as a labor issue and does not pursue the issue of aggregate wage determination.

<sup>11</sup> In Groshen’s findings, approximately half of the variation in wages among employees (using a sample from the U.S. Current Population Survey) can be explained by years of education, age, age-squared, occupation, race, sex, union status, and industry. He then hypothesizes on the impact of five employer characteristics on wage variation: employers sorting employees by ability, conditions of employment (such as working conditions), costly information causing mistakes on the part of some employers, cost efficient wages above market rate (savings on supervision), and workers’ claims on firm profits in imperfectly competitive markets. Holmlund and Zetterberg (1991) examine the determination of industry wages in five countries with very different institutional labor market characteristics and conclude that the “marked dependence of industry wages on sectoral conditions is difficult to reconcile with a competitive labor market model,” and that “decentralization in wage setting may be conducive to rent sharing, rather than bring labor markets closer to textbook descriptions of competitive models” (p. 1028).

wage determination in China and its evolution during the reform period. It is primarily qualitative analysis that can provide the context for quantitative research questions.

### 3 Labor contracts

Prior to the reform period, virtually all of China's workers were in publicly owned undertakings – two-thirds of them in collective agriculture – with little or no labor mobility. The beginning of (limited) rural-to-urban labor mobility dates to the mid-1980s.<sup>12</sup> In urban areas, the 'labor contract system' was gradually introduced starting 1983 to replace lifetime employment.

Collective agriculture and urban lifetime employment went hand in hand with collectively determined and state-regulated wages. It is only with the transition from collective agriculture to the household responsibility system in agriculture and from fixed employment to the labor contract system in urban areas that any scope for wage determination outside collective and state channels emerged.

In a very different development, the non-state economy went from the absence of formal labor relations to the introduction of labor contracts in the late 1990s. Along with the establishment of formal labor relations came a formalization of wage setting.

#### 3.1 From fixed workers to contract workers

The labor contract system was formalized on 1 October 1986. All new workers in SOEs were to be hired on contracts, dissolving the traditional "fixed" (or lifetime) employment system (SC, 12 July 1986). New workers were to be treated identically to fixed workers, with the one exception that new workers were to contribute to a government-administered pension scheme – in the traditional pension system enterprises pay pension to their former employees.<sup>13</sup> The regulation foresaw three possible durations for the contract: five years ("long-term"), one to five years ("short-term"), or for a fixed period with automatic roll-

<sup>12</sup> In rural areas, in the early 1980s the government encouraged farmers to "leave the land without leaving the village," in 1983 the government began permitting farmers to engage in long-distance transport and marketing of agricultural products, in 1984 farmers were allowed to work in nearby towns in collectively owned township and village enterprises, in 1985 an urban migrant temporary resident permit system was established, and in 1988 national identity cards were issued to replace letters of recommendation (Cai, Park, and Zhao, 2008).

<sup>13</sup> The contribution is equivalent to 15 percent of wages, with at most 3 percent to be paid by the worker.

over. The State Council on 18 May 1992 revised the duration to be unlimited, limited, or for the contract to specify completion of a specific task.<sup>14</sup>

Over time, the special status of “fixed” workers disappeared in official regulations while enterprises were encouraged to adopt labor contracts for all laborers. The Labor Ministry on 22 August 1994 in a “suggestion” on the implementation of the Labor Law states that fixed workers are also to confirm their labor relationship with the employing unit through labor contracts; by end-1995, at least 80 percent of those who had not yet signed a labor contract should have done so (100% in provinces with “relatively good work fundamentals”), and by 1996 even the provinces with difficulties should have labor contracts in place for 100% of the originally fixed workers.<sup>15</sup>

The implementation of labor contracts implied the freedom for firms to select and hire workers. The Labor Law that took effect on 1 January 1995 explicitly permitted no-fault dismissal of workers in response to changing economic conditions.<sup>16</sup> But the massive layoffs that took place in the 1998–2000 SOE reform program likely reflect a planned and coordinated program of dismissal rather than the exercise of a regular right for enterprises to dismiss.<sup>17</sup> For other years, it is unclear to what extent enterprise owners can exercise a right to dismiss. On the one hand, Cai, Park and Zhao (2008) write that until the late 1990s the government continued to tightly restrict the dismissal of workers. Meng (2000) interprets even contract laborers as *de facto* permanent laborers and believes contracts did not provide employers with a flexible hiring and firing device. Yang, Chen and Monarch (2010) believe that a new reporting regulation (presumably of the late 2000s) in effect im-

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<sup>14</sup> The original 1986 regulation was later subsumed in the PRC Labor Law effective 1 January 1995 (NPC, 5 July 1994). The State Council ordinance of 23 July 1992 on transforming the management mechanism of industrial SOEs states in Article 17 that enterprises can either move towards labor contracts (*hetonghua guanli*) or implement the comprehensive labor contract system (*quanyuan hetong laodongzhi*) that covers all laborers in the enterprise (and may constitute the wholesale adoption of contracts). The enterprise can sign labor contracts of limited or unlimited duration, or specify, in the contract, fulfillment of a specific task. The enterprise has the right to, in accordance with the law, terminate contracts and dismiss staff and workers. No special mention is made of “fixed” workers. A much earlier regulation by the Commerce Ministry (5 August 1985) requested that state-owned commercial enterprises are to gradually resolve the drawbacks (*bibing*) of the “iron rice bowl.”

<sup>15</sup> The Labor Ministry on 13 February 1996 reported that by 1995, 80 percent of all staff and workers had signed contracts.

<sup>16</sup> In state-owned enterprises, the transition from fixed workers to labor contract workers could not be used to dismiss workers, while workers could not use this opportunity to unilaterally (without reasonable cause) end the labor relationship (LM, 4 August 1995). The Labor Ministry on 26 April 1996(a) further regulated how workers were to resign, and workers who refused to sign a labor contract but insisted on maintaining labor relations could be dismissed after a prescribed period.

<sup>17</sup> In the late 1990s, almost 50mio workers, 40 percent of the public enterprise workforce, were dismissed (Cai, Park, and Zhao, 2008, and Naughton 2007, Chapter 8).

plies the existence of an external approval mechanism for all significant layoffs; the regulation requires enterprises that plan to lay off 20 or more people, or more than 10 percent of their labor force, to inform the upper-level labor unions 30 days beforehand.

However, an earlier survey, of around 1992, found that 69 percent of 933 SOEs had direct or indirect decision-making power over recruitment and about 86 percent had direct or indirect decision-making power over dismissal, but managers typically chose not to dismiss (Meng, 2000). One may wonder if any reluctance to dismiss is due solely to political imperatives or to plain cost-benefit analysis as is conducted by firms in any country. Furthermore, if the priority of enterprise owners is not profit maximization (which could be the case for SOEs), any reluctance to dismiss may not be the result of constraints on dismissal but the result of enterprise priorities.

If there are restrictions on dismissals, they will primarily apply to the traditional SOEs. In 2010, traditional SOEs accounted for 6.7 percent of employment in the directly reporting industrial enterprises (all industrial enterprises with independent accounting systems and annual sales revenue in excess of 5mio yuan RMB).<sup>18</sup> If data were available on *all* industrial enterprises, the share of the traditional SOEs in industrial employment would be even smaller. In 2010, therefore, restrictions on the freedom to dismiss are likely to have only minimal impact on employment in China. This was different in earlier years: in 1994, the corresponding share of traditional SOEs was 51 percent.<sup>19</sup>

The issue of freedom to dismiss is important for the determination of the wage level. When the total wage bill is fixed but there is freedom to vary individual laborers' wages within that total – as became the case starting 1989 (details below) – dismissal of laborers is likely to directly translate into higher wages.

### 3.2 Labor contracts for the non-public economy

By the late 1990s, the focus of contracts shifted to non-state enterprises, with the intention not a transition from “fixed” to contract workers but from the absence of any formal employment relationship to the use of contracts in order to formalize employment relation-

<sup>18</sup> See Statistical Yearbook 2011, p. 499.

<sup>19</sup> See Industrial Yearbook 1995, pp. 79 and 82. In 1994, the group of SOEs included all forms of state-owned enterprises (including state-owned companies), and the aggregate industrial employment in the directly reporting industrial enterprises was for all SOEs plus all non-state industrial enterprises with independent accounting system at township level and above.

ships. The issue of labor contracts enjoys a prominent position in the PRC Labor Law of 1995 and in its 2007 revision (NPC 5 July 1994, 29 June 2007): when labor relations are established, a labor contract should be signed (Art. 16 in the 1995 law, Art. 10 in the 2007 revision).

But despite early reports of “significant progress” (*zhongda jinzhan*) in the adoption of labor contracts by non-public enterprises (LM, 2 April 1997), the issue remained acute.<sup>20</sup> By mid-1998, the share of laborers covered by labor contracts varied widely by province and enterprise ownership form.<sup>21</sup> A 1998 report by the Labor and Social Security Ministry (28 August 1998), the successor of the Labor Ministry, requested that at least 80 percent of the “backbone” collective-owned enterprises at the township level in each province are to have implemented the labor contract system by end-1998.<sup>22</sup> A 5-year “Labor and Social Security Master Plan” for 1998–2002 requested that by end-1999 80 percent of all urban private enterprises and urban sole proprietorships with employees are to have implemented the labor contract system, and by 2000 all employers covered by the Labor Law are to have adopted the labor contract system (LSSM, 1 March 1999).<sup>23</sup> Yet by 2005, fewer than 20 percent of the laborers in non-state small and medium-sized enterprises had formal contracts (NPC, 18 December 2005).

The Labor and Social Security Ministry responded by declaring “labor relations” (*laodong guanxi*) established even in the absence of a labor contract as long as certain conditions are met (LSSM, 25 May 2005).<sup>24</sup> It followed up with a 3-year plan to promote the

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<sup>20</sup> A multitude of regulations on labor contracts ensued, issued by individual departments. See, for example, Post and Electricity Ministry, 23 April 1997.

<sup>21</sup> The report includes a table with data on the current (June 1998) share of laborers employed with contracts, by province and with a break-down into township and village collective-owned enterprises, private enterprises, and sole proprietorships.

<sup>22</sup> The term “province” is used here to denote the Chinese terms *sheng* and, equally, *diqu*. *Diqu* is rarely further explained in the source, but when it is, it typically covers provinces (*sheng*), self-administered regions (*zizhiqu*), cities directly subordinate to the central government (*zhixiashi*) and extra-plan cities (*jihua danlie shi*); the first three, administratively, are provincial-level entities, while the fourth is treated equivalent to a province in the planning system.

<sup>23</sup> A subsequent circular of 5 November 1999 on the implementation of the labor law laments the poor implementation of the labor law, including the lagging adoption of labor contracts by non-public enterprises (but also other items such as wage arrears and missing social security contributions).

<sup>24</sup> Thus, even if the employing unit does not issue a written labor contract, “labor relations” are established as long as the following conditions are met: (i) employer and employees qualify as such according to laws and regulations, (ii) the employing unit applies labor regulations to its employees, and the employee is under the labor administration of the employing unit and undertakes, for compensation, labor as arranged by the employing unit, and (iii) the labor provided by the employee is part of the business of the employing unit. The following are evidence of labor relations between an employer and a specific employee: a wage list that includes the employee (or, similarly, insurance for the employee), an employment card issued by the employer,



labor contract system, now with special attention to the private sector (31 March 2006). Incentives in form of the provision of model labor contracts specific to each sector, the free distribution of all major documents as well as relevant software followed a year later (13 March 2007). In 2008, finally, the SC issued an order according to which enterprises which have not issued contracts to their employees within one month must pay double salary, starting in the second month, through the end of the year (18 September 2008).

None of these measures appears to have resolved the issue, however. A joint circular of the Human Resources and Social Security Ministry, the All-China Federation of Trade Unions, and the China Enterprise Confederation / China Enterprise Directors Association, issued on 30 April 2010, initiates a special campaign to promote the use of the labor contract system in small enterprises (with small enterprises defined in a 2003 circular involving the National Bureau of Statistics). The objective is to use the three years 2010 through 2012 to “basically implement” labor contracts in small enterprises. The 2010 target is 65 percent coverage, and the 2011 target 80 percent coverage.

Overall, the transition from fixed labor to labor contracts in SOEs in the 1980s and 1990s likely favored wage increases when, once enterprises started to dismiss surplus labor, a given pool of wages was shared among fewer workers. The establishment of formal labor relations in the non-public economy in the late 1990s – though gaining momentum only in the second half of the 2000s – endows employees with the full rights accorded by law to laborers and thus improves employees’ bargaining power for higher wages. It also facilitates unionization and collective bargaining (on which more below).

## 4 Total wage bill and wage classification

The pre-reform, planned economy was designed to channel resources from agriculture to the urban sector and from the urban sector to the state, which would then apply the resources towards its objectives. Thus, the state procured food resources from agriculture at state-determined (low) prices that allowed it to keep urban wages at a low level. The resulting enterprise profits flowed into state coffers. The non-agricultural (by definition urban) wage system was designed to provide minimal wage distinction among different types of workers while maintaining tight control over total wage payments through wage plans. In

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a registration form filled in by the employee, a record of examination of the employee by the employer, attendance records, and “other employment documentation” (*laodongzhe de zhengxin*).

the reform period, as fixed employment turned into labor contracts (previous section), the wage classification system and the wage plan system (next section) also evolved.

## 4.1 Total wage bill and wages

The key variable across government regulations on wages is the “total wage bill” (*gongzi zong’e*). The total wage bill was first defined by the State Council on 21 May 1955. This temporary regulation listed 26 components of the total wage bill and six items that were not to be included (for example, one-time bonuses for inventions, “wage surcharges” and welfare expenditures in state organs and administrative facilities). The regulation applied to state-managed (*guoying*) units, cooperatives, public-private managed units, private enterprises, administrative facilities, state organs, and mass organizations (*tuanti*). As the National Bureau of Statistics (NBS) later explained, after 1956 this temporary regulation was only applied to “units owned by the whole people” (the term used at the time for “state-owned” units); while it was not clear if it should be implemented for urban collective-owned units and units in other ownership, in the official statistics these were nevertheless handled according to the temporary regulation (NBS, 1 January 1990).

On 30 September 1989, the State Council replaced the 1955 temporary regulation by a “Regulation on the components of the total wage bill.” This regulation newly includes a definition of the total wage bill as the total labor remuneration (*laodong baochou zong’e*) paid by a unit in a given period directly to the total of all staff and workers in that unit. The units covered by the regulation are enterprises owned by the whole people, collective-owned enterprises, administrative facilities, all types of cooperative units (*heyingshi danwei*), government and Party organs, and mass organizations. A later article in the regulation specifies that the calculation of the total wage bill in private units, in industrial and commercial units operated by overseas Chinese, Hong Kong, Macau, and Taiwanese entrepreneurs, and in foreign-invested units is to also follow this regulation.

The total wage bill comprises six components (each further elaborated on in the source): hourly wages (including, among others, the “basic salary” and the “positional wage,” *jichu gongzi he zhiwu (gangwei) gongzi*), pay for piecework, bonuses, grants and subsidies, overtime wages, and wages paid under “special circumstances” (such as wages paid during maternity leave). A list of fourteen categories describes what is *not* included in wages, such as prizes, expenses for labor insurance and employee benefits, pension contri-

butions, all expenses related to “labor protection” (*laodong baohu*), and expenses for medical aid and living subsidies of dismissed contract laborers. The NBS on its website (currently) clarifies that total wages are pre-tax wages and include deductions made by the work unit for housing, water and electricity fees, and laborer contributions to a housing fund and to social insurance funds.<sup>25</sup>

A follow-up regulation by the NBS of 1 January 1990 offers additional explanations. As in the 1955 regulation, the total wage bill covers monetary and non-monetary labor remuneration – this is different from the “average wage,” which only considers the monetary wage.<sup>26</sup> Paragraphs describing the evolution of the new regulation state that the intention is to continue to focus on the total wage bill rather than labor income (*zhigong shouru*) because the latter is not favorable for the plan administration of staff and worker wages. The 1955 focus on “wages to be paid” is now replaced by “wages actually paid” (with adjustments if wages are paid early at public holiday times).

The adoption of the new regulation also has a substantive effect on what is covered by the “total wage bill.” A number of innovations increase the coverage of the total wage bill (such as the new inclusion of most types of one-time bonus payments), while other innovations decrease the coverage of the total wage bill (royalties and lecture fees are newly to be excluded). This implies that data on the total wage bill experience a statistical break (of unknown size) in 1990; this may also affect other, related data, such as data on average wages.

While the “total wage bill” appears a concept specific to the Chinese context, other variables such as an individual’s “wage” or the “average wage” appear to match common usage of the term in the West. Non-monetary benefits, not included in the average wage, are likely more pervasive in state-owned units than in units in other ownership forms. While many of these non-monetary benefits may have disappeared over time (such as free schooling, free showers, and free haircuts provided within the work unit), others may have become more substantial over time. Thus, with the rise in house prices across China, the provision of subsidized housing, or of opportunities to purchase highly subsidized housing, can constitute a very significant non-monetary benefit that is typically extended only by state-owned units. Chinese wage data, then, may not allow an accurate comparison of total employment benefits across ownership forms, and may furthermore be

<sup>25</sup> See [http://www.stats.gov.cn/tjsj/zbjs/201310/t20131029\\_449543.html](http://www.stats.gov.cn/tjsj/zbjs/201310/t20131029_449543.html), accessed 28 January 2014.

<sup>26</sup> See previous note for the source.

biased downward in international comparisons if laborers in other countries enjoy fewer non-monetary benefits.

## 4.2 Wage classification system and the three stages of wage reform

In the first wage reform, of 1956, a wage classification system based on occupation, region, industry, ownership (state vs. collective), administrative level (central vs. local), and type of workplace (size and technological level) was introduced.<sup>27</sup> At the core was a complex structure of salary standards for more than three hundred occupational classifications that allowed some variation of individual wages. Wages comprised six components: basic wage, bonuses, benefits and subsidies, overtime wages, supplementary wages, and a component 'other.'

