



Technical Assistance Report

Project Number: 48459-001
Policy and Advisory Technical Assistance (PATA)
June 2015

People's Republic of China: Reforms in the Public Sector Compensation System

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 25 May 2015)

Currency unit	–	yuan (CNY)
CNY1.00	=	\$0.1614
\$1.00	=	CNY6.1974

ABBREVIATIONS

ADB	–	Asian Development Bank
PRC	–	People's Republic of China
TA	–	technical assistance

NOTE

In this report, "\$" refers to US dollars.

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POLICY AND ADVISORY TECHNICAL ASSISTANCE AT A GLANCE

1. Basic Data		Project Number: 48459-001	
Project Name	Reforms in the Public Sector Compensation System	Department /Division	EARD/EAPF
Country Borrower	China, People's Republic of MOF, PRC	Executing Agency	Ministry of Finance
2. Sector		ADB Financing (\$ million)	
✓ Public sector management	Public administration		0.30
		Total	0.30
3. Strategic Agenda		Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change		Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional systems and political economy	No gender elements (NGE)	✓
Knowledge solutions (KNS)	Public financial governance Knowledge sharing activities		
5. Poverty Targeting		Location Impact	
Project directly targets poverty	No	Nation-wide	High
6. TA Category:	B		
7. Safeguard Categorization	Not Applicable		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		0.30	
Policy and advisory technical assistance: Technical Assistance Special Fund		0.30	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		0.30	
9. Effective Development Cooperation			
Use of country procurement systems		No	
Use of country public financial management systems		No	

I. INTRODUCTION

1. The Government of the People's Republic of China (PRC) requested the Asian Development Bank (ADB) to provide technical assistance (TA) to reform the public sector compensation system.¹ A TA fact-finding mission on 7 April 2015 reached an agreement with the government on the impact, outcome, outputs, implementation arrangements, costs, financial arrangements, and terms of reference for consulting services for the TA. The design and monitoring framework is in Appendix 1.²

II. ISSUES

2. The PRC economy has entered a new stage of development, aiming to achieve sustainable growth by transforming the economic structure, enhancing urbanization, and maintaining balance between economic growth and social development.³ The role of the public sector has become increasingly important in realizing sustainable growth. The public sector covers various tiers of governments and public institutions, such as public schools and research institutions.⁴ It provides various services that are necessary for economic activities and society, such as administrative services and social protection. Efficiency in the public sector is critical to the provision of necessary services for those in need with limited fiscal resources.

3. The Third Plenary Session in November 2013 stressed the importance of public sector efficiency, and in March 2015 the Third Session of the 12th National People's Congress identified public sector reform as a focal issue. The fundamentals are to redefine the role of the public sector to meet the market economy system, and fulfill the rule of law in the public sector. Public sector reform focuses on restructuring governments and public institutions, streamlining administration procedures, and strengthening capacity for law enforcement. To restructure the public sector and streamline the administration, human resources need to be reallocated and restructured. Furthermore, competent personnel must be attracted and retained to meet the newly defined role of the public sector and strengthen law enforcement. The management of human resources is, therefore, highlighted as a practical reform area.

4. To strengthen human resource management, the PRC compensation system, including salary and various benefits, needs to be reformed. Governance and incentives are key. Governance is essential to ensure transparency and accountability for the needed restructuring of the human resources and corresponding responsibilities. An incentive mechanism is necessary in a compensation system to attract and retain competent personnel and improve performance. An incentive mechanism links the performance and professional expertise with salary increases. Creating a meritocracy system will be important to identify professional competencies and hard work, which will lead to better performance and improved efficiency in the public sector.

5. The critical bottlenecks in strengthening governance of the compensation system of the PRC's public sector are (i) lack of clear administrative authority and process in determining salary and various benefits of government personnel, and (ii) discrepancies between the budget allocation and actual expense for salaries. The basic salary in the public sector is based on the salary schedule in the PRC. However, each tier of government or each public institution has

¹ The TA is included in ADB. 2015. *County Operations Business Plan: People's Republic of China, 2015–2017*. Manila.

² The TA first appeared in the business opportunities section of ADB's website on 22 May 2015.

³ The PRC has defined the new stage of development as "a new normal."

⁴ In the PRC, public institutions are categorized as "public service units."

certain discretion in the salary amount and increases for each staff member. The administrative authority and process for the discretion is not clearly defined. In addition to the salary, public sector personnel are entitled to various benefits, such as compensation for transportation costs.⁵ The administrative authority and process to determine those benefits are also unclear. Such unclear processes critically undermine governance of human resource management, and make the corresponding responsibility for the performance obscure.