A second wage reform, of 1985, still retained compensation according to rank, occupation, region, and type of workplace, but the more than three hundred occupational classifications were replaced by just four: manual vs. non-manual worker/staff, in enterprises vs. in government agencies and not-for-profit organizations. A State Council circular of 1 May 1985 decreed that enterprises were officially de-coupled from administrative facilities and state organs in matters of wage reform and wage adjustments. Small SOEs (and collective-owned enterprises) were asked to continue to apply the principle of being themselves responsible for profit and losses (*zifu yingkui*); these enterprises were to determine their own mode of internal distribution as long as their state tax obligations were fulfilled and the enterprise development fund had been replenished. The Ministry of Labor set salary standards for state workers in large and medium-sized SOEs, which were then used by local governments in setting salary standards for all other SOEs. The wage reform allowed some flexibility in form of bonus payments that depended on enterprise profitability or a combined indicator of economic returns.

The third wage reform, of 1993, finalized a formal link between profits and wages in SOEs and introduced a minimum wage. The following year, on 5 July 1994, the National People's Congress (NPC) passed the PRC Labor Law. The developments in the reform period are discussed in more detail after the next section.

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<sup>27</sup> This section draws on detailed regulations that are discussed later in the paper. In the English language literature, see Cai, Park and Zhao (2008), Yueh (2004), Knight and Song (1995), Bian (1994), and Meng (2000).

## 5 The wage plan system

In 1959, the State Planning Commission (SPC) issued trial measures on the administration of the wage fund (*gongzi jijin*), regulating wage payments effective 1960 (SPC, 11 December 1959). Virtually all institutions in China – enterprises and non-enterprises – became subject to a strictly implemented annual and quarterly labor (including wage) plan.<sup>28</sup> The wage plan was an integral element of the state planning system, a counterpart to production planning for the consumer goods sector.

An institution would draw up its own quarterly and monthly “wage fund usage plan” within the framework of the labor plan issued by the superordinate department. Banks could not release an amount exceeding the (approved) monthly wage fund usage plan by more than 5 percent, or the quarterly plan by more than 1 percent.

### (i) Wage plan system vs. bonuses

The introduction in 1978 of the bonus system and piece rates disrupted the traditional wage plan system.<sup>29</sup> By 1983, SOEs were widely allowed to redistribute after-tax profits, including for employee welfare purposes and bonuses, subject to government-determined percentages. The total wage funds for the year became a priori indeterminate and new regulations on the wage plan system were issued.

Along with bonuses and later the wage-performance link (more on which further below) came particular taxes. In order to place a limit on wage increases, the State Council in 1985 issued two sets of tax regulations. First, SOEs that had opted to link wages to their economic efficiency were to pay a wage adjustment tax (*gongzi tiaojieshui*) if wages exceeded the planned wage bill by more than 7 percent; the precise wage adjustment tax rate (and a deductible) depended on how much the planned wage bill was exceeded, rising sharply the more it was exceeded (SC 3 July 1985(a)).<sup>30</sup> The wage adjustment tax was to

<sup>28</sup> The trial measures specify SOEs, private-public joint ventures which had already agreed on a dividend (presumably to the private owners), administrative facilities, state organs, and social organizations.

<sup>29</sup> According to the State Council (7 May 1978), no more than 30 percent of all work units in a province or (central) department were to introduce bonuses and piece rates. Bonuses were not to exceed 10 percent of the approved wage bill. With bonuses supposedly also came penalties: a State Council regulation of 10 April 1982, applicable to SOEs and urban collective-owned enterprises, lists eight types of performances which should trigger bonuses, and seven types of behavior which—if not remedied after criticism and education—should trigger administrative or economic penalties.

<sup>30</sup> The Finance Ministry in its implementing instructions narrowed the group of enterprises to those large and medium-sized SOEs which had been approved by the state to link their total wage bill to the amount of taxes and profit they remitted (FM, 18 September 1985).

be paid on total wages, which include not only wages paid out of the wage fund but also all other wage income, boni, allowances, subsidies (unless approved by the state) and in-kind awards. Second, all other SOEs were to pay a bonus tax on all bonus wages paid that exceeded 4 months' standard wages, where total wages are defined identically to the case of the wage adjustment tax (SC 28 June 1984, SC 3 July 1985(b)).<sup>31</sup> The precise tax rate (and the deductible) also depended on how much the planned wage bill was exceeded, and also rose sharply with higher wage payments.<sup>32</sup> Collective-owned enterprises and administrative facilities became equally subject to the bonus tax (SC, 24 August 1985, 20 September 1985): collective-owned enterprises were subjected to the SOE regulations, while administrative facilities were subjected to lower limits on tax-exempt wage payments that exceed the planned wage bill than SOEs (with a distinction between three types of administrative facilities ranging from those fully dependent on state budget appropriations to those partially dependent and those fully self-financing).<sup>33</sup>

Both, bonus tax rates and wage adjustment tax rates were reduced in 1987 in order to "increase incentives for staff and workers to improve production, increase economic efficiency, and effectively control the consumption funds" (FM, 17 February 1987). The amounts exempt from bonus tax were raised slightly in 1988, in the case of SOEs from bonuses equivalent to 4 months of standard wages to 4.5 months (FM, 7 May 1988).

Parallel to the establishment of adjustment and bonus taxes focused on the work unit, the State Council introduced an individual income adjustment tax applicable to all Chinese citizens living in China, with the main regulation going into effect on 1 January

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<sup>31</sup> On the coverage of bonus payments see the Finance Ministry's implementing instructions (FM, 12 September 1985). For a short period before, bonus payments equivalent to only two and half months of wages were exempted from the bonus tax (SC, 16 April 1984). Two 1984 regulations laid out the rights of enterprises to choose how to determine wages. The State Council first clarified that enterprises could issue bonuses, could use "flexible wages" that comprised regular wages and incentive funds, or could use piece rates with no upper limit to the total wage bill (SC, 8 May 1984). It then reiterated, as part of a general regulation, that enterprises enjoyed the right to determine which form their wages would take, as long as they adhered to national wage scales and regional wage distinctions (SC, 10 May 1984).

<sup>32</sup> Earlier attempts to control the amount of bonuses (for example, SC, 28 December 1984), appear to largely have failed. As part of the transition from profit surrendering to tax payments (*ligaishui*), a separate "adjustment tax" (without the qualifier "wage") of 70 percent was levied on the amount of profits exceeding the (pre-) approved volume of profit (SC, 18 September 1984); a State Council regulation of 17 February 1989 regularized a "state budget adjustment fund" (*guojia yusuan tiaojie jijin*) with a 10 percent tax on all extra-budgetary funds, SOE special funds, and post-tax profits of enterprises in all ownership forms (including sole proprietorships).

<sup>33</sup> The implementing instructions (FM, 2 November 1985, 15 November 1985) provide exhaustive lists on what income is subject to the bonus tax (all income that is not subject to state-approved exemptions, such as state-approved subsidies). The wage bill can potentially be raised every year, with state approval. For SOEs, the Finance Ministry notes a three percent legitimate annual increase in wages (FM, 25 October 1985).

1987 (SC 25 September 1986). By late 1993, the individual income adjustment tax regulation fused into the PRC Individual Income Tax Law (SC, 16 May 1994; NPC, 31 October 1993). Adjustment and bonus taxes were abolished effective 1 January 1994 (SC, 23 January 1994). Enterprises began to pay corporate income taxes while employees began to pay individual income taxes.

In response to the development of the bonus system in the reform period, the Labor and Personnel Ministry on 8 November 1983 issued a second trial measure for the administration of the wage fund “to control the increase in staff and workers and in total wages, stop the reckless issuing of bonuses and other irregular wage payments, prevent the loss of control over the consumption fund, and control the increase in currency in circulation.” The measure applies to SOEs, administrative facilities, and state organs; i.e., it excludes collective-owned and private enterprises, at this point in time a negligible part of the economy. The work unit devises a quarterly wage fund usage plan that is approved by its superordinate department in accordance with the state wage plan and the work unit’s production tasks and increases in labor productivity. Any alteration of the wage fund usage plan needs approval. All wage payments are conducted through one designated bank account. If the number of laborers is reduced, the wage fund is to be reduced correspondingly (a requirement that ends in 1989); if it is increased, approval must be sought for increases in the wage fund. Work units that pay bonuses, piece-rate wages, or flexible wages (*fudong gongzi*) are to follow the state guidance plan (with no further explanation offered).

Two years later, the State Council on 24 September 1985 explicitly replaced the previous trial measure by a “Temporary wage fund administration measure” that applies to enterprises, administrative facilities, state organs, and social organizations. It covers labor remuneration of staff and workers as well as allowances and subsidies paid in accordance with state regulations. All wage payments continue to be made through one designated bank account and are subject to the state wage plan. The state’s wage plan covers each province and each (central) department individually. A province or central department then distributes the overall wage quota to its subordinate units (and sends a copy of the allocation to the bank). The work unit draws up the quarterly or monthly wage fund usage plan. Bonuses are handled separately “in accordance with state regulations;” the accumulated bonus fund of the unit can be used to pay bonuses, flexible wages, allowances, subsidies, and other types of self-funded income. The State Council explicitly acknowledges that SOEs which are approved by the State Council to link wages to economic efficiency fol-

low a separate planning procedure from the wage plan system. That did not free them of the wage plan, but led to more flexible arrangements (discussed below with the wage-performance link).

By the 1990s, the traditional wage plan system – consisting of an economy-wide wage plan with breakdowns by department and localities, and then all the way down to the individual institution – saw three developments: (i) all individual institutions that had not adopted a different remuneration system continued to follow a strict wage plan (*gongzi zong'e baogan*);<sup>34</sup> (ii) in the early 1990s the traditional wage plan system became a “flexible total wage fund plan” (*tanxing gongzi zong'e jihua*); and (iii) in the second half of the 1990s first an economy-wide “wage control line” (*gongzi kongzhi xian*) was introduced and then a “wage guidance line” (*gongzi zhidaoxian*).<sup>35</sup>

## (ii) Flexible total wage fund plan (1990s)

In an initial circular on the implementation of a “dynamically adjustable flexible labor wage plan” (*dongtai tiaokong de tanxing laodong gongzi jihua*) the Labor Ministry (the successor to the Labor and Personnel Ministry) on 20 March 1993 required all industrial departments under the State Council (excluding companies) to implement a flexible wage plan.<sup>36</sup> The flexible wage plan limit/target (*daodashu*) comprises two components: (i) the total wage base, and (ii) the absolute increase in value-added during the plan period times a wage share (in value-added) which depends on the sectoral average share of the enterprises under this department, the sectoral average, and the national average. Other measures of growth are also possible, including the ratio of profit and taxes to total funds (*zijin lishui li*), the ratio of profit and taxes to wages, or value-added per worker. Provincial industrial departments were to issue similar regulations.

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<sup>34</sup> Evidence continues well into the 2000s, for example in a circular on the wage-performance link in central enterprises issued by the State Asset Supervision and Administration Commission on 19 September 2003.

<sup>35</sup> Some mechanisms used in the implementation of the wage plan system continued to be enforced. For example, a State Council circular of 31 March 1989 exhorts enterprises which link wage payments to economic efficiency to strictly implement the “wage fund administration manual” (*gongzi jijin guanli shouce*), a recording and registration mechanism for all wage-related payments of an enterprise. (LM, 8 October 1993, similarly refers to an enterprise “total wage fund usage manual” (*gongzi zong'e shiyong shouce*) which is to be filed with the labor department or the superordinate department.) The administration of the wage plan of collective-owned enterprises was also to be strengthened (although there appears to be no government regulation subjecting collective-owned enterprises to similar wage administration as the default wage plan for SOEs).

<sup>36</sup> Employment was to be controlled only indirectly, via the determination of the total wage bill.



On 8 October 1993, the Labor Ministry clarified that the flexible total wage fund plan was to follow the “two-below” (*liangge diyu*) principle, namely that

- (1) the increase in an enterprise’s total wages should be smaller than the improvement in enterprise performance, and
- (2) the increase in average real wages per staff and worker should be smaller than the increase in labor productivity.

Provinces and central departments are to estimate an annual as well as a medium-and long term flexible total wage fund plan for all enterprises under their jurisdiction (including the enterprises that implemented the wage-performance link). These plans are to be passed on to lower administrative levels in form of guidance plans (*zhidaoxing jihua*).<sup>37</sup> All enterprises (with no specific reference to ownership) are to report their total wage plans to their superordinate department and to the labor department at the same administrative level. Provinces and central departments are to in regular intervals publish domestic and international labor costs by industry as well as indicators of economic efficiency across enterprises in an industry, in order to “guide enterprises in managing well internal distribution.”

The implementing instructions, issued only a few days later (LM, 5 November 1993) assert that the state implements a “dynamically adjustable” flexible wage plan (*dongtai tiaokong de tanxing laodong gongzi jihua*) for all provinces and central departments, with these entities to report their flexible wage plan to the Labor Ministry by March 1994. Starting 1994, the flexible wage plan is to cover all urban units independent of ownership. The dominant remuneration system outlined in the implementing instructions is the wage-performance link, subject to the “two-below” principle, and constrained by the flexible wage plan. Stock companies, once listed on the stock market, are allowed to determine their wage bill themselves, except that those with more than 50 percent state ownership should follow the rules of SOEs, namely adopt the wage-performance link.

A few months earlier, on 22 June 1993, the Labor Ministry had already issued a similar but more detailed regulation, directly addressed to SOEs only. This regulation,

<sup>37</sup> Provinces and central departments, within the constraints of the state plan, were to “accommodate different types of enterprises according to administrative level and enterprise type” (*dui butong leixing de qiye shixing fenji guanli he fenlei zhidao*), i.e., provinces and central departments appear to have had the authority to determine the fate of a particular enterprise’s wage bill. On the one hand, this opens up much scope for bargaining, on the other hand, given the different policy constraints that different enterprises faced, it may have been plausible not to implement simple rules that apply equally to every enterprise.

among others, also asserts that enterprises have the right to self-determine how to use and how to distribute the total wage bill covered by the wage plan. Enterprises draw up their (forecast, *yuji*) wage plan at the same time as they draw up their production plans, and file the wage plan with the superordinate department and the labor department. Every year, at least 10 percent of the increase in the total wage fund should go into an enterprises wage reserve fund. If wages in a province or department exceed the flexible wage plan, then the province or department is to pay an amount equal to that excess to the central Finance Ministry, and the next period's total wage fund is to be cut by that same amount.

The Labor Ministry on 8 February 1994 admonished provinces and central ministries to adhere to the flexible wage plan and to ensure that wage increases in enterprises conform to the flexible wage plan. On 13 May 1994, the Labor Ministry reiterated the importance for enterprises under the flexible wage plan to adhere to the plan. In the same paragraph, it asks enterprises that operate under the wage-performance link to adhere to those rules, enterprises which contract the wage bill to adhere to the contract, and enterprises under plan administration to adhere to the wage plan.

The Labor and Social Security Ministry (the successor to the Labor Ministry) on 3 March 1995 issued a flexible wage plan measure to cover all enterprises, from central and local SOEs to urban collectives and "others," including township and village enterprises. It introduces variables of the newly adopted System of National Accounts to the establishment of provincial wage plans, replacing earlier variables from the Material Product System. Thus, the wage plan can be based on secondary and tertiary sector value added, on labor productivity in the secondary and tertiary sector, or on the share of wages in these sectors. The "two-below" principle continues to be in effect. A complex formula for establishing the increase in total wages is presented that incorporates a sharp brake on large wage increases.<sup>38</sup>

On 7 February 1997, the Labor and Social Security Ministry issued a circular on the main wage objectives and policies in the Ninth Five-Year Plan. The state's flexible wage plan is to remain the main macroeconomic control method during this period of tran-

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<sup>38</sup> The Labor and Social Security Ministry on 24 April 1995 also issued a regulation on supervising and inspecting the source, use and balance of total wages in enterprises, including checking on the implementation of the wage-performance link and the administration of the wage plan (or the lump-sum wage guarantee). The regulation contains a large element of self-inspection, but also inspections by labor, fiscal, and auditing departments. It does not mention a timetable or any periodicity of inspections.

sition, while the scope of experiments with state wage guidelines is to be gradually expanded.

(iii) Special case: wage control line (second half of the 1990s)

After three years of double-digit inflation as measured by the GDP deflator, the Labor Ministry in collaboration with the State Planning Commission on 7 June 1996 issued a circular on the introduction of a “wage control line” for those enterprises under central government departments (and central extra-plan conglomerates) in which the average wage per staff and worker in the previous year (1995) exceeded 180 percent of the nationwide average staff and worker wage. Provinces are asked to decide on which local enterprises are to be covered by a wage control line. Wages are to be controlled at a (unspecified) level that is to be dependent on the difference between the average staff and worker wage in the enterprise vs. nationwide, and on the achievement of the economic performance objective and “related factors.” The annual increase in the total – explicitly monetary – wage bill is to be kept below that of all nationwide enterprises. In enterprises implementing the wage-performance link, if the performance-determined wage bill exceeds the planned wage bill the excess performance-determined wages are to be retained in a wage reserve fund to bridge shortfalls in other periods.

In thirteen central government departments and companies (for example, the Transportation Ministry) addressed by a circular issued by the same two institutions a year later, on 5 September 1997, this was indeed achieved.<sup>39</sup> The circular issued specific 1997 wage baseline (*jishu*) and control-line values for each of the thirteen departments and companies.

In later years, at the central level, the concept of the wage control line appears to have metamorphosed into an explicit plan for the wage bill of each of a number of enterprises. Thus, the Labor and Social Security Ministry on 26 October 1999 issued a list of 60 central enterprises (companies) with their 1999 wage plan base line (*jihua jishu*) and the planned 1999 wage increase (*jihua zengjiashu*). On 11 August 2000, the 1999 regulation was extended with two innovations: enterprises which meet the “two-below” criterion were allowed to conduct trials in determining themselves their wage bill, and subsidies provided

<sup>39</sup> According to the circular, in 1996 the total wage bill as well as the average wage in the aggregate of these thirteen departments and companies increased slightly less than the nationwide averages of these two variables (with the values being in the range of 10-13 percent), but specifically the electric power-related departments and financial departments exceeded their wage control lines.

by enterprises as part of the housing reform are not subject to the wage-performance link and not included in the plan wage base line.

(iv) Wage guidance line: experiments (second half of the 1990s)

The Labor Ministry (or, likely, the Labor and Social Security Ministry but mislabeled in the source) on 30 January 1997 promoted a wage guidance line for all enterprises irrespective of ownership, apparently in effect previously in three cities (Beijing, Shengzhen, and Chengdu), and now to be extended to a further seven provinces (Jiangsu, Jiangxi, Shandong, Guangdong, Hunan, Shanxi, Jilin). The wage guidance line is to be announced each year before the end of March and to be implemented simultaneously with the flexible wage plan and the wage-performance link until it can become the major macro-control instrument for wage distribution.

Trial measures lay out the details, from the limitation to urban enterprises and the principles (such as the “two-below” principle) to the criteria for establishing the wage guidance line.<sup>40</sup> There is to be a base, lower, and upper wage guidance line, with state-owned and state-controlled enterprises (SOSCEs) not to exceed the upper wage guidance line (with more severe restrictions in state monopoly sectors).<sup>41</sup> Wage determination in the non-public economy (as well as any collective wage bargaining) is to be based on the wage guidance line with, under normal circumstances, wage increases no lower than the base line.<sup>42</sup>

Three years later, the Labor and Social Security Development Master Plan for 1998–2002 (LSSM, 1 March 1999) called for wage guidance lines to be established within 2–3 years in most regions (*diqu*) of the country, with sectoral wage guidance where possible. All medium-sized and large cities are to establish a (unspecified) “labor market price system” (*laodongli shichang jiawei zhidu*) and a labor cost forecasting and early warning system.

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<sup>40</sup> The criteria being the annual economic growth rate, labor productivity, and the urban CPI as the main factors, while considering the urban employment situation, the “labor market price” (*laodongli shichang jiage*), labor costs, and the foreign trade situation.

<sup>41</sup> SOSCE is a term first introduced in the national statistics in 1998. The previously used category SOEs did not capture limited liability companies and stock companies with a significant (controlling) state share. Since 1998, the term SOE in Chinese official use may refer either to state-owned enterprises that have not adopted the company system (i.e., a subset of SOSCEs), or, occasionally, to SOSCEs. For details on the ownership classification system see Holz (2013).

<sup>42</sup> The trial measures come with mathematical formulas incorporating the various criteria as well as half a dozen parameters. The parameters are not specified but to be determined by the authority that sets the wage guidance line.

On 25 October 1999, the Labor and Social Security Ministry emphasized the role of guidance wage *rates* for macroeconomic control and for enterprise wage setting. Labor and social security departments at national, provincial, and municipal level are to in regular intervals investigate, analyze, summarize, collect and process wage data, in particular at the level of central cities, in order to establish a set of wage rates (*gongzi jiawei*) by profession (*zhiye*) that is to be publicly announced and that is to guide enterprises to “rationally” set wages.<sup>43</sup> For 1999, 35 large and medium-sized cities are chosen for implementation, with provinces invited to choose a further one to two central cities “where the conditions are right.” In 2000, the coverage was to be expanded to 100 trial cities for labor force markets changes (*sanhua jianshe shidian*), and in 2001 to all municipal-level and above central cities.<sup>44</sup> Wage level data are to be published once a year, before the end of June.

#### (v) Wage plan and wage guidance line in the 2000s

According to a report by the World Trade Organization of 1 October 2001 on China’s accession, the representative of China indicated (*biaoshi*) that “Chinese state-owned enterprises are basically run in accordance with market rules, and the government no longer directly manages employment, finances, and materials (*ren, cai, wu*) of state-owned enterprises or production activities such as production, supply, and marketing” (Art. 43). That is not evident in the wage plan system.

The wage guidance line as well as the system of wage rates (and forecasts of labor costs) are well confirmed in a list of labor issues for 2002 (Labor and Social Security Ministry, 29 January 2002).<sup>45</sup> In specific industries, the state directly sets the total wage bill as well as the wage level (LSSM, 9 September 2002). The Labor and Social Security Ministry declaration of the “main work points” for 2005 still contained a reference to the continuation of the “wage guidance line,” guidance wage rates, and sectoral labor cost guidance

<sup>43</sup> The circular also refers to the establishment of the “three changes” (*sanhua jianshe*) towards a scientific, standardized, and modern labor force market.

<sup>44</sup> A Labor and Social Security Ministry circular of 28 January 2000, on the “main issues” of 2000, reiterates the application for the 100 trial cities and also mentions the expansion of the wage guidance line to 25 provinces.

<sup>45</sup> The wage plan is also still explicitly mentioned. On 16 September 2002 the Labor and Social Security Ministry together with the Finance Ministry and the Auditing Office announced an investigation of wage payments in 2001, with emphasis on the sectors transportation, electric power, post and telecommunications, and tobacco. Specifically to be investigated are adherence to the “two-below” principle, the wage-performance link, the wage plan, the local wage guidance line, as well as implementation of the wage fund usage manual. Sources of wage and non-wage remuneration are also to be examined, and payment of the personal income tax. The investigation is to include “administrative investigation,” special audits by independent (“social”) intermediaries, and enterprise self-examination.

(LSSM, 1 April 2005). Central enterprises under the State Asset Supervision and Administration Commission that do not implement the wage-performance link as of 2006 still follow a wage plan, and those that do implement a wage-performance link need to file their wage plan beforehand (SASAC, 6 March 2006).

The issue of directly controlling the wage bill of enterprises has faded from central documents. Circulars by the Labor and Social Security Ministry of 6 November 2007 and by the Human Resources and Social Security Ministry (the successor to the Labor and Social Security Ministry) of 14 October 2008, while mentioning macroeconomic control of the *SOE* total wage bill, are no longer concerned with a wage plan; instead, they focus on the wage-performance link. A State Council policy document on income distribution of 3 February 2013 speaks of perfecting the wage guidance line system and establishing a uniform enterprise remuneration survey and information distribution system.

At the provincial level, the wage guidance line lives on. The Human Resources and Social Security Ministry continues to approve provincial wage guidance lines every year. For example, the base, upper and lower wage guidance line in Beijing in 2010 was 11 percent, 16 percent, and 3 percent, and in Gansu in 2013 17 percent, 20 percent, and 7 percent (HRSSM, 13 June 2010, 18 June 2013).

## (vi) Evaluation

Economic reforms with the introduction of incentives in form of bonuses or piece rates and liberalization of production decisions required a softening of the wage plan system in the reform period. Similar to the financial system where an aggregate credit plan with a breakdown by banks dominated lending decisions throughout the first two decades of reform, the wage plan was meant to constrain the total wage bill, as well as the total wages paid by individual institutions within the aggregate wage plan, at least through the early 1990s. Just as the mandatory limit of the credit plan was regularly exceeded, the wage plan probably was never a perfectly binding constraint.

Mechanisms for enforcement of the wage plan appear to be missing throughout. Penalties in case the wage plan was exceeded are nowhere mentioned. There is also no mentioning of the wage plan as a criterion for promotion of government officials.

In the 1990s, the wage plan first turned into a flexible wage plan and then a wage guidance “line” (with a high, base, and low line). At the enterprise level, many institutions abandoned the fixed, lump-sum wage plan in favor of the wage-performance link (next

section), although up through 2003 a wage plan constraint is mentioned in regulations as secondary constraint (in addition to the constraints imposed by the wage-performance link). Only in 2004 is the wage plan explicitly abandoned, at least for enterprises under SASAC. State-regulated wages (and a wage total) continue to be the default *modus operandi* for administrative facilities and state organs.

Sometime around the second half of the 2000s, the wage guidance line assumed the function of prompting wage increases in line with the guideline in the non-public sector, while providing upper limits on wage increases in the public sector. Economy-wide wage guidance continues to be very much alive at the provincial level.

## 6 Wage setting in enterprises

The institutions of wage setting in enterprises evolved during the reform period. Four developments stand out: (a) adoption of a link between wages and economic performance, and the evolution of (b) collective (wage) bargaining, (c) manager compensation, and (d) wage determination in foreign-funded enterprises.

### 6.1 The wage-performance link

Profit sharing is a mechanism of labor remuneration that has been widely discussed in the Western literature. The motivation for firms to offer profit sharing to their employees may vary from productivity increases to substitution (for example, for fixed pay components, or in lieu of fixed employer retirement savings) and a human capital argument (enhance attraction and retention of higher quality human capital). In countries with strong labor unions profit sharing may play a lesser role because of the alternative framework of bargaining by labor unions for wage increases.<sup>46</sup> In the case of China, the introduction of the wage-performance links for SOEs, with extensions to collective-owned enterprises, appears a means of institutionalizing mechanisms for wage increases on an economic basis as an alternative to state-ordained, administratively determined wage increases.

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<sup>46</sup> The large, Western literature is not being reviewed here. See, for example, Long and Fang (2012).

### (i) Initial stage (1985–1992)

In a circular on wage reform in SOEs of 1 May 1985, as part of the second wage reform, the State Council required large and medium-sized SOEs to begin linking staff and worker wages (their total wage bill) to “economic efficiency” (performance).<sup>47</sup> A dozen circulars over the subsequent decade elaborated further on the link to performance, marginally varied the application over time, and expanded the coverage.

Underlying the link between wages and performance is a

- base year wage bill value (*gongzi zong’e jishu*),
- an economic efficiency (or performance) indicator with a base year value (*jingji xiaoyi zhibiao he jishu*),
- and a multiplication factor (*fudong bili*)  $X$  – if economic efficiency increases by 1 percent, the wage bill may increase by a factor of  $X$  percent.

The administration follows a two-tier system whereby the state issues a base year wage bill value, economic efficiency indicator, and multiplication factor for each province and each central department. At the next level, the province and central departments translate the provincial or departmental overall permitted wage increase into an enterprise-specific wage increase. The enterprise is relatively free to determine the distribution of the wage funds between workers, but is to typically follow the principle of “distribution according to labor.”

Industrial enterprises can adopt “tax and profit remittances” (*shangjiao shuili*) as performance indicator. The multiplication factor ( $X$ ) at the enterprise level can vary between 0.3 and 0.7, i.e., a 1 percent improvement in the performance indicator translates into a 0.3–0.7 percent increase in the total wage bill. The year 1985 was to see a trial implementation of the wage-performance link, followed by 3–5 year guaranteed arrangements starting in 1986.

Four years later, in line with the completion of any 3-year arrangements entered in 1986, the Labor Ministry (in collaboration with the Finance Ministry and the State Plan-

<sup>47</sup> The State Council temporary stipulation of 27 February 1988 on the SOE contract responsibility system lists as main contents of the contract the profit that is to be surrendered to the state, the technological updating task, and the wage-performance link. The stipulation states that the wage-performance link can be determined in accordance with (unspecified) state regulations and the enterprise’s actual circumstances. The stipulation offers no further explanations. Thus, while the wage-performance link according to this stipulation is a key part of every SOE contract, the absence of details suggests that the wage-performance link was still work in progress.



ning Commission, and forwarded by the State Council), referring back to the State Council 1 May 1985 decision, elaborated further on the two-tier system (LM, 6 March 1989). The multiplication factor for provinces and departments ranges from 0.5 to 0.75, with the precise value depending on, mostly, labor productivity, per capita taxes and profit, and per capita non-agricultural national income. The number of laborers no longer affects the wage bill; this is a very new development, giving incentives to reduce the number of laborers in order to increase wages per laborer. In determining the index values and multiplication factors between province (or central department) and enterprises, care is to be taken to avoid wage increases solely due to an economic indicator increasing because of price increases (i.e., price changes are not to affect wages), and adjustment tax may have to be paid depending on the size of the wage increases. A number of requirements, such as quality and safety requirements, have to be met before any wage increase may be granted. Provinces and departments that currently do not yet implement a wage-performance link are to continue the method of guaranteeing enterprises' total wage bill as a lump sum.

The Labor Ministry on 23 November 1989 issued detailed implementing instructions (explicitly referring back to the State Council circular of 6 March 1989). No distinction is made between large and medium-sized vs. small SOEs; starting in 1989, all regulations simply refer to SOEs. The relevant economic indicator for determining the total wage bill of provinces and central departments (i.e., of all SOEs under the jurisdiction of a province, or central department) is either tax and profit remittances (*shangjiao shuili*), or realized taxes and profit (*shixian shuili*). Each of these indicators can also be combined with a physical quantity or workload. The base year values of the wage bill, performance indicator, and the multiplication factor are determined by the Labor Ministry in conjunction with the Finance Ministry and the State Planning Commission. The base year value of the wage bill is in principle the previous year's total reported wages.

The province or central department then chooses one of five performance indicators to determine an enterprise's wages: (i) tax and profit remittances, (ii) realized taxes and profit, (iii) and (iv) sales volume or actual workload and one of the two indicators (i) or (ii), and (v) guaranteed share of wages in production value (limited to construction enterprises). The multiplication factor, similar to the state-province or state-central department tier, depends on labor productivity, the rate of wages to profit and taxes, profit and taxes relative to capital, and the sector in which the enterprise operates. Those SOEs that newly started the wage-performance link in 1989 can include up to 4.5 months' worth of

bonuses (if they were actually paid) in the previous year's wage bill value (where 4.5 months is equal to the tax-free amount of bonuses).<sup>48</sup> All others are to eventually shift to the same approach, of including all wage-related payments in the costs. If the change in the performance indicator implies wage increases in excess of 15 percent, an increasingly sharp brake is imposed on the wage increases (with detailed percentages provided). Wage increases are not allowed at all if taxes and profit are not paid as specified. Actual wages paid may also fall in correspondence with the performance indicator, but only up to a maximum of 20 percent.

The wage plan system continues to be in effect and serves as a second mechanism of control that is explicitly referred to. Wage payments determined by performance still face the constraint that they cannot exceed the quotas set in the wage plan.

A document by the State System Reform Commission of 10 April 1990 on deepening enterprise reform and strengthening enterprise administration in the period of retrenchment contains a passage that all enterprises which implement the contract responsibility system are to in principle adopt the wage-performance link. This again indicates a shift for all SOEs, independent of size and organizational arrangement, to the wage-performance link. It is repeated in a Labor Ministry "suggestion" of 20 November 1990, which further proposes that enterprises should gradually move from one performance indicator to a combination of performance indicators. In determining the base year wage bill value of an enterprise each year, the previous year's base year value should not be exceeded by more than 20 percent; three different methods are proposed to limit the increase in the base year wage bill value. In addition, a lengthy list of requirements must be met before any wage increases can be implemented; this includes, among others, maintaining and increasing the asset value, and a labor productivity target. Wage increases may also not cause the wage plan to be exceeded.

This document was followed by a request to extend the wage-performance link beyond SOEs to include urban collective-owned enterprises. On 22 October 1990, the State Council reported that one-quarter of urban wages were paid to 30mio workers in 500,000 collective-owned enterprises (adding up to a wage bill of 5bn yuan RMB) and that these wage payments should be made in accordance with performance. Collective-owned enter-

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<sup>48</sup> Price increases for an enterprise's product sales must be controlled for when calculating an enterprise's performance. Provinces are invited to decide on the wage policies for collective-owned enterprises. (LM, 19 December 1989).

prises can choose to follow wage standards approved by the labor departments, or to base wages on economic efficiency or other criteria (in which case with approval of the labor, tax, and superordinate departments). After-tax profits are to be allocated to three funds, namely the production development fund, the staff and worker collective welfare fund, and the bonus and dividend fund. Only the latter can be used to make income-related payments. Collective-owned enterprises are to pay both the bonus tax and the individual income adjustment tax.<sup>49</sup>

By 1992, according to a circular by the Labor Ministry of 4 October 1992, all departments which “meet the conditions” (*you tiaojian de*) should implement the wage-performance link in their SOEs. The performance indicator base value and the multiplication factor are determined by the state, and the department then determines the wage distribution method in its enterprises. The department itself should use a combined performance indicator with realized taxes and profit as the main component. Various subsidies are to be included in the department’s base year wage bill value. If performance indicators improve due to price increases, the price increases must be factored out. The circular acknowledges that economic measures imposed by the state can severely affect the performance of an SOE and describes the necessary steps to have performance indicators adjusted. Otherwise, each year’s total base year wage bill value equals the previous year’s actually paid wage bill (less adjustment taxes paid). The multiplication factor in 1992 remains unchanged from the previous year.