6. In addition, the budget allocation for personnel costs is not necessarily consistent with the actual expense, which indicates that the personnel cost budget may not be executed as planned. This inconsistency between the budget allocation and its actual expense poses a critical question for transparency and responsiveness in budgeting for personnel costs. For the actual expense, governments, particularly local governments, prioritize budget execution for economic development-related expenses, and they further tend to reallocate budget for personnel costs to economic development expenses. Such inconsistency in budget allocation and actual expense sometimes causes budget deficits and results in no payment or delayed payment of salaries, which substantially deteriorates public sector performance. This is a serious problem, particularly at lower tiers of government in the PRC.

7. Another challenge is an incentive mechanism. Compared with the private sector, the public sector does not have an incentive mechanism clearly built in the compensation system. The salary closely links to seniority, but not much to performance. The wage structure is relatively flat in the public sector compared with the private sector. Such wage structure offers relatively high wages for entry level personnel, but low at the middle level in the public sector. That may result in low retention for mid-level personnel, and hinder strengthening of public sector performance. Furthermore, recent policy initiatives to reform the public sector's special entitlements would have an impact on the overall package of compensation. In particular, the government recently released a policy to unify the public sector pension program with the urban enterprise workers' program.⁶ The impact of such a policy change on the compensation package will need to be clarified.

8. The public sector compensation system needs to be reformed to strengthen human resource management and improve public sector efficiency. The wage structure needs to be reformed, and the administrative authority and process for determining compensation needs to be clearly defined. Further, a clear incentive mechanism needs to be built in the compensation system.

9. ADB's country partnership strategy, 2011–2015 for the PRC identifies inclusive growth as one of three pillars.⁷ Efficiency and effectiveness of the public sector need to be improved to ensure the provision of needed public services for inclusive growth.

10. The TA will continue and complement support provided by ADB. Previous ADB TA projects supported improving administration procedures and regulatory frameworks, or targeting

⁵ Those benefits significantly vary among institutions and across regions.

⁶ The PRC pension system has a long history of reforms over the decades. As the result of developments focused on different groups of retirees, the present pension system comprises three separate pension programs: (i) the urban enterprise workers' program, (ii) the special occupations program for civil servants and employees of the public sector, and (iii) the urban and rural residents' program. To unify the public sector program with the urban workers program, the State Council released Decision on the Reform of the State Employee Pension System in January 2015.

⁷ ADB. 2012. *Country Partnership Strategy: People's Republic of China, 2011–2015*. Manila.

beneficiaries of public services.⁸ An ongoing ADB TA project focuses on coordinating social services, and public and private sector collaboration to improve public sector performance.⁹ The TA will focus on inputs in the public sector, i.e., human resources, to improve its performance with particular attention to its compensation system. The TA will help the government strengthen governance and incentive mechanisms in human resource management, which is necessary to realize reforms in the public sector and improve efficiency and effectiveness.

III. THE POLICY AND ADVISORY TECHNICAL ASSISTANCE

A. Impact and Outcome

11. The impact will be improved efficiency and effectiveness of the public sector. The outcome will be an improved public sector compensation system, in terms of governance and incentives. The achievement will be measured by the provision of policy recommendations on improving governance and incentives in the public sector compensation system.

B. Methodology and Key Activities

12. The TA will deliver two major outputs:

- (i) policy recommendations (a knowledge product) on improving a compensation system in the public sector produced; and
- (ii) capacity of relevant government officials improved to enhance their understanding of a better compensation system in the public sector. The knowledge product will be disseminated to government officials and other stakeholders at workshops.

13. The policy recommendations (a knowledge product) will be based on reviews of the current compensation system of government institutions as well as public service units, particularly education, research, and medical institutions, in the PRC; and an analysis of international good practices for compensation systems for the public sector.¹⁰ It will also analyze lessons from failed reforms in other countries. The scope of the reviews and analysis will cover a whole compensation system, including basic salaries and various benefits. Key areas to be analyzed will be (i) an administrative mechanism and process to determine the salary and other benefits in the public sector with a clear authority and responsibility, (ii) a system of budget allocation for personnel costs and actual expense, (iii) wage structures, (iv) regional salary differences, and (v) incentive mechanisms. The last three areas will also be analyzed in comparison with the private sector. The knowledge product will also cover issues of performance measurement. The TA will analyze challenges in the current compensation system of the PRC public sector to improve human resource management and public sector efficiency and effectiveness. The TA will produce policy recommendations to address those challenges.