## (ii) Standardization and widespread application (1993–1996)

On 9 July 1993, as part of the third wage reform, the State Council in conjunction with several ministries issued a formal ordinance on linking SOE wages to their performance. The regulation is based on the “two-below” principle – as elaborated above, the increase in an enterprise’s total wages should be smaller than the improvement in enterprise performance, and the increase in average real wages per staff and worker should be smaller than the increase in labor productivity. The base year wage bill value of an enterprise should be set in accordance with the locality’s “flexible wage plan.” Three performance indicators are promoted as main indicators: realized profit and taxes, realized profit, and tax and profit remittances. Other performance indicators are also possible, including ones that comprise a physical quantity or workload component. Maintaining and increasing the value

<sup>49</sup> Detailed instructions can be found in measures issued by the Labor Ministry on 5 October 1991.

of state assets (*guoyou zichan baozhi zengzhi*) is now an absolute requirement, which, if not met, prevents any wage increase. The base year wage bill value is to include all forms of income payment, including various bonuses, and all wage-related income is to be included in the enterprises' costs. The base year wage bill value and the multiplication factor can be adjusted annually, or every 3–5 years.<sup>50</sup> The regulation also includes elements that already appeared in earlier documents, but it does not make the two-tier distinction. It focuses solely on the wage-performance link for enterprises. Individual government departments then followed with their detailed regulations for the enterprises under their control.<sup>51</sup>

The Labor Ministry in a regulation on the implementation of the Labor Law on 22 August 1994 included a special allowance for listed stock companies and trial enterprises for the modern enterprise system: these enterprises may gain approval to decide themselves on their wage level, within the constraints of the “two-below principle.” All the while, the flexible wage plan system is still in effect.<sup>52</sup>

In 1996, the Labor Ministry and the Finance Ministry standardized the wage-performance link and limited wage payments. Thus, all SOEs that meet the requirements are to implement the wage-performance link (LM, 12 December 1996(a)). Otherwise, SOEs are to use wage contracting, or rely on the wage plan. The “two-below principle” applies to all SOEs. The performance indicator is to usually be one of the following three: realized profit, realized profit and taxes, or taxes (and profit) paid (*shangjiao shuili*). An absolute requirement for wage increases is the maintenance and increase in state assets. Employment reductions are to lead to a decrease in the base year wage bill value by 50–70 percent of last year's average wage times the number of laid-off workers. All wage increases must be linked to performance and approved by the Labor and Finance departments. No other wage items may enter costs. If performance falls, wages should decrease

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<sup>50</sup> A year later, on 13 July 1994, the Labor Ministry and the Finance Ministry issued a circular on auditing or examining (*shenhe*) some issues in the implementation of the wage-performance link. This circular includes special arrangements for enterprises where the average increase in the staff and worker monetary wages is below the increase in the local staff and worker living cost index.

<sup>51</sup> See, for example, a joint Labor Ministry, Finance Ministry, and Foreign Economic and Trade Ministry regulation for foreign trade enterprises of 31 July 1997.

<sup>52</sup> The wage system in effect in Chinese enterprises abroad was also revised (FM, 9 February 1995; Labor Ministry, 3 July 1995). Previously, wages in Chinese enterprises abroad were set in accordance with wages in Chinese embassies abroad and in the New China News Agency (*Xinhuashe*) in Hong Kong and Macau. Starting 1995, Chinese enterprises abroad are to set wages predominantly according to performance, while trying to match wages in other enterprises in the locality. The initial wage is to be determined by the unit and its (domestic) superordinate department and to take into consideration the consumption level, price level, minimum wages, relevant regulations and the locality's living conditions. Wage increases then are to depend on performance. Implementation may not have been smooth as the Labor Ministry in 1996 tried to obtain information on wage payments by enterprises abroad in 1992–1994 (LM, 26 April 1996(b)).

but may not fall below the local minimum wage (and the wage reserve fund may be tapped into if need be).

A separate circular (LM, 12 December 1996(b)) issued at the same time specifically addresses the wage-performance link in 1996, with numerous clauses to address special cases. Of the more general clauses, the base year wage bill value is last year's actual wage bill, unless last year's actual wage bill is lower than the average of the previous three years, in which case it is the average of the previous three years. The 1996 wage bill is to be strictly limited in order to prevent the "consumption funds" from rising too fast. Wage increases of up to 10 percent face no restrictions. Higher wage increases face an increasingly higher discount on the additional percentage increase (above 10 percent). Thus, wage increases between 10 and 25 percent face a 50 percent discount, wage increases between 25 and 40 percent a 70 percent discount, and wage increases above 40 percent a 90 percent discount. To simplify matters, fifteen departments and conglomerates, including the Railway Ministry and the Petrochemical Corporation, report their wage-performance link arrangements directly to the Labor Ministry and the Finance Ministry.

### (iii) Shifting framework of wage setting (1997)

On 7 February 1997, the Labor and Social Security Ministry issued a circular on the main wage objectives and policies in the Ninth Five-Year Plan. It lists an overall target of an annual 4.5 percent increase in staff and workers' average *real* wages. Most SOEs are to continue the wage-performance link. SOEs in monopoly sectors or in sectors related to people's livelihood are subject to relatively direct state administration that is intended to maintain wages in these SOEs at "market levels" (rather than have them be far higher). In the case of competitive SOEs, on the other hand, state control is to gradually transition to (unspecified mechanisms of) indirect control. Non-state enterprises are to use collective bargaining to set wages. While total wages, the wage level, and the distribution system in these enterprises are freely determined without state interference, the state is supposed to exercise "indirect control" (*jianjie tiaokong*). A few SOEs that "meet the conditions" can also implement collective bargaining on a trial basis. (More on collective bargaining below.)

The continued wage-performance link is regarded as one of the major policies during the transition period for determining total SOE wages; provinces and departments are requested to continue to conscientiously implement it. Maintaining and increasing the

value of state assets is a criterion that must be fully met before any wage increase is allowed; some enterprises may explore including this objective formally in the performance criterion by combining it with the realized taxes and profit objective. Otherwise, the key performance indicator is realized taxes and profit (alone, without additional criteria). In the longer run, society-wide average labor costs are to play a larger role in limiting SOE wage payments, with detailed sectoral data to be published by the labor departments for everyone's information. All wage payments continue to have to be made via the "wage fund administration manual," the recording and registration mechanism used for all wage-related payments of an enterprise. The wage-performance link does not preclude the continued application of the flexible wage plan as the main macroeconomic control method during this period of transition, while the scope of experiments with state wage guidelines is to be gradually expanded.<sup>53</sup>

#### (iv) Further developments (late 1990s, 2000s)

As in earlier years, in 1997 the Labor Ministry and the Finance Ministry issued a joint circular on the wage-performance link in the current year (LM, 23 September 1997), with no innovations in 1997. From 1997 until at least 2012, in almost every single year, the Labor and Social Security Ministry and then its successor, the Human Resources and Social Security Ministry, together with the Finance Ministry, issued a circular on the wage-performance link in that year.<sup>54</sup> Provinces and cities likewise issued their near-annual circulars on the implementation of the wage-performance link in the locality.

The national-level circulars throughout retain the earlier wage-performance link arrangements, while at times introducing small changes. The themes are recurrent: a shift to realized profit or realized profit and taxes as sole performance measures, exhortations to strictly limit wage increases (with the 1996 restrictions on wage increases above 10 percent continuously in place), if need be lower the multiplication factor (especially for monopoly industries), an absolute requirement of meeting the target for asset maintenance/increase before any wage increases can occur, a list of special circumstances and how to address

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<sup>53</sup> Under the heading "wage-performance link," the Labor and Social Security Development Master Plan for 1998-2002 (LSSM, 1 September 1999) proposes to explore adjusting average wages according to the wage guidance line, average wages across society, and the "labor market price." How this new method is to be reconciled with the link of wages to performance is not explained.

<sup>54</sup> See LSSM, 8 October 1998, 7 September 1999, 11 August 2000, 30 August 2001, 24 November 2003, 10 November 2004, 28 November 2005, 9 November 2006, 6 November 2007; HRSSM, 14 October 2008, and 30 December 2010. A 2012 circular is mentioned in other circulars but cannot be found (and may be a provincial-level circular, of which there are many all the way through 2013).

them, and an invitation to provinces to issue wage-performance link regulations for their enterprises. A deadline is typically given, for late in the year (September through November) to submit the current year's wage-performance details to the auditing authority.

The following innovations deserve special mention. In 1998, the adjustment factor explicitly becomes a function of the profit and tax rate per worker, the ratio of wages to profit and taxes, and labor productivity. For enterprises, the multiplication factor is at most 0.7, for departments (with several enterprises) at most 0.75. An intention is stated to gradually shift from the total wage bill as target to the wage level as target (repeated in most subsequent years). The default institution for auditing (examining and approving) the wage-performance link is the Labor and Social Security Ministry together with the Finance Ministry. The State Economic and Trade Commission (later abolished) is to audit the enterprises under its control.<sup>55</sup>

The 1999 circular covers the same ground as the 1998 circular, and is then itself referenced in the 2000 and 2001 circulars.<sup>56</sup> The 2000 circular newly states that housing subsidies are not part of wages (and do not enter the wage-performance link). The 2000 circular further specifies that enterprises that have turned into companies and adopted the shareholding system can tentatively determine their wage bill themselves as long as they follow the "two-below" principle. In the 2001 circular, enterprises are requested to report their "wage administration measures" via their owner to the Labor and Social Security Ministry and the Finance Ministry. In 2001, furthermore, a few representative and competitive enterprises are to be chosen to experiment with keeping the remuneration method

<sup>55</sup> The Beijing Labor Department on 15 April 1998 decided that enterprises which paid less than 7920 yuan average wages in 1997 will not continue the wage-performance link in 1998 (without, however, specifying an alternative remuneration mechanism). Special regulations also exist for a small number of large conglomerates. The Labor and Social Security Ministry together with the Finance Ministry on 8 February 1999 issued a "response" to the State Tobacco Monopoly approving the (1998) performance indicator (profit and taxes) base year indicator to be 49,134.31 million yuan, the base year wage bill value 3,684.31 million yuan, and the multiplication factor 0.8. The same institutions on 29 December 1998 issued a "response" to the Railway Ministry likewise approving the various numerical values (with the Railway Ministry also using transport volume performance indicators).

<sup>56</sup> A Qingdao Labor and Social Security Department regulation of 7 December 1999 provides details on the wage-performance link in *collective-owned* enterprises. It provides eight circumstances under which the base year wage bill value ought to be adjusted, for example, if university graduates are allocated by the state to the enterprise (but also including an absolute increase of 12 yuan per worker). Nevertheless, in principle, collective-owned enterprises are free to determine the wage bill themselves while the multiplication factor should be held constant. The enterprise is to report the wage bill value together with the performance indicator and the multiplication factor (the latter two to be approved by the tax authority) to the superordinate government department. Apart from the wage-performance link, collective-owned enterprises are further to consider the wage guidance line. Under the guidance of the state, collective-owned enterprises are to gradually move towards determining their wage level themselves, giving due consideration to the society-wide wage level and the enterprise's economic performance.

and the index numbers constant for three years, with the actual remuneration practice audited by an independent (“society”) intermediary.

The 2003 circular became somewhat of a milestone in that it is referred back to in the 2004 through 2010 circulars as well as in numerous, including more recent local regulations. It reiterates in much detail the earlier measures and introduces no fundamental innovations.<sup>57</sup> Auditing now seems to be more generally assigned to independent audit organizations. The central Auditing Office joins the Labor and Social Security Ministry and the Finance Ministry in examining implementation of the state’s wage-performance link regulations. The State Asset Supervision and Administration Commission (SASAC) joins the same two institutions in supervising and approving the annual wage schemes. This is the last circular to explicitly mention the progressive restrictions that apply to wage increases above 10 percent, first promulgated in 1996.

The 2004 circular regulates in more detail the case of enterprises that have adopted the company system. If the state does not hold a controlling stake, the wage-performance link is no longer to be implemented and the enterprise administration and employees are to determine the wage bill and the wage level through collective bargaining. If the state holds a controlling stake, the labor and fiscal departments are to implement “macroeconomic administration and supervision” (*hongguan guanli he jiandu*) of the wage distribution according to the general requirements of state regulations on “adjusting the sectoral wage relationships” (*tiaojie hangye fenpei guanxi*) and the enterprise’s concrete circumstances (with no mentioning made of a continuing wage-performance link).

Furthermore, as previously requested in the 2001 circular, a small number of competitive enterprises with “standard” (*guifan de*) wage distribution and financial administration are to experiment with keeping the wage-performance link unchanged for three years. Implementation is to be audited by an independent intermediary. Across all enterprises, any increases in the wage bill should primarily be used to address wage distribution issues within the enterprise.<sup>58</sup>

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<sup>57</sup> For example, it reiterates the details on how to determine the performance indicator base year value, the wage bill base year value, and the multiplication factor. For the multiplication factor, the following information from the enterprise is to be considered: labor productivity, average labor costs, average profit and tax rate, the ratio of total wages to the performance indicator, enterprise size, and industrial sector. Comparisons are also to be conducted with other enterprises, vertically and horizontally.

<sup>58</sup> Five institutions are given special authority to organize the implementation of this circular for their enterprises: SASAC, the Railway Ministry, the State Tobacco Monopoly, the National Postal Service, and the State Civil Aviation Administration. This arrangement continues across subsequent circulars, with the precise



In 2005, those enterprises whose (on-post) staff and workers in 2004 enjoyed a salary level more than double the salary level of the local urban (on-post) staff and workers are to strictly audit their performance indicator base value and their base year wage bill value, and to adjust the multiplication factor downward, a statement repeated in 2006, 2007, 2008, and 2010.<sup>59</sup> In 2006, the multiplication factor in these circumstances is to be decreased below 0.6. In 2010, the (percentage) increase in the average staff and worker wage base year value may not exceed the (percentage) increase in the provincial urban (on-post) average staff and worker wage.

The 2006 circular also provides a new variation of the statement on companies: those *non-public* enterprises that have been turned into companies can choose to no longer implement the wage-performance link. They are to, in accordance with the company law, discuss and determine labor remuneration with the representatives of the staff and workers. By 2008, the term “can choose to” (*keyi*) again becomes a factual statement of “no longer implements” (*bu zai shixing*), similar as in 2004.

The Company Law of 1993, revised in 2004 (NPC, 29 December 1993, 28 August 2004), does not impose a particular remuneration system. In Article 55 and Article 121 (in the two versions of the law) it requires that in matters related to wages of staff and workers, the opinion of the firm’s labor union and staff and workers should be sought first, and representatives from the labor union or the staff and workers should be invited to attend the relevant meetings that determine wages.

The 2006 through 2008 circulars, otherwise, are brief with no significant innovations. Apart from a reference to a 2012 circular that cannot be substantiated (and a 2009 circular is neither referenced nor can be found), the final circular on the wage-performance link appears to be the one of 2010, then issued by the Human Resources and Social Security Ministry together with the Finance Ministry. It newly regulates that for enterprises that have already undergone the monetization reform with five types of subsidies paid out to staff and workers, these monetized subsidies are not to be included in the base year wage bill value and are also no longer to be included in the staff and worker welfare costs, but to

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list undergoing minor changes (thus, in 2006, the Water Works Ministry is included while SASAC receives no special mentioning).

<sup>59</sup> Guangdong province regulates that the national 2006 regulation applies to SOEs in Guangdong province where the wage level is *three times* (not: double) the average urban (on-post) staff and worker wage (GDHRSSO, 28 December 2007).

be listed separately and not to exceed a value equivalent to 14 percent of total wages.<sup>60</sup> The five subsidies are for housing, transportation, communications, holidays, and meals.

A Hebei province circular of 2011 on the wage-performance link (HBHRSSO, 10 June 2011) explicitly states that those enterprises which in 2010 had established collective wage bargaining are to terminate implementation of the wage-performance link (or of the total wage contract system). Those enterprises that have not yet established collective wage bargaining are to continue implementation of the wage-performance link (or the total wage contract system).

A Hunan provincial circular of 2013 on the wage-performance link (HNHRSSO, 20 November 2013), still refers back to the 2003 Labor and Social Security Ministry regulation, but then proceeds with three innovations. First, the annual salaries of managers are not part of the wage-performance link. Second, if the average wage of (on-post) staff and workers is more than double the average wage of urban (on-post) staff and workers, then the salary increase of the first may not exceed the salary increase of the latter. Third, while the wage-performance link continues to determine the overall wage bill, the enterprise and the staff and workers are to conduct collective bargaining with that total wage bill as basis, and to also consider the wage guidance line and the guiding prices on the labor resource market.

A research report by the Central Party School of 30 May 2011 recommends increased flexibility in determining wages in SOEs. It details the practice in the Bao Steel (Baogang) company with a position-specific base wage, a performance wage, and a location wage, and laments the otherwise widespread loss of talent from SOEs in that key administrators and technical as well as operational personnel leave the firm for higher market

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<sup>60</sup> These new arrangements address a circular issued by the Finance Ministry on 12 November 2009, and a Finance Ministry response to questions on 3 December 2009. The response splits labor costs into wages and welfare payments. The circular defines welfare costs as all monetary and non-monetary expenditures for staff and workers except wages, bonuses, allowances, subsidies that are part of the total wage bill, education costs, social security costs and supplementary pension contributions, supplementary health insurance, and housing funds. The response then splits welfare payments into those that are expressed as a proportion of wages and those not expressed as a proportion of wages; the circular addresses the latter, which include various health expenditures, enterprise-internal welfare departments, hardship allowances, special expenditures on retirees, and "others." The circular and the response are of relevance to the wage-performance link because they make explicit that certain subsidies are to be considered wages, whereas in the practice of the wage-performance link these were not considered wages but social welfare items. In order not to have to revise the performance and wage indicators, the regulation on the wage-performance link treats these previous welfare payments now as special wage items outside the wage-performance link. The response also provides an idea of the size of the (presumably pure) welfare payments, with welfare expenditures in central enterprises on average being equivalent to 7 percent of the total wage bill (with, across enterprises, a high of 26 percent and a low of 0.6 percent).

wages, while the firm retains those laborers whose market wages are below their current wage.

(v) State-owned enterprises in central ownership (2003–)

With the establishment of the State Asset Supervision and Administration Commission (SASAC) in 2003, SASAC began to regulate the wage-performance link for the enterprises under its jurisdiction (SASAC, 8 August 2003). Annual regulations are available for 2003 through 2008.<sup>61</sup> The 2003 circular provides the platform for the developments in the following year.

SASAC requests enterprises that are not yet implementing the wage-performance link (and still following the wage plan) to explore a shift to the wage-performance link. All enterprises are to adopt realized profit as performance indicator (with a transition period for a combined indicator to progressively favor realized profit for enterprises that are still using a volume indicator). The performance indicator base year indicator and the multiplication factor are to gradually incorporate horizontal (intra-industry) comparisons rather than rely only on vertical (presumably intra-conglomerate) comparisons. Starting 2003, labor cost indicators, including a comparison domestically and internationally, are to enter the determination of the wage bill. The wage distribution within the enterprise is to consider the market price of labor and the contribution to production, while egalitarianism is to be avoided. SASAC will audit the wage-performance link of the central enterprises (conglomerates) as well as their total wage plan, while each central enterprise within the SASAC-approved scope will then break the overall figures down by (subsidiary) firm. Control of an enterprise's total wage bill enters the assessment of the major responsible personnel.

The 2004 circular explicitly ends the “double-control” procedure of using both the wage-performance link and the wage plan, with central enterprises that implement the wage-performance link no longer subject to an annual wage plan (which suggests that the wage plan up through 2003 was still applied in parallel to whatever other control measures were in place). Enterprises are to determine their wage plan themselves based on the expected improvement in performance and the labor cost affordability.

Central enterprises abroad and domestic shareholding companies with varied ownership are to start experimenting with the wage-performance link and to issue their

<sup>61</sup> See SASAC, 19 September 2003, 9 February 2004, 15 December 2005, 22 November 2006, 9 November 2007, and 31 October 2008.

own administrative measures, to be approved by SASAC. The wage fund usage manual of central enterprises in Beijing will no longer be examined by SASAC. Central enterprises that previously applied for provincial approval for their wage plan now fall under SASAC's remit. A separate regulation issued by SASAC and the Tax Office, of 5 April 2004, clarifies that the Labor and Social Security Ministry and SASAC have completed the transfer of authority regarding supervision and administration of enterprise's wage distribution to SASAC, and that the Tax Office will consult enterprise's wage-performance link arrangements and implementation of the "two-below principle" when examining enterprises' pre-tax deduction of wages.

The 2005 circular again encourages all enterprises to adopt the wage-performance link, and volume measures may no longer be used as performance measure, with realized profit (if need be in combination with a low-weight volume measure) becoming the one and only performance measure. Enterprises whose (on-post) staff and workers enjoy a salary level more than double the salary level of the local urban (on-post) staff and workers will have their multiplication factor adjusted downward by SASAC, a measure that is promulgated for SASAC enterprises at the same time as it is by the Labor and Social Security measure for all enterprises (see section above). A number of paragraphs address violations of the wage-performance link and excessive wage payments.<sup>62</sup>

The 2006 circular refers back to the 2005 circular. The high wage level in some enterprises remains relevant and a number of channels that are being used to allow hidden wage increases are being discussed. Foreign subsidiaries of central enterprises may determine their own wage bill but have to report it together with their labor costs (*rengong chengben*). The circular asks to continue exploring a new wage-performance link that focuses on total labor costs, with the objective of eventually replacing control of the wage bill by control of labor costs and wage levels. For the first time, the introduction of the wage-performance link is mentioned for (non-enterprise) administrative facilities (*shiye danwei*).

The 2007 circular is brief and refers back to the 2006 circular. Realized profit is to be the one and only performance indicator, "except in a very few enterprises with relatively low wage level." The most recent available, 2008 circular is equally brief and contains no major innovation.

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<sup>62</sup> Investigations remained an ongoing concern, with the 2004 investigation focusing on SOEs in the power, telecommunications, finance, and transportation sectors (LSSM, 5 November 2004).

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## (vi) Evaluation

Early on, the wage-performance link appears to have simply been a way to determine wage increases in SOEs using mechanisms other than administrative fiat. (Around 1990, an attempt was also made to extend the wage-performance link mechanism to urban collective-owned enterprises, but this never seems to have taken off.) The initial request was to use one performance indicator, which soon became a combination of performance indicators, before it returned to a single indicator, in form of profits. Enterprises may simply have chosen that indicator which benefited their employees most. The criteria determining the value of the multiplication factor also evolved over time, and the phrasing appears sufficiently general that enterprises (or their superordinate departments) have some flexibility in choosing the value of their multiplication factor. In practice, the multiplication factor may simply be the 0.7 limit by default, unless an enterprise is able to push it higher still.

Numerous factors made determining base year values difficult. For example, enterprises might sell or close parts of their undertakings, and enterprises might be assigned new university graduates or retired military personnel. This would open the door to frequent adjustments. Companies might also be able to shift profits from one enterprise to another to ensure maximum overall wage increases.

Large wage increases in the early 1990s (also see Figure 1) led to counter-policies. To prevent “excessive” wage increases, a number of constraints were applied or newly introduced. The wage plan quota continued to apply throughout the 1990s (until 2004). Newly introduced in 1993 were the “two-below” principle as well as the requirement to maintain if not increase state assets before any wage increases could be paid.<sup>63</sup> Wage increases in excess of 10 percent became subject to progressively severe restrictions starting 1996.

More recently, the concern has shifted to wage inequality. Starting 2005, if the average wage in an SOE is more than twice the local urban average wage, wage increases are to remain below average local urban wage increases. But concerns about implementation of the wage-performance link remain. A circular issued by the Labor and Social Security Ministry (in collaboration with the Finance Ministry and the Auditing Bureau) on 16 November 2006 asks for increased supervision of wage payments in SOEs. The finance, electricity, telecommunications, tobacco, coal, and petroleum sectors are to be the focus of

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<sup>63</sup> This latter requirement could explain the relatively large volume of assets in SOSCEs (and SOSCE’s relatively low return on assets).

a special inspection covering the year 2005, including implementation of the wage-performance link, but also the administration of performance salary (presumably of management, on which more below), and implementation of the total wage plan.<sup>64</sup>

Despite the flurry of central policies in the 1990s, direct oversight over the enterprise wage bill appears to have been weak all along. Enterprises have to report their planned wage increases (and the relevant performance indicator, base year wage bill, and multiplication factor values) towards the end of the current year, which suggests that the details of an enterprise's wage-performance link are not so much subject to approval than to a reporting mechanism that might, at worst, lead to questions being asked. Companies increasingly are free of the wage-performance link, implying that the state relies on other mechanisms in companies, such as the Board of Directors or the Supervisory Board, to limit wage increases.

In line with the view of the wage-performance link as a wage determination mechanism more than a wage control mechanism, the state's policy measures over time are not only about excessive wage increases and wage inequality, but also about wage increases that are too low. For example, Beijing in 1998 decided that if profits are too low, enterprises could drop the wage-performance link.

## 6.2 Collective (wage) bargaining

### (i) Collective bargaining (not limited to wages)

In the early 1990s, collective wage bargaining emerged as a new way of determining wages, different from the wage-performance link promoted for SOEs, and different from the state-determined wage plan that still applied to other SOEs. The early regulations covered collective bargaining between employers and employees, one component of which was wages, while many later regulations specifically focused on collective *wage* bargaining.

The Labor Ministry, in the context of implementing the Labor Law, on 22 August 1994 asked for collective contracts to begin in the non-public economy, with SOEs to only gradually proceed with collective contracts once the modern enterprise system is established. Later in 1994 it issued a "Collective Contract Regulation," inviting enterprise repre-

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<sup>64</sup> Other issues are the issuing of wage-type payments to staff and workers, remuneration of managers, and payment of personal income taxes.

sentatives and representatives of the employees to reach a 1–3 year agreement on wages, work hours, vacation time and other (specified) matters concerning labor (LM, 5 December 1994). Employees are to be represented by the labor union, and in the absence of a labor union can elect their representatives with a simple majority. Labor departments at county level and above are charged with examining these agreements and facilitating in case of conflicts.

Throughout the following years, collective bargaining and collective contracts focus on the non-state economy, and those pilot SOEs that had been chosen to implement the “modern enterprise system” (LM, 17 May 1996, LSSM, 1 March 1999). This includes foreign-owned enterprises and the private economy where unionization is to go hand in hand with collective bargaining and collective contracts (with more details provided in the section on foreign-funded and private enterprises below).<sup>65</sup>

While the Labor Ministry issued detailed regulations for collective contracts to be reported to the labor departments for auditing (LM, 4 November 1996), these regulations appear to have been followed only in half of all cases of collective contracts: as of end-1996, 135,000 enterprises had signed collective contracts, but the number of collective contracts audited by the labor departments numbered only 68,000. Consequently, the Labor Ministry asked local labor departments to establish auditing departments for collective contracts, with specialized personnel and one “leading comrade” in charge (LM, 11 March 1997), while issuing detailed work flow charts and forms to fill in (LM, 8 May 1997).

A circular issued by the Labor and Social Security Ministry in conjunction with other ministerial-level organizations on 14 November 2001 asked for further implementation of the collective contract system, and when that is not possible to at least collectively agree on wages; contractual wages may not be lower than the minimum wage. The local labor departments are one of three parties involved in the process, the other two being employers and employees.

On 20 January 2004, the Labor and Social Security Ministry issued a revised collective contract regulation to take effect on 1 May 2004. The revised regulation lists further items that can be included in the contract (such as special protection for female workers and minors, or technical training) and elaborates on each item, such as providing details on

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<sup>65</sup> A host of related circulars are issued around this time (such as LM, 31 October 1996 and 4 November 1996), in part as a response to local requests for clarification about the details of the labor contract and about the government administration responsible for supervising the establishment of labor contracts (answer: the labor departments).

wage matters that can be included. The head of the labor union is to serve as the chief representative of employees. This revised regulation is further promoted in a Labor and Social Security circular of 30 August 2004, which, among others, specifies that no one has the right to refuse collective bargaining. Non-public enterprises, in particular small enterprises, should explore regional or sectoral collective bargaining. The circular does not specify an authority in charge of making such supra-enterprise collective bargaining happen.

## (ii) Collective wage bargaining

A development that started with the original collective contract regulation of 1994 but then gained momentum separately and came to dominate the issue of collective bargaining is a set of regulations more narrowly focused on collective *wage* bargaining. The Labor and Social Security Development Master Plan for 1998–2002 (LSSM, 1 September 1999) called for collective wage bargaining in foreign-funded and private enterprises, with trial implementation in small SOEs that are undergoing systemic transformation (*gaizhi*) and collective wage bargaining based on “democratic decision-making” and “democratic administration” in large and medium-sized SOEs. The labor and social security “main issues” of 2000 as announced in a circular of the Labor and Social Security Ministry on 28 January 2000 also include a call for widespread collective wage bargaining in the non-public economy, and pilot implementation in a very few SOEs that have undergone systemic transformation.

The initial regulation for collective wage bargaining is a “trial measure for collective wage bargaining” issued as a Labor and Social Security Ministry decree on 8 November 2000. The decree covers very similar territory as the original collective *contract* regulation, with more details on what is involved in wages (such as bonuses, allowances etc.), and also requesting consideration for, among several factors, the regional/sectoral/enterprise-specific living costs, and maintaining and increasing the value of state assets. Collective wage bargaining is usually to occur once a year.

By end-2004, 339,000 employers (*yongren danwei*) had established the collective wage bargaining system (NPC, 28 December 2005). According to a circular issued on 6 February 2005 by the Labor and Social Security Ministry in conjunction with other ministerial-level organizations, “currently the emphasis ... is on the non-public economy, the SOEs that are undergoing the shareholding reform, and collective-owned enterprises.” While approximately 300,000 enterprises are reported to already use collective wage bar-



gaining, more work supposedly remains to be done. Regions with a concentration of small enterprises are to actively promote regional and sectoral collective wage bargaining. At this point, the local labor departments are given a larger role to play: they are to complete the regulatory framework, analyze wage levels, labor costs, and inflation, and in regular intervals issue guidance wages and adjust the minimum wage.

The following year, on 17 August 2006, the same institutions issued “suggestions” on beginning work on regional and sectoral collective bargaining (not limited to wage bargaining, though mentioning wage bargaining in first place), starting with a reference to the many small non-public enterprises. Regional or sectoral labor unions are to take the lead. Regional collective bargaining is to occur at the level of townships and urban street offices, sectoral collective bargaining typically at the county level. Collective wage bargaining is to be included in the local economic and social development plan under the guidance of the Party Committee and government.

Collective wage bargaining is also seen as antidote to the problems caused by an economic downturn. The Human Resources and Social Security Ministry in conjunction with the All-China Federation of Trade Unions and the China Enterprise Confederation/China Enterprise Director Association on 21 January 2009 issued suggestions on rapidly increasing the use of collective wage bargaining. Enterprises that encounter production difficulties are invited to enter collective bargaining with all staff and workers, including migrant workers.

According to a news item in 2009, the All-China Federation of Trade Unions issued guiding suggestions on sectoral collective wage bargaining on 20 July 2009, stating that from now on, non-public small and medium-sized enterprises will no longer be able to determine wage standards at the enterprise level; wages are to be determined by enterprise representatives and a sectoral or local labor union. Separately, on the occasion of the 2009 National People’s Congress it was reported that a “Wage Law” was in the making but was not yet at a stage for comments to be invited.<sup>66</sup>

By 2010, a joint circular of the Human Resources and Social Security Ministry, the All-China Federation of Trade Unions, and the China Enterprise Confederation / China Enterprise Directors Association, issued on 5 May 2010, asked for an all-out effort for 2010–2012 to implement collective “contracts” – centered on wage bargaining – in enter-

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<sup>66</sup> For the news items see entries in *China Infobank* dated 1 November 2009 and 10 March 2009.

prises with trade unions. A 60 percent coverage is to be achieved in 2010, and a 80 percent coverage by 2011. Enterprises without trade unions are to be reached by regional or sectoral collective contracts. The focus is to be on the non-public economy and on labor-intensive enterprises. The initiative for collective bargainings is assigned to grassroots trade union, with help and guidance from higher-level trade union organizations.<sup>67</sup>

According to a policy statement on income distribution by the State Council on 3 February 2013, the focus in collective wage (and other) bargaining should be on the non-public enterprises with gradual development of regional and sectoral wage bargaining. By 2015, the coverage of collective bargaining should be 80 percent (of an undefined basis).

Traditional SOEs (i.e., SOEs organized in accordance with the 1988 SOE Law and not transformed into companies) are the only category of enterprises not explicitly covered by collective wage bargaining. Some could still follow tightly regulated state wage scales, and others could retain the wage-performance link. As described above, in industry, their share in employment had fallen to single-digit levels by the late 2000s.

### (iii) The reality of collective wage bargaining.

Blecher (2002), writing about the large-scale dismissal of state workers in the late 1990s, noted the extent of workers' hegemonic acceptance of core values of the market and the state: workers do not rise up against the current ideology and often unquestioningly accept their fate. Blecher concludes that even if state hegemony were to fail, market hegemony will probably survive and might even be strengthened. Market hegemony indeed appears to thrive: workers who are aware of their bargaining power ask for wage increases.

Chen (2010) reports on spontaneous strikes in the Dalian Development Area that at their peak involved 20,000 workers. Subsequently, all enterprises hit by strikes raised workers' salaries (and abolished some practices that the workers thought unreasonable). Salary increases constituted the principal demand.

Similarly, Chan and Ngai (2009) examining two cases of labor strikes by migrant workers in 2004 and 2007 report salary increases as the main demand. Workers in one factory produced a written list of demands that started with "To adjust our current wage stan-

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<sup>67</sup> Five specific types of enterprises are to be targeted: enterprises without collective bargaining and collectively signed contracts, enterprises where the collective contract period is ending, enterprises without collective wage bargaining (and collective wage agreements), enterprises which have not seen wage rises, or low wage rises for a long period, or where the wages of 50 percent of the staff and workers are lower than 50 percent of the average wage in the locality, and SOSCEs and collective-owned enterprises which implement the annual salary for managers.

dard. We all know the market wage standard now, and thus demand it should be adjusted to the following ways [...]; the above does not include any subsidy.”<sup>68</sup>

A report by the China Labour Bulletin in late 2011 (covering 2009–2011) notes that workers are increasingly proactive. They are no longer content to wait for the government to introduce new policies or legislation, or to increase the minimum wage, but increasingly take matters into their own hands by initiating strikes for higher pay and other demands.

### 6.3 Compensation of SOE managers

In the early reform period, compensation of SOE managers remained limited, with perhaps bonuses that exceeded those of the average staff and worker, but otherwise little differentiation between management and average staff and workers. Greater wage differentiation soon ensued, followed by adoption of the “annual salary” system (which includes a performance-based component), and explicit evaluation criteria.

#### (i) Early wage differentiation

Compensation of managers became an issue with the introduction of the SOE contract responsibility system in the second half of the 1980s, when enterprises gained greater leeway in the allocation of funds. The original stipulation on the contract responsibility system (SC, 27 February 1988) denoted only one article (out of forty-five) to manager compensation: manager income may not exceed average staff and worker income by more than one to three times; in exceptional cases, it may be somewhat higher. If the contract is not fulfilled, manager income may be slashed to one-half the “basic wage.”

The Labor Ministry on 27 August 1992, referring back to the contract stipulation, issued suggestions on how to “improve and perfect” the distributional mechanisms for SOE manager compensation. Manager compensation depends on fulfillment of the contract, the extent of contractual obligations, risk, and “other factors,” with preservation and increase of state assets and the enterprise development potential being further singled out as

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<sup>68</sup> One may wonder what the statement refers to when it mentions the “market wage standard?” Is this truly a market wage, or is this a local state-ordained minimum wage, or a local state wage (increase) guidance line?

fundamental factors.<sup>69</sup> Actual compensation is expressed in multiples of average staff and worker wages. SOE managers' compensation should not be more than double the average wage. Though, if the SOE's best historical performance is exceeded, SOE managers' compensation may be between double and triple the average wage, and in (other) exceptional (listed) circumstances may also reach double to triple the average wage. If an SOE is leased out (*zulin jingying*), the absolute maximum manager compensation is five times the average wage.