⁸ ADB. 2010. *Technical Assistance to the People's Republic of China for Capacity Development for Rural Pension Administration and Services*. Manila; ADB. 2012. *Technical Assistance to the People's Republic of China for Streamlining Legal and Regulatory Framework for Social Assistance*. Manila; and ADB. 2012. *Technical Assistance to the People's Republic of China for the Performance Evaluation Model for the Urban and Rural Subsistence Security System*. Manila.

⁹ ADB. 2014. *Technical Assistance to the People's Republic of China for Improving Efficiency in Public Service Procurement, Delivery, and Financing*. Manila.

¹⁰ The PRC public sector comprises government institutions, such as the central and local governments, and public service units, such as public schools, research institutions, and health institutions.

14. To enhance awareness of key issues and policy recommendations to address the challenges, workshops for relevant government officials and other stakeholders will be conducted during project implementation.

C. Cost and Financing

15. The TA is estimated to cost \$315,000, of which \$300,000 will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-other sources). The government will provide counterpart support in the form of counterpart staff, data, logistics, and other in-kind contributions; and will assist in arranging meetings with counterpart agencies (Appendix 2).

D. Implementation Arrangements

16. The TA will be implemented over 24 months, from July 2015 to July 2017. The executing agency is the International Economic and Financial Cooperation Department of the Ministry of Finance. The implementing agency is the Comprehensive Department of the Ministry of Finance.

17. The TA will require a total of 25.5 person-months of consulting services: an international public sector management specialist for 5 person-months, a national public sector specialist (government institutions) and team leader for 7.5 person-months, a national public sector specialist (public service units of education and research institutions) for 7 person-months, and a national public sector specialist (public service units of medical institutions) for 6 person-months. Four consultants will be engaged individually, since finding an appropriate firm to provide the specific experts would be difficult. All consultants will be recruited in accordance with ADB's Guidelines on the Use of Consultants (2013, as amended from time to time). The terms of reference and specified deliverables are in Appendix 3. Proceeds of the TA will be disbursed in line with ADB's *Technical Assistance Disbursement Handbook* (2010, as amended from time to time). ADB will establish an advance payment facility with the Comprehensive Department to administer activities related to workshops, subject to the department's capacity to complete the activity and liquidate the advance.

18. The Comprehensive Department will provide counterpart staff, relevant existing information on each of the focal issues, including support to collect needed data to consultants; and arrange meeting appointments for consultants with relevant agencies and organizations.

19. The Comprehensive Department, with ADB support, will monitor project-specific indicators and targets set in the design and monitoring framework. Project-specific issues will be discussed with government counterparts during review missions. Technical milestones will be monitored by reports to be prepared by consultants, and reviewed by the executing and implementing agencies and ADB. The team leader will monitor milestones related to TA implementation.

20. Project outputs and good practices will be disseminated through workshops for relevant government officials and other stakeholders. The Comprehensive Department will be responsible for the conduct of workshops; all workshops are expected to be attended by an ADB mission, government officials, and specialists in relevant fields to ensure the inclusion of expert views and wide dissemination of project outputs.

IV. THE PRESIDENT'S DECISION

21. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$300,000 on a grant basis to the Government of the People's Republic of China for Reforms in the Public Sector Compensation System, and hereby reports this action to the Board.

DESIGN AND MONITORING FRAMEWORK

Impact the technical assistance project is aligned with:

Efficiency and effectiveness of the public sector improved by 2025 (Reform Plan in the Public Sector, 2015, project-derived)

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
<p>Outcome The public sector compensation system improved, in terms of governance and incentives</p> <p>Outputs 1. Policy recommendations (a knowledge product) on improving a compensation system in the public sector produced</p> <p>2. Capacity of relevant government officials in compensation systems improved</p>	<p>a. Policy recommendations on improving governance and incentives in the compensation system of the public sector accepted by the government by 2020</p> <p>1a. Studies on the current compensation systems of government institutions and public sector units completed by December 2016</p> <p>1b. A study on international practices for public sector compensation systems completed by December 2016</p> <p>1c. Policy recommendations completed by March 2017</p> <p>2a. About 50 participants in workshops and their knowledge on a compensation system of the public sector improved by March 2017</p>	<p>a. Ministry of Finance and related government reports; TA completion report</p> <p>1a. Three TA technical reports</p> <p>1b. TA technical report</p> <p>1c. TA final report</p> <p>2a. Proceedings of workshops</p> <p>2b. Summary of collected comments and discussions of the workshops</p>	<p>The government will not continue to support reforms of the public sector compensation system.</p> <p>Each tier of government and public service units will not have sufficient capacity to implement the accepted policy.</p> <p>Necessary data and information will not be made available by the government or externally before March 2016.</p>
<p>Key Activities with Milestones</p> <p>1. Policy recommendation (a knowledge product) on improving a compensation system in the public sector produced</p> <p>1.1 Complete an analysis of the current compensation system for government institutions in the PRC by 4Q 2016.</p> <p>1.2 Complete an analysis of the current compensation system for public service units of education and research institutions in the PRC by 4Q 2016.</p>			

- 1.3 Complete an analysis of the current compensation system for public service units of medical institutions in the PRC by 4Q 2016.
- 1.4 Complete an analysis of international practices by 4Q 2016.
- 1.5 Complete the final report, including policy recommendations by 1Q 2017.