On 13 May 1994, the Labor Ministry admonished SOE managers not to increase their own wages without obtaining prior approval from the relevant department. According to the circular, managers of "a small number of SOEs" have been increasing their own salaries without going through the regular approval procedures. While a new administrative regime for remuneration of enterprise managers is said to be forthcoming, currently the 1992 measure is still in effect. This is the first time that approval by the relevant departments is made an explicit requirement, although it may have been implicit in the contract responsibility system earlier.

## (ii) Introduction of "annual salaries"

The Labor and Social Security Ministry on 7 February 1997 issued a circular on the main wage issues during the Ninth Five-Year Plan. The circular announces trial implementation of annual salaries for managers, explicitly allowing for divergence in manager and staff and worker salaries. Manager salaries are to take into account the difficulty of managing the enterprise, risk, and performance. All compensation of managers is to be included in the annual salary, which consists of two components, the "basic income" and the "efficiency income" (performance-based income). The basic income is expressed as a multiple of average staff and worker wages in the locality and enterprise, while no further details are provided on the performance-based income, except that no performance-based income may be paid if the manager does not maintain or increase the value of the state assets.<sup>70</sup>

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<sup>69</sup> Maintaining and increasing state assets became a major recurrent topic of subsequent years and was first regulated by the State Asset Administration Office on 31 December 1994 with trial measures, before the Finance Ministry issued regulations on 26 April 2000(b), and 19 March 2001.

<sup>70</sup> Localities issued their own specifications, often with much detail. The Qinghai Labor and Personnel Office, for example, on 15 December 1994 determined that management compensation is to consist of a basic salary and "risk income" (performance-based income, *fengxian shouru*), with the risk income being equivalent to 30 percent of the basic salary if all assessment indicators meet the target, and 50, 70, or 100 percent of the basic salary if they are exceeded (with detailed criteria given). The Shanghai Labor Office on 16 August 1995 asked for the selection of a few (large) trial enterprises to implement the annual salary system, with a

Two years later, the Labor and Social Security Development Master Plan for 1998–2002 (LSSM, 1 September 1999) asked for management salaries to be guided by the price of managers on the labor market, with enterprises performance and the maintenance and increase of state assets as main criteria. On 28 January 2000, the Labor and Social Security Ministry in a circular on the “main issues” for 2000 announced the trial implementation of annual salaries (*nianxin*) plus share allocations for managers in enterprises that had undergone the modern enterprise system reform. The Labor and Social Security Ministry in its circular on the “main issues” for 2002 reiterated that “trial work” on annual salaries for management of central enterprises is to be “done well” (*zuohao*). Localities are to gradually standardize the annual salary experiments and to establish incentive and constraint mechanisms (29 January 2002).<sup>71</sup>

A State Economic and Trade Commission circular (co-signed by the Labor and Social Security Ministry and the Personnel Ministry) of 13 March 2001 abolished administrative ranks for enterprise personnel, thereby potentially freeing management salaries from state salary constraints. Staff and worker salary levels, without special mentioning of managers, are now to be determined by the enterprise (presumably the managers) within the macroeconomic control objectives of the state and according to “society’s” average wages and enterprise performance.

### (iii) Evaluation criteria for manager compensation

In 1999, the Finance Ministry introduced detailed instructions for “state-owned capital performance evaluation,” with a follow-up circular in the same year and further instructions in 2000 (FM, 1 June 1999, 13 August 1999, and 26 April 2000(a)). The 2000 instructions include a sentence to the effect that this performance evaluation can form the basis for manager evaluation (such as for managers of SOEs with trial implementation of the annual salary, stock compensation, and option incentives).

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basic salary and an “additional salary” (*jiaxin*) as the two components. The basic salary is in the 20–50,000 yuan range (as long as state assets are preserved), while the additional salary depends on the increase in state assets and other performance indicators (such as the return on net assets) and is to remain within the same amount as the basic salary, with the possibility of reaching up to three times the basic salary in exceptional circumstances.

<sup>71</sup> Outside the state sector, Fleisher and Wang (2003) in a panel survey of 200 large rural enterprises (mostly township and village enterprises) in 1984 through 1990 find that the ratio of wages of both enterprise directors and technical workers to those of production workers is positively related to potential economic profit. (Given the limitations of their data, they cannot test if the positive link to profit also holds for absolute wages of directors, technical workers, or production workers.)

After its establishment in 2003, SASAC moved to regulate manager compensation in the enterprises under its control with an initial “temporary measure” in 2003 that was revised in 2006, 2009, and 2012 (SASAC 25 October 2003, 31 December 2006, 28 December 2009, and 29 December 2012). Localities then proceeded similarly for their local SOEs.<sup>72</sup>

The 2003 regulation (Section 4) specified three types of compensation for the “responsible persons” in enterprises: the basic (annual) salary, the performance (annual) salary, and medium-/long-term incentives. Remuneration in each of these three categories depends on the letter grade (A–E) obtained in the manager evaluation, where the performance salary is expressed as a multiple of the basic salary, with the multiplication factor depending on the letter grade. Managers themselves appear to have much say in the establishment of the specific target values for each evaluation criterion (which range from annual profit to enterprise-specific criteria established by SASAC): “Responsible persons in the enterprises shall, in accordance with the annual performance evaluation requirements established by SASAC and in accordance with the development plan and management situation of the enterprise, propose the values for next year’s management targets that are to be completed” (Art. 9.1, and similarly in the 2006, 2009, and 2012 revisions).

Numerous revisions were introduced in the subsequent 2006, 2009, and 2012 regulations, fine-tuning various aspects of the evaluation mechanism. For example, in 2006, SASAC surrendered to the Board of Directors the authority to evaluate management in those solely state-owned companies which were experimenting with a Board of Directors and in which external directors accounted for more than half of all directors. By 2009, additional requirements were introduced: the company must have a complete corporate governance structure and a sound management appraisal system in place, and all members of the salary and evaluation committee must be external directors. The authority to approve management-proposed target values for the performance criteria (the achievement of which would then trigger particular compensation) in those companies is, however, not explicitly shifted to the Board of Directors.

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<sup>72</sup> For example, the Gansu government on 14 September 2011 issued a regulation on standardizing management compensation in SOEs. It identifies three types of income: basic annual salary, annual performance salary, and medium- and long-term “incentive income.” The basic salary is not to exceed average staff and worker wages more than five times. For the performance-based salary, it refers to the SASAC regulation of 28 December 2009, while the incentive salary is to be determined according to “relevant regulations” of the state.

The relative weights attributed in the evaluation system to different criteria also changed over time. In 2003, the basic weight for total profit is 30 points, for return on net assets 40 points, and for all others 30 points. (Additional points are possible if targets are significantly exceeded, up to a maximum of specified single-digit additional points.) By 2012, the basic weight for total profit is 20 points and for value-added 50 points (with additional criteria that are expressed in terms of additional points or in terms of percentages of total points achieved). This suggests a large-scale shift to economic growth targets away from return on assets.

The regulations on evaluation criteria do not expand on medium-/long-term incentives. A regulation on compensation of management through equity, issued by the China Securities Supervision and Regulatory Commission on 6 December 2006, remains a purely technical “trial measure” that does not regulate the amount of equity that may be given to management. Details are available in the case of equity incentives for management of Chinese state-controlled stock companies that are listed abroad, issued by SASAC on 27 January 2006. Numerous restrictions apply. For example, during any one equity incentive plan period, the total equity awarded may not exceed 10 percent of the company’s capital, the equity awarded in the first instance should not exceed 1 percent of the company’s capital, and the cumulative volume of equity awarded to all upper-level administrators (*gaoguan*) should not make up more than 40% of their total remuneration.

Compensation based on management evaluation appears to not have been a smooth process. A SASAC circular of 26 December 2007 provides “suggestions” on how to strengthen administration of management compensation. These suggestions include that the annual salary (basic salary plus performance salary) of responsible persons may not increase more than enterprise performance, and that responsible persons of central state-owned enterprises may in principle not hold a second position and draw a salary in a subsidiary. “Guiding suggestions,” issued by the Human Resources and Social Security Ministry (together with the central Organization Department, the Supervision Ministry, the Finance Ministry, the Auditing Bureau, and SASAC) on 16 September 2009 and not available publicly, are reported to have issued “explorative principles” for medium-/long-term incentives (including equity incentives), while otherwise focusing on annual salary and performance salary in an attempt to balance incentives for management with adjusting income dis-

parities between management and staff and workers. Supplementary insurance for managers also became regulated and on-the-job consumption was to be curbed.<sup>73</sup>

The “guiding suggestions” thus include a curb on the 1997 permission for salaries of managers to diverge from average staff and worker salaries. The issue received further attention in subsequent years. For example, a State Council policy document on income distribution of 3 February 2013 requests strengthening the administration of the salary administration of top management in SOEs by controlling the total wage bill and requiring salary increases of management to remain below increases in average staff and worker salaries (presumably in relative growth terms).

A news item of 2013 reports that in 2010 and 2011 SASAC set annual salaries of responsible persons in central enterprises at 90 percent and 80 percent of the maximum limit set by the Human Resources and Social Security Ministry, which then is said to translate into an average salary of responsible persons in central enterprises of between 650,000 and 700,000 yuan.<sup>74</sup> Such fixed numbers appear plausible only for the *basic* annual salary (though the article does not make the distinction), as the performance salary depends on the grade received in the annual evaluation. Regulations by the Human Resources and Social Security Ministry specifying limits for management salaries appear not available in the public realm.

#### (iv) Evaluation

With manager salaries in the early reform years expressed as multiples of average staff and worker wages, managers had every incentive to drastically increase the total wage bill. The link was partially severed in 1997 only: the basic salary continued to be expressed as mul-

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<sup>73</sup> Remuneration principles in financial intermediaries (all under the Finance Ministry) closely follow those of the central enterprises under SASAC. According to a Finance Ministry regulation of 8 February 2010, management in financial intermediaries also enjoys a basic salary, performance salary, and medium-/long-term incentives, with the basic salary determined by position, comparable salaries in the local financial sector, the management situation, and competitiveness. Technically, the basic salary is set equal to average staff and worker wages in central enterprises times 5, multiplied by an adjustment factor and by a distribution factor, with the latter two incorporating the various criteria. The performance salary is not to exceed three times the basic salary and depends on the letter grade obtained in the management evaluation. The annual percentage increase in basic salary plus performance salary together may generally not exceed the percentage increase in average staff and worker wages. (The percentage increases and other elements of the remuneration system promptly became the subject of an investigation launched by the Finance Ministry on 26 November 2010.) The distribution factors of financial institutions that have become stock companies are to be determined internally within the financial institution (“according to the legal procedures”).

<sup>74</sup> See the article “The average annual salary of responsible persons in central enterprises in 2011 was between 650,000 and 700,000” (2011 nian yangqi fuzeren pingjun nianxin zai 65 wan zhi 70 wan zhijian). At <http://energy.people.com.cn/n/2013/0125/c71661-20329591.html>, accessed 12 March 2014.



multiple of average staff and worker salaries, while the efficiency salary is dependent on efficiency measures. The link was reinstated for wage *increases* around 2009, though this renewed link may be difficult to enforce in the face of much varied mechanisms of management compensation.

With the introduction of a formal management evaluation system around 2000, and then rigorously regulated for central enterprises starting 2003, the mechanisms of management compensation appear to have become much more fragmented, with basic salary, performance salary, and the medium-/long-term incentives on which very little is known. The basic salary appears subject to limits imposed by the Human Resources and Social Security Ministry and be de facto close to these limits. The performance salary early on depended mostly on profit and profitability, before the weighting began to favor value-added and thereby economic growth. With the performance salary potentially exceeding the basic salary up to around three times, profit/profitability and value-added could well be the driving forces of management compensation. The extent and thereby importance of the performance salary depends on the target values. Early on, management itself determined the target values, and later on the Board of Directors in companies, so that the default performance salaries de facto may well tend to be the upper limits permitted by the regulations.

Overall, it appears that the criteria for management compensation closely follow the general wage determination process in effect at any point in time. Early on, staff and workers enjoyed bonuses while management salaries were determined as a multiple of staff and worker wages (including bonuses). Later, efficiency measure gained importance for management compensation just as the enterprise in total entered a wage-performance link. Most recently, the focus appears to have shifted to value-added as the size of the total pie which, after paying taxes, making depreciation allowances, and remunerating the owner of the enterprises, is distributed to staff and workers (possibly increasingly via collective bargaining) and to managers (whose performance criteria now include a heavy weight on value-added).

In the literature, Sheng and Zhao (2013) are exceedingly critical of SOE management compensation mechanisms. They claim that formal management compensation constitutes only a small part of management remuneration; on-the-job consumption amounts to a multiple of formal compensation. In their study they find that management compensation itself shows no correlation with performance (measured as profits). In their view, SOEs are

being used by management as well as employees to extract high salaries as well as large amounts of non-formal remuneration.

## 6.4 Foreign-funded enterprises

Wage-setting in foreign-funded enterprises (and in private enterprises) does not fall under a state-ordained wage-performance link or a detailed wage plan. However, wage guidance lines, labor contracts, collective (wage) bargaining, and minimum wages (below) all apply to these enterprises. Collective (wage) bargaining appears to particularly target the foreign-funded and private enterprises. The Labor Ministry in 1994 made explicit that wage levels in foreign-invested enterprises (including equity and contractual joint ventures, wholly foreign-owned enterprises, and joint stock companies) are to be determined by the enterprise in accordance with the guidance wage line issued by the local government or labor department and to be adopted through collective discussions (LM, 11 August 1994).

Nominal wages (*mingyi gongzi*) of senior Chinese management in foreign-invested enterprises are determined by the Board of Directors in accordance with the principle of same pay for same work (with wages of foreign employees in mind), while “actual wages” (*shide gongzi*) in form of actual labor remuneration of Chinese management are determined by the Chinese side according to the production scale, average staff and worker income, labor productivity, profitability, maintenance of state assets, realized profit, and production responsibility (LM, 14 July 1995). Two years later, the Labor Ministry (14 February 1997b, repealed by LSSM, 18 May 2004) reiterated the arrangements for “actual wages” of Chinese management, now specifying as criteria the enterprise’s internal wage system and wage standards, labor productivity, return on capital, realized profit, average wages of the enterprise’s staff and workers, and the government’s “relevant regulations.” The difference between nominal and actual wages of Chinese management is to be redistributed to supplement Chinese staff and workers’ social insurance, social welfare, and housing fund.<sup>75</sup>

By 1996, first collective bargaining and then collective wage bargaining began to take hold in the foreign-funded sector. (For details, see section above on collective (wage)

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<sup>75</sup> The redistributive measure led to a number of follow-up regulations (for example, LM, 3 November 1997). This regulation also mentions the use of the “total wage bill usage manual” (*gongzi zong’e shiyong shouce*) as a recording mechanism for all wages paid in foreign-funded enterprises.

bargaining.) The Labor Ministry in early 1997 issued “suggestions” on collective wage bargaining in foreign-funded enterprises (LM, 14 February 1997a). It listed three prerequisites for collective bargaining (such as the labor union or more than half of the staff and workers requesting collective wage bargaining), four principles (such as remuneration according to labor, and same remuneration for same labor), and ten specific sets of indicators that are to be considered (reflecting enterprise performance but also regional and sectoral factors, as well as the state wage guidance line).<sup>76</sup>

A wage/income administration measure was issued on the same day (LM, 14 February 1997b). It required the Board of Directors of newly established foreign-funded enterprises to fix wages at a level no lower than the local average staff and worker wages, and it made wage increases (passed by the Board of Directors or resulting from collective wage bargaining) dependent on just four indicators: the enterprise’s economic performance, labor productivity, the local urban consumer price index, and the local government’s wage guidance line. The measure was repealed in 2004 (LSSM, 18 May 2004), presumably leaving wage decisions in foreign-funded enterprises an enterprise-internal matter, subject to collective bargaining.

## 7 Wage setting in state organs and administrative units

In the second wage reform, of 1985, wage determination in state organs and administrative units was decoupled from that in enterprises, with a continued focus on wage plan and bonus payments rather than a wage-performance link for state organs and administrative units. The third wage reform, of 1993, proceeded alongside a significant reform of China’s administrative apparatus.<sup>77</sup>

<sup>76</sup> The three prerequisites are: enterprises must have started production; either the labor union or more than half of the staff and workers must have requested collective wage bargaining; and the enterprise has the basic data and information needed to implement collective wage bargaining. The four principles are: the internal wage/income distribution must follow “distribution according to labor” and “same remuneration for same labor;” the real wage level should increase based on the economic development of the locality and of the enterprise; the interests of both the enterprise and the staff and workers are to be considered; and neither side is to exhibit excessive behavior during the bargaining period. The ten indicators are: regional, sectoral, and enterprise labor costs; regional and sectoral average staff and worker wages; the government wage guidance line; the urban household consumer price index; the total staff and worker wage bill of the enterprise and the average staff and worker wage; realized profit and taxes; labor productivity based on net material output; maintenance and increase in state assets; the ratio of wages to profit and taxes; and the return on capital.

<sup>77</sup> Instructions on wage reform for employees of state organs and administrative facilities were issued by the State Council on 15 November 1993, followed by detailed implementing instructions issued by the Personnel Ministry for civil servants on 11 January 1994.

For state organs, salaries are unified across occupations and comprise four components: (i) position-based salary (*zhiwu*) with a salary range for each position, (ii) 15 salary ranks (*jibie*),<sup>78</sup> (iii) basic salary (identical for everyone), and (iv) an age-based salary. In late 2001, for example, the monthly position-based salary of a minister ranged from 560 to 1190 yuan RMB, the rank-based salary from 115 to 1166 yuan RMB, the basic salary was 230 yuan RMB, and the age-based salary amounted to one yuan RMB per work year (SC, 23 September 2001). Most of the existing special allowances for staff in state organs are to be abolished, and staff are to be compensated by a corresponding choice of wage standard (position and rank) in the new system. Allowances are to be based on geographic location, with special allowances for remote locations. A special allowance is also retained for (and tied to) specific posts, such as public security work. Bonuses can be paid as part of the December salary. This new wage standard is to be adjusted once every two years.<sup>79</sup> The basic wage is to be adjusted in accordance with urban living costs, while the other three components of the salary are to be adjusted in accordance with the level of economic development and the wage level in comparable positions in enterprises.

The wage standards of administrative facilities follow similar principles, although much depends on in which of five categories the facility falls (ranging from educational units to financial institutions), and employees typically enjoy just one wage component (the positional component) plus allowances, which seem to play a more important role for administrative facilities than for state organs. Bonuses are possible. A distinction is made between professional and technical personnel (*zhuan ye jishu ren yuan*), administrative personnel (*guan li ren yuan*), and workers (*gong ren*, of technical and “ordinary” type).

Three types of administrative facilities are identified. Administrative facilities that are fully dependent on budgetary appropriations follow the principle of “guaranteed wage bill:” no matter if the number of employees increases or decreases, the wage bill remains the same (which obviously creates incentives for the unit to reduce formal employment and increase income per worker via allowances and bonuses). Administrative facilities that are partially dependent on budgetary appropriations either follow the “guaranteed wage bill”

<sup>78</sup> Art. 19 of the Civil Servant Law of 2005 (NPC 27 April 2005) specifies that the rank (*jibie*) depends on the position (*zhiwu*), moral integrity and professional competence (*de cai biao xian*, also translated as political integrity and ability), work performance (*gong zuo shi ji*), and qualifications (*zili*, also translated as seniority).

<sup>79</sup> Details on specific wage scale adjustments are readily available for the wage scale adjustments of 1 July 1999, 1 October 2001, and 1 July 2003. For example, on 1 July 2003, the positional wage component was adjusted from the (at each position) starting wage of 50-480 to 100-850. That is a very large adjustment at a time of no inflation, with a doubling of the positional wage component. The other wage components were not adjusted. (For the three adjustments, see SC, 31 August 1999, 23 September 2001, and 17 November 2003.)

principle or some other approved procedure. Administrative facilities that are self-supporting may follow the same remuneration system as enterprises do. Further regulations apply on how much of the wage bill may be spent on non-fixed wages, i.e., on allowances and bonuses (for the three types of administrative facilities: 30 percent; 40 percent; “can be a bit more than 40 percent”). The wage scale of administrative facilities is also adjusted regularly, according to the same criteria as in the case of state organs (except that the criterion of living costs is replaced by inflation).

The 1993 wage reform thus produced a very regular wage progression. Staff and workers in state organs and administrative facilities move up the wage scale as they advance in their jobs, and at the same time benefit from bi-annual adjustments of the complete wage scale. While entry and exit into the work force of state organs and administrative facilities may balance each other and an individual’s job progression thus may have no influence on the overall wage bill (or the average wage), the bi-annual adjustment is likely to have created a momentum for regular wage increases. These wage increases are not tied via any formula to, for example, price increases. Rather, the reference to three vaguely phrased underlying factors – living costs for state organs and inflation for administrative facilities, economic development, and wage level in comparable positions in enterprises – suggests scope for a large political or otherwise non-economic element in wage determination.

Subsequent years saw no innovations in wage setting in state organs and administrative units. Most recently, a State Council policy document on income distribution of 3 February 2013 requests the establishment of a survey system to obtain data on civil servant salaries vs. the salaries for comparable positions in enterprises. The basic salary is to be increased while subsidies and allowances are to be reduced.

## 8 Minimum wages

In the reform period, minimum wages were first established in 1994 following a regulation issued by the Labor Ministry on 24 November 1993.<sup>80</sup> The Labor Law of 1994 (NPC, 5 July 1994, Art 48) confirmed the implementation of a minimum wage system, and the La-

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<sup>80</sup> A minimum wage regulation for commerce was issued in 1963 and repealed in 1984. Shenzhen may have introduced a minimum wage for the first time in 1992, with published minimum wage data available for the years since 1993.

bor and Social Security Ministry on 30 December 2003 issued a revised minimum wage regulation effective 1 March 2004.<sup>81</sup>

The published minimum wage is a monetary wage, i.e., does not include in-kind payments. Minimum wages are province-specific, and within a province minimum wages may vary by district and/or sector. They are set by the month, but can also be set by the week, day, or hour.<sup>82</sup> Adjustments are to be made no more than once a year (LM, 24 November 1993), and later at least once every two years (LSSM, 30 December 2003). A number of factors are to be taken into account when determining minimum wages; Table 1 provides an overview.

Minimum wages are set at the provincial level, by the provincial labor department in collaboration with the labor union and enterprises. Subsequent regulations place responsibility for setting minimum wages on the labor departments under the guidance of local governments “while actively consulting the relevant departments and social organizations” (LM, 8 October 1994), or on local labor departments in conjunction with (*huitong*) the labor union and the enterprise federation or the entrepreneur’s association (LSSM, 30 December 2003).<sup>83</sup>

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<sup>81</sup> The revised Labor Law of 2007 (NPC, 29 June 2007) no longer contains a section regulating minimum wages, but refers to the minimum wage (for example, in Art. 72, on part-time labor).

<sup>82</sup> Many news items report hourly wages in addition to monthly wages, with what appears an unexplained statistical break in the hourly wage in the mid-2000s. Earlier values of hourly minimum wages seem to be derived as monthly minimum wage divided by (approximately) the number of monthly work hours; later hourly minimum wages can be close to double that value. There could be a distinction between hourly wages of full-time employees (obtained as monthly minimum wage divided by monthly work hours) vs. hourly wages of part-time employees, or a distinction between hourly wages paid vs. hourly wages paid including benefits. In the case of Beijing, starting 1 January 2013, the former value is 8.05 yuan per hour compared to a monthly minimum wage of 1400 yuan (173.91 work hours per month), and the latter value is 15.2 yuan per hour, including pension contribution, health insurance, and unemployment insurance (Beijing HRSSO, 28 December 2012). The Labor and Social Security Ministry on 30 December 2003 in explaining how to derive the hourly minimum wage (for part-time employment) from the monthly minimum wage states that the translation of the monthly minimum wage into the hourly minimum wage contains a mechanic part (20.92 work days per month, 8 hours per day) as well as a part that depends on various local fees and an adjustment factor. The Labor and Social Security Ministry in a circular of 5 April 2005 asked provinces that had not yet issued hourly minimum wages to in their determination of hourly minimum wages consider the pension contribution and health insurance fees that are to be paid by the work unit.

<sup>83</sup> Fang and Lin (2013) report that minimum wages may vary by county, i.e., the differentiation occurs not only at the provincial level but also at the municipal and then at the county level.

Table 1 Criteria to apply in the determination of the local minimum wage level

	1993	1994	2003	2007	2008	2011	2013
Minimum living cost standard	x	x	x				
Average salary of staff and workers	x		x	x	x		
Average wages		x					
Labor productivity	x	x				x	
Urban employment situation	x						
Employment situation		x	x	x	x		
Economic development	x		x	x	x	x	x
Regional differences in econ. development		x					
Urban CPI			x	x	x		
Price changes						x	x
Impact on low-income staff and workers					x		
2015 target of 40 percent of urban average wage							x(4)
Notes	(1)		(2)	(3)			

1993: LM, 24 November 1993 (Minimum wage regulation)

1994: NPC, 5 July 1994 (Labor Law)

2003: LSSM, 30 December 2003 (Minimum wage regulation)

2007: LSSM, 12 June 2007

2008: HRSSM, 7 August 2008

2011: China's Minister of Human Resources and Social Security, news item of 9 March 2011 in *China Info-bank*.

2013: SC, 3 February 2013 (policy document on income distribution)

(1) Higher than social benefits and unemployment insurance benefits, and lower than average wages.

(2) Consider social security fees paid by staff and workers and housing subsidies. (First appeared in a response by the Labor and Social Security Ministry to a local inquiry in LSSM, 5 November 2001.)

(3) Ensure that minimum wages do not rise less than the CPI and that they gradually increase in line with economic growth.

(4) The target is stated separately from the criteria: minimum wages are to reach 40 percent of local urban laborers' average wages by 2015 in most regions (*daduoshu diqu*).

According to the original regulation of 1993, enterprises covered by the minimum wage requirement include all domestic enterprises with economic activities and in which laborers receive labor remuneration. A subsequent sentence, however, specifies that provinces are to decide if township and village enterprises are included or not, a sentence that does not survive beyond this 1993 regulation. The Labor Ministry in 1994, in a circular regarding the implementation of the minimum wage system, makes explicit that the coverage besides enterprises includes sole proprietorships, state organs, administrative facilities, and social organizations (LM, 8 October 1994). The Labor and Social Security Ministry in 2003 in the revised minimum wage regulation explicitly includes "private (*minban*) non-enterprise units" (LSSM, 30 December 2003).

The 1993 and 2003 minimum wage regulations both offer details on how to determine the level of the local minimum wage (LM, 24 November 1993; LSSM, 30 Decem-

ber 2003). An appendix to a Labor Ministry circular lists eight possible methods to calculate the level of the minimum wage and explains in detail two methods (one centered on average living cost expenditures, and one on Engel's law), with variation according to the factors reported in Table 1 (LM, 24 November 1993). It also mentions the international norm of minimum wages being set at 40–60 percent of average wages, and asks to consider if the minimum wage level is feasible for the majority of the local enterprises.

The translation of the monthly minimum wage into an hourly minimum wage involves the number of work hours per day, and the number of work days per week and month. Effective 1 March 1994, work hours were set at 8 hours per day and 44 hours per week, revised shortly thereafter to 8 hours per day and 40 hours per week starting 1 May 1995 (SC, 3 February 1994; LSSM, 25 March 1995; SC, 25 March 1995; PM, 26 March 1995).<sup>84</sup> The number of public holidays annually increased from 7 to 10 on 18 September 1999 and to 11 on 1 January 2008.<sup>85</sup> I.e., wages per hour worked increased on these occasions solely due to changes in weekly work hours and in the number of holidays per year.

By the mid-2000s, a number of exhortations to increase the minimum wage were issued. Thus, the Labor and Social Security Ministry on 5 April 2005 issued a circular that asked provinces that had not yet raised the minimum wages in 2004 – the date given is 2004 even though the circular was issued in 2005 only – to increase them in a timely manner. Especially those provinces that have not increased minimum wages since 2002 are to act and in principle adjust and promulgate new minimum wages within “this year” (presumably, 2004).

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<sup>84</sup> The changes in work hours are not to affect employment or overall wages (LM, 8 February 1994b). If enterprises experience difficulties in implementing the new arrangements, implementation can be delayed through 1 May 1997. A further regulation by the Labor Ministry of 24 April 1997 then addressed continued difficulties (pay overtime wages for in excess of 40 work hours, and provide a plan on how to as soon as possible implement the 40 hour work week), and was followed by additional responses to local questions (LM, 10 September 1997)..

<sup>85</sup> See SC, 18 September 1999 and 14 December 2007, for the two changes. Both are revisions of the original 1949 regulation. Different conversion factors of months into days appear to have been in use over time. One news item in *China Infobank*, for China, reports 21.16 days as of 8 June 1999, compared to 21.5 days “earlier.” Another news item (of 5 July 2002) specifies 20.92 days per month (as in the Labor and Social Security Ministry regulations of 17 March 2000 and 30 December 2003) and 167.4 hours per month, effective 1 May 2000. For Shenzhen, the news item in *China Infobank* of 8 June 1999 reports that with the year 1999, the hourly minimum wage in Shenzhen increased while the monthly minimum wage remained unchanged, and this change in hourly minimum wage is due solely to a change in the number of public holidays to seven. Shenzhen's earlier hourly minimum wage reflects exactly three public holidays, in contradiction of the nationwide regulation stipulating seven public holidays through late 1999. The Labor and Social Security Ministry on 3 January 2008 decreed that the work year has 250 work days (365 less 104 days of rest, less 11 days of public holidays), which implies 20.83 work days per month. For the calculation of daily and hourly wages, public holidays do not enter the calculation, and a month therefore has 21.75 days (365 days less 104 days of rest, divided by 12 months); this replaces the regulation of 17 March 2000.



In 2005, a NPC report on the implementation of the Labor Law (NPC, 28 December 2005) found a number of faults with local minimum wages. The wages of 12.7 percent of the staff and workers covered by the NPC investigation were below the local minimum wage level; piece rates were set such that the minimum wage was unachievable within the legal eight work hours per day; and some localities set the minimum wage level very low.<sup>86</sup>

In 2007, the Labor and Social Security Ministry requested that minimum wages do not rise less than the CPI and increase in accordance with local economic growth (LSSM, 12 June 2007). Localities that have adjusted minimum wages only once in the last two years are asked to raise minimum wages again before the end of 2007; similarly for localities in which over the last two years minimum wages have not risen in step with the average staff and worker wage and where the current minimum wage level is “distinctly” (*mingxian*) low compared to the average staff and worker wage. Production units in which production is at normal levels and performance is improving are not to use minimum wages (but to set their wages at a higher level).<sup>87</sup> This expectation is repeated in later local regulations.<sup>88</sup>

In 2008, the Human Resources and Social Security Ministry (the renamed Labor and Social Security Ministry) requested that provinces which so far had not yet adjusted the minimum wages in this year were to do so in a timely manner in the second half of the year. Criteria to use in determining the adjustment are: local economic development level, average staff and worker wages, urban CPI and employment situation, and especially the impact of price rises on low-income staff and workers. The adjustment to the minimum wages may not be lower than the increase in the urban CPI.

A news item of 2011 reports that the federation of trade unions in foreign-owned enterprises in Beijing, after two rounds of collective bargaining, for the first time “proposed” (*tichu*) in the collective contract that minimum wages in foreign-owned enterprises should not be lower than 150% of the Beijing minimum wage.<sup>89</sup> (And, for the first time,

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<sup>86</sup> Similarly, Chan (2003, p. 43) reports that “the minimum wage, set by the month, does not reveal the illegally long hours worked by migrant workers to attain that minimum. According to a survey I conducted in China’s footwear industry, the average workday there amounts to about 11 hours each day, often with no days off—that is, about an 80-hour work-week.”

<sup>87</sup> Conversely, production units that for production reasons could not pay higher wages than the minimum wage should discuss the matter with all staff and workers (or their representative’s committee) and obtain their agreement, and then file a report with the local labor departments.

<sup>88</sup> See, for example, Beijing HRSSO, 28 December 2012.

<sup>89</sup> See news item in *China Infobank* of 5 April 2011.

the collective contract this year would include collective wage bargaining, and there would be a push for wage increases to be linked to enterprise performance.)

By the end of September 2011, local authorities in 21 of China's 31 provincial-level regions had increased minimum wages (in 2011) by an average of 21.7 percent.<sup>90</sup> In 2012, 25 provinces increased minimum wages by an average of 20.2 percent, and for 2013 13 provinces announced increases in minimum wages by an average 16.9 percent by 1 April 2013.<sup>91</sup> According to the Human Resources and Social Security Ministry, as part of the 12<sup>th</sup> Five-Year Plan (2011–15), minimum wages will grow by an average rate of at least 13 percent per year, and minimum wages in most parts of the country will reach more than 40 percent of the average income of local urban residents by 2015.<sup>92</sup> The 2015 minimum wage target of 40 percent (of local urban laborers' average wage) is confirmed verbatim in a policy document on income distribution issued by the State Council on 3 February 2013.

Table 2 presents monthly minimum wages for Shenzhen and Beijing, two localities for which a comprehensive set of data can be compiled from numerous individual media reports. Shenzhen's minimum wage is typically the highest in the country.<sup>93</sup> Comparing the development of Shenzhen and Beijing's minimum wages over time to the national CPI and to national secondary sector real labor productivity (Figure 2), the minimum wage increases between 1994 and 2010 are very much in line with increases in real labor productivity: the minimum wages of Shenzhen and Beijing increased 3.7- and 4.2-fold, real labor productivity in the secondary sector 3.8-fold.<sup>94</sup> The urban CPI increased only 1.6-fold. Minimum wages thus appear to be adjusted in line with real labor productivity changes, while the CPI – at least at a graphical level of analysis – appears to play no role.

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<sup>90</sup> Financial Times, "China Labour Costs Soar As Wages Rise 22%," 25 October 2011, with the minimum wage increases announced by the Ministry of Human Resources and Social Security. Several more provinces had promised minimum wage increases before the end of the year.

<sup>91</sup> See news items in *China Infobank* of 28 May 2013 and 5 April 2013. None of these sources elaborates on how the average percentages are obtained.

<sup>92</sup> See "China's Minimum Wage to Grow Over 13% Annually," 29 June 2011, Xinhua News Agency, accessed at [http://www.chinadaily.com.cn/business/2011-06/29/content\\_12803800.htm](http://www.chinadaily.com.cn/business/2011-06/29/content_12803800.htm) on 8 December 2011. China aims to increase urban and rural per capita net income by more than 7 percent per year in real terms over the five years to 2015.

<sup>93</sup> The minimum wage values for Beijing in the early years often come with the attribute "staff and workers." It is unclear if the minimum wage at that time applied only to staff and workers, and not, for example, to migrant workers. At the very latest with the 2003 minimum wage regulation, the minimum wage applies equally to all laborers.

<sup>94</sup> National rather than Shenzhen and Beijing labor productivity data are used because of the difficulty of matching local output and employment data. Employment data are not consistently defined over time, and furthermore may not include all (relevant) migrant workers.

Table 2 Minimum wages of Shenzhen and Beijing (yuan RMB)

	<i>Shenzhen</i>			<i>Beijing</i>	
	Start date	End date	Minimum wage	Start date	Minimum wage
1993			280		
1994			285	1.12.94	210
1995			380		240
1996			398	1.7.96	270
1997			420	1.6.97	290
1998			430	1.7.98	310
(1) 1999			430	1.5.99	320
(2) 1999				1.9.99	400
2000	1.5.00	30.4.01	547	1.7.00	412
2001	1.5.01	30.4.02	574	1.7.01	435
2002	1.5.02	30.4.03	595	1.7.02	465
2003	1.5.03	30.4.04	600		465
(1) 2004				1.1.04	495
(2) 2004	1.5.04	30.4.05	610	1.7.04	545
2005	1.7.05	30.6.06	690	1.7.05	580
2006	1.7.06	30.6.07	810	1.7.06	640
2007	1.10.07	30.6.08	850		730
2008			1000		800
2009			1000		800
2010	1.7.10		1100	1.7.10	960
2011	1.4.11		1320	1.1.11	1160
2012	1.2.12		1500	1.1.12	1260
2013	1.3.13		1600	1.1.13	1400

Start and end dates are in the format Day.Month.Year. No end date is ever published for Beijing minimum wages.

A news item for Beijing of 5 April 2011 in *China Infobank* specifies that the minimum wage for foreign-invested enterprises is 1.5 times the official minimum wage.

Sources: Numerous news items as well as regulations in *China Infobank*; Chan (2003).

This should put to rest any discussion of the relationship between minimum wages and prices, a discussion that by 2011 had become standard fare in the Chinese press. For example, the Chief Economist of the National Bureau of Statistics, Yao Jingyuan, when asked by CCTV, responded that the minimum wage should be linked to the CPI, and that an increase in the minimum wage will not drive up the CPI, reasoning that all around the world inflation is not determined by minimum wages.<sup>95</sup> Figure 2 suggests no relationship between minimum wages and prices.

<sup>95</sup> See news item of 2 May 2011 in *China Infobank*.

Figure 2 Minimum wage and real labor productivity, 1994=1



The minimum wage data presented here take into consideration increases in the postulated minimum wage during the year; when the data of increase is not known, the most plausible date is assumed.

Sources: For minimum wage data, see Table 2; for secondary sector real output, *Statistical Yearbook 2011*; and for the number of laborers (used in the derivation of real labor productivity) of the years since 1990 *Statistical Yearbook 2011*, and for the years prior to 1990 Holz (2008b).

How prevalent is the application of the minimum wage? At one end of the spectrum, Chan (2003, p. 42) writes:

*“When China first instituted a minimum legal wage system in the early 1990s, it had the good intention of protecting workers in the export sector. But soon the function of the minimum wage changed character. It simply became the amount that employers reported to the government they had paid their workers in the labour-intensive export industries; they rarely pay assembly line workers above the monthly legal minimum wage.”*

The 2005 NPC report on the implementation of the Labor Law (NPC, 28 December 2005) stated that many enterprises, even with good performance, were using the minimum wage as their standard rather than raising wages in accordance with enterprise performance and the local government’s wage guidance. By 2013, the Shenzhen Human Resources and Social Security Office responded to the question of if the 2013 increase in the minimum wage will not increase enterprise costs with the answer that it is not the case that most employee

groups (*qunti*) were collecting wages at the level of the minimum wage (suggesting they collected higher wages), and that the minimum wage rather set an example and helped enterprises to upgrade operations.<sup>96</sup>

Fang and Lin (2013) match county-level minimum wage data with urban household survey data for a representative sample of 287,668 wage (worker) observations in 2004 through 2009 and find that 5.62 percent of their wage observations are below the minimum wage level and 3.28 percent are exactly at the minimum wage level.<sup>97</sup> I.e., 91.09 percent of their wage observations are above the minimum wage.

## 9 Evaluation

With the beginning of economic reforms in 1978 and the second and third wage reforms (of 1985 and 1993), the wage determination mechanisms in China underwent major changes. The issue of wage determination in China comprises two aspects: one is the search for mechanisms to objectively determine wages, while a second aspect, relevant in particular in the 1980s and 1990s, is the need for measures in a newly liberalizing economy to prevent what the state considers “excessive” wage increases.

The introduction of piece rates and then bonus payments played a major role in kick-starting urban economic reforms right at the outset of the reform period in 1978, but then threatened to get out of hand. Until 1993, the state imposed brakes on wage increases in form of (i) wage adjustment taxes on those SOEs that implemented the wage-performance link, (ii) progressive bonus taxes on all other SOEs, collective-owned enterprises, and administrative facilities, and (iii) personal income adjustment taxes that mostly affected those individuals not subject to the wage adjustment tax or the bonus tax. In 1994, the state replaced these constraints by personal income taxes, i.e., the state no longer targets wage *increases* (with a sharply progressive tax), but personal income (with a progressive tax).

In 1985, the wage system for enterprises parted ways with that for state organs and administrative facilities. While new mechanisms for determining wages in SOEs were introduced, the state continued (and continues until today) to directly set wages for state

<sup>96</sup> See news item of 1 March 2013 in *China Infobank*.

<sup>97</sup> The table reporting the data is labeled “characteristics of workers earning the minimum wage, 2004-2009,” which would seem to indicate that one observation is one worker-year wage.

organs and administrative facilities. Wage scales of state organs and administrative facilities are typically adjusted bi-annually. Some of these adjustments may happen in response to the development of market wages, but they may also happen for other (such as political) reasons.

In the case of SOEs, starting in the mid-1980s, wage payments of an increasing number of SOEs – and by the early 1990s possibly of nearly all SOEs – were explicitly linked to efficiency changes, often measured as tax and profit remittances, later as a combination of indicators, and then as profit only.<sup>98</sup> (In the case of state monopolies, the state attempts to administratively prevent wage rises too far above “market” levels.) Each year’s base year value of the wage bill is in principle set equal to the previous year’s total reported wages; this year’s wage bill may exceed the base year value if efficiency improves. I.e., the wage bill has a tendency to ratchet up in correspondence with profitability, while it is unlikely, in practice, to decline when profitability declines.

Starting in the late 1990s, but then especially in the second half of the 2000s, collective bargaining was promoted throughout the economy. Collective wage bargaining strikes at the heart of wage setting across the non-public economy, with only recent forays into SOSCEs (SOEs and “state-controlled” enterprises).

At the lower end of the wage scale, wages have become increasingly supported by the state-determined minimum wages. These appear to be revised largely in step with labor productivity changes, with revisions frequently occurring in response to central policy statements.

Until the mid-2000s, the two-tier wage plan system constituted a second, independent brake on SOE wages, transitioning from a rigid wage plan to a “flexible” wage plan. The introduction of wage (increase) guidance lines in the mid-1990s then also encompassed the non-public economy. Local wage guidance lines continue to be issued today, typically with the upper line intended to constrain wage increases in SOSCEs, and the lower line setting a minimum rate of increase for the non-public economy.

The SOE reform program of the years 1998–2000 combined massive lay-offs of workers with SOE bankruptcies and the introduction of the “modern enterprise system” for

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<sup>98</sup> Labor productivity increase is a criterion that appears time and again in the regulations on SOE wage determination, though not in prominent position, with the link explicitly being between wages and a profit measure.

those SOEs deemed viable.<sup>99</sup> This was followed by the creation of the State Asset Supervision and Administration Commission (SASAC) in 2003 to manage centrally owned state companies (and the creation of similar commissions at provincial level to manage sub-central state companies and enterprises). On the one hand, these companies may enjoy greater freedom in determining wages, potentially stepping beyond the wage-performance link requirement, while on the other hand SASAC retains the authority to directly regulate wages in these companies. At the same time, the central government appears to have lost interest in trying to micro-manage enterprise wage bills across the country via wage plan quotas and detailed wage-performance link regulations. Rather, SASAC has become responsible for macro-managing wages in central enterprises, while similar commissions at the local government level do the same for locally owned state enterprises.

Some of the state's wage controls may never have been very effective. The independent wage plan for provinces (central departments) and those enterprises that did not implement the wage-performance link not only had to be reconciled with the concept of some wages being linked to performance, but also lacked mechanisms for enforcement. The wage plan regulations softened by the end of the 1990s, and the wage plan seems to have faded away as effective tool for managing wages in the mid-2000s.

In the two-tier wage-performance link system, the state determines provincial (and central departmental) total wage bills based on provincial (or departmental) performance, and the province (or department) then proceeds likewise with their subordinate SOEs. But the central government is unlikely to have been able to implement a successful constraint on the provincial (central departmental) wage bill, and ultimately on enterprise wage payments. The system appears too cumbersome, and the few documents that mention this upper tier do not provide the details necessary to properly implement such a system. To the extent that it may have been implemented, the total provincial (central departmental) wage bill was probably the outcome of much political bargaining between center and province (central department), and similarly for the relationship between provinces (central departments) and enterprises.

The wage-performance link at the enterprise level likely equally lacked rigor all along, as the frequent circulars requesting, among others, that the multiplication factor not

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<sup>99</sup> The concept of the modern enterprise system includes clearly allocated property rights, clear rights and responsibilities, separation of government and enterprise, and scientific management. It is to be achieved through the company system.

exceed 0.7, attest. The hiring of new laborers and other changes may have provided frequent reasons to adjust base values, which then opened up opportunities for further manipulations.

Table 3 illustrates the potential impact of government regulations on wage determination across the economy in 2009 and 2010. Data are reported for both years due to a change in label for the formal sector laborers from “staff and workers” in 2009 to “urban employment” in 2010, with virtually no change in coverage. The focus in the following is on the 2010 data.

In 2010, 36.7 percent of economy-wide employment was in agriculture. Income in agriculture in the early reform period depended almost solely on state-determined agricultural procurement prices. In 1978, 92.4 percent of agricultural procurement occurred at state-determined prices, 1.8 percent at state guidance prices, and 5.8 percent at market prices. By 1990, the three percentages were 25.0, 23.4, and 51.6, and by 2000 4.7, 2.8, and 92.5.<sup>100</sup> The range of agricultural procurement subject to state-determined procurement prices thus had fallen drastically by 1990 and narrowed to almost insignificance by 1999.

Nevertheless, the state retained a strong, indirect influence in price determination. By 2004, the central government established annual minimum state procurement prices for all major grains. The state grain system offers to purchase an unlimited amount of grain at the minimum state procurement price. The market price of each type of grain is typically slightly above the minimum state procurement price, but in some years, the market price has fallen below the minimum state procurement price. In recent years, market and minimum state procurement prices tended to be above world market prices.<sup>101</sup>

This implies that the state retains its dominant role in determining agricultural income. In the early years, it did so through compulsory procurement at state-determined prices, and it currently does so through its decisions on annual minimum state procurement prices. By limiting imports of grains and setting the annual minimum state procurement price, the state in effect determines agricultural revenues from grain sales, as market prices rarely diverge much from the minimum state procurement price. By regulating the price of intermediate inputs (such as gasoline) and by setting minimum state procurement prices in response to price changes in intermediate inputs, the state effectively determines rural in-

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<sup>100</sup> See Dangdai (1993) and *China Price Yearbook* 1992, p. 79, and 2001-2002, p. 678.

<sup>101</sup> See the article “Liangshi zui di shougoujia zhengce zi 2004nian zhixing yilai” (Implementation of the Grain Minimum Procurement Price since 2004) in the magazine *Zhongguo tongji*, no. 2 (2014), pp. 53-55.



comes from grain production. It is only in non-grain agricultural production that rural incomes may be subject to stronger market forces.

In 2010, 28.7 percent of economy-wide employment was in the secondary sector, i.e., in industry and construction, and 34.6 percent in the tertiary sector. In each of these two sectors, formal sector laborers (“urban employment,” staff and workers) accounted for about one-quarter of employment.

Among urban employees, 67.2 percent of staff and workers were employed by enterprises, 9.4 percent in state organs, and 23.0 percent in administrative facilities. The remainder is split between non-profit organizations (0.2 percent) and “others” (0.2 percent).<sup>102</sup> This means that the wages of one-third of the laborers in the formal urban sector (in state organs and administrative units) are directly determined by the government. The wages of much of the remaining two-thirds of laborers reflect a mix of government wage scales/wage plan for some of the traditional SOEs, wage-performance link mechanisms, possibly collectively wage bargaining, and possibly somewhat independent wage setting (for example, in companies and foreign-invested enterprises).

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<sup>102</sup> For comparison, in 1994 75.8 percent of all staff and workers were employed by enterprises (71.2% in non-agricultural enterprises), 6.8 percent in state organs, and 17.4 percent in administrative facilities; staff and workers accounted for 22.6 percent of total employment (*Labor Statistical Yearbook 1995*, pp. 9, 119).

Table 3 Employment and wage by institution and sector, 2009

	2009		2010	
	Year-end employment in thousand	Average annual wage (th. yuan)	Year-end employment in thousand	Average annual wage (th. yuan)
<b>Total</b>	<b>125,730</b>	<b>32,244</b>	<b>130,515</b>	
<b>A. By institution</b>				
Enterprises	84,127	31,302	87,768	
Administrative facilities	29,298	33,352	30,058	
State organs	11,833	36,468	12,227	
Non-profit organizations	176	29,561	197	
Others	296	22,777	264	
<b>B. By sector</b>				
Primary sector				
Agric., forestry, husbandry, fishing	3,737	14,356	3,757	16,717
Secondary sector				
Mining	5,537	38,038	5,620	44,196
Manufacturing	34,919	26,810	36,372	30,916
Utilities	3,077	41,869	3,105	47,309
Construction	11,775	24,161	12,675	27,529
Tertiary sector				
Transportation, storage, postal serv.	6,344	35,315	6,311	40,466
Information transfer, computer serv.	1,738	58,154	1,858	64,436
Wholesale and retail trade	5,208	29,139	5,351	33,635
Accommodation and restaurants	2,021	20,860	2,092	23,382
Finance	4,490	60,398	4,701	70,146
Real estate	1,909	32,242	2,116	35,870
Leasing and business services	2,905	35,494	3,101	39,566
Scientific research, technical service	2,726	50,143	2,923	56,376
Water, environment, public facilities	2,057	23,159	2,189	25,544
Resident and other services	588	25,172	602	28,206
Education	15,504	34,543	15,818	38,968
Health care, social security / welfare	5,958	35,662	6,325	40,232
Culture, sports, entertainment	1,295	37,755	1,314	41,428
Public management, social organiz.	13,943	35,326	14,285	38,242
<b>Reference</b>	<b>Economy-wide employment (1)</b>			
Total	779,950	(2)23,728	761,050	(2)25,848
Primary sector	297,080		279,310	
Secondary sector	216,840		218,420	
Tertiary sector	266,030		263,320	

(1) 2010 economy-wide employment data are based on the 2010 population census, which also triggered a retrospective (downward) revision of employment values of earlier years (with revised 2009 employment of 758,280 thousand).

(2) Labor remuneration (summed provincial labor remuneration in the income approach to the calculation of GDP) per laborer.

Sources: 2009: *Labor Statistical Yearbook 2010*, p. 8, for economy-wide employment (data available in 10,000 only), and pp. 153–6 for staff and worker data; *Statistical Yearbook 2010*, p. 54, for labor remuneration. 2010: *China Population and Employment Statistical Yearbook 2011*, pp. 217–75, for employment by institution; *Labor Statistical Yearbook 2011*, p. 7, for economy-wide employment (data available in 10,000 only), and pp. 16–18 for urban worker data with wage data on pp. 37–9; *Statistical Yearbook 2011*, p. 60, for labor remuneration.

The remaining three-quarters of laborers in the secondary and tertiary sectors are subject to a wide variety of employment circumstances, from self-employment in sole proprietorships to employment in township and village enterprises and employment in foreign-invested enterprises that may escape inclusion in the formal sector. The mechanisms of wage determination range from the absence of any mechanism to (state-determined) minimum wages starting 1993, collective wage bargaining (under guidance of state-controlled labor unions and the state labor departments) starting in the mid-1990s but gaining full momentum only in the late 2000s, and the state wage guidance lines. For those non-state enterprises eager to attract laborers currently employed by SOEs, wages in SOEs could also provide a reference point.

Overall, thus, wage determination in China appears highly segmented at any point in time, and the mechanisms of wage determination under continuous transition during the reform period. In specific industries, wage determination could be more uniform, such as in industries dominated by state-owned enterprises (with the wage-performance link as dominant wage setting mechanism for much of the reform period), or in industries dominated by private enterprises (with minimum wages as the dominant wage setting mechanism until the arrival of collective wage bargaining).

The government's focus appears to have shifted from microeconomic management of the wage plan system first to macroeconomic control of the wage bill and more recently to a more differentiated approach of keeping wages in SOSCEs under check while encouraging wage increases in the non-public sector.<sup>103</sup> With wage guidance lines, minimum wages, and collective bargaining, the state now focuses on economy-wide arrangements for wage setting. As owner of the SOSCEs, in addition, it protects the state's interests vis-à-vis the employees' interests through the wage-performance link and the adoption of the company system; in companies, the state is in a position to exercise discretionary control over labor remuneration through its representatives on the Board of Directors and the Supervisory Board. Wages of employees of state organs and (state-owned) administrative facilities are state-determined as in other countries around the world.

<sup>103</sup> According to a policy statement on income distribution by the State Council on 3 February 2013, the main objectives currently are (1) to double the per capita urban and rural real income between 2010 and 2020, (2) to reduce income inequality among regions and citizens and (3) to improve the income distribution (the latter, by adjusting income that is too high, standardizing hidden incomes, and banning illegal incomes), and (4) to raise the share of labor remuneration in national income.

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