2. Capacity of relevant government officials in compensation systems improved

- 2.1 Conduct interim workshop by 3Q 2016.
- 2.2 Conduct final workshop by 1Q 2017.

Inputs

Asian Development Bank: \$300,000 Technical Assistance Special Fund (TASF-other sources)

Note: The government will provide counterpart support in the form of counterpart staff, data, logistics, and other in-kind contributions.

Assumptions for Partner Financing

Not applicable.

PRC = People's Republic of China, Q = quarter, TA = technical assistance.
Source: Asian Development Bank.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Amount
Asian Development Bank^a	
1. Consultants	
a. Remuneration and per diem	
i. International consultant (5 person-months)	105.00
ii. National consultants (20.5 person-months)	114.50
b. International and local travel	21.50
c. Reports and communications ^b	6.00
2. Survey	8.00
3. Workshops ^c	20.00
4. Miscellaneous administration and support costs ^d	5.00
5. Contingencies	20.00
Total	300.00

Note: The technical assistance (TA) is estimated to cost \$315,000, of which contributions from the Asian Development Bank (ADB) are presented in the table above. The government will provide counterpart support in the form of counterpart staff, data, logistics, and other in-kind contributions. The value of government contribution is estimated to account for 5% of the total TA cost.

^a Financed by ADB's Technical Assistance Special Fund (TASF-other sources).

^b Includes cost of written translation of documents and interpretation.

^c Includes venue rental; participants' travel and accommodation; interpretation; translation and other logistics; and administration costs for conferences, seminars, workshops, training, research networking, and other high-level meetings. Any workshops, training, or seminars must occur in ADB eligible members.

^d Including editing and translation of reports and other logistics and administration costs.

Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

1. The technical assistance (TA) will require a total of 25.5 person-months of consulting services (one international consultant for a total of 5 person-months and three national consultants for a total of 20.5 person-months). The international consultant should preferably have a postgraduate degree or equivalent with about 10 years of international experience in the area of expertise. The national consultants should preferably have a master's degree or equivalent and about 8 years of professional experience in the area of expertise. Consultants will be engaged as individual consultants in accordance with the Asian Development Bank (ADB) Guidelines on the Use of Consultants (2013, as amended from time to time). The consultants will be responsible for the timely submission of TA outputs and deliverables, and organizing and implementing all TA activities. All reports are to be of high quality and produced in English. Precise work timelines and deliverables with dates will be defined at inception, documented in the final inception report, and agreed upon with the executing and implementing agencies and ADB.

2. **Public sector management specialist** (international, 5 person-months). The specialist should have professional expertise and experience in public sector management, particularly compensation systems in the public sector. Knowledge of public sector compensation systems in the People's Republic of China (PRC) would be preferable. The specialist will undertake the following:

- (i) Work closely with other consultants and the executing and implementing agencies and ADB; and be responsible for delivering a knowledge product, an inception report, and a final report.
- (ii) Analyze international good practices for public sector compensation systems, including salaries and allowances, by focusing on (a) an administrative mechanism and process to determine salaries and other benefits in the public sector with clear authority and responsibility, (b) a system of budget allocation for personnel costs and actual expense, (c) wage structures, (d) regional salary differences, and (e) incentive mechanisms. The last three issues will also be analyzed in comparison with those in the private sector. The analysis will cover the issue of performance measurement, and lessons from failed reforms in other countries. The analysis will examine challenges in the current public sector compensation system of the PRC to improve governance and incentives in the management of human resources, and public sector efficiency and effectiveness; and produce policy recommendations to address the challenges. Based on the analyses, the specialist will draft and complete a knowledge product (a technical report with policy recommendations); submit it to the executing and implementing agencies and ADB; and disseminate it at workshops.
- (iii) Advise national consultants on the outlines and contents of their technical reports.
- (iv) Draft and complete an inception report, and submit it to the executing and implementing agencies and ADB.
- (v) Draft and complete a final report comprising a summary of the project, an executive summary, including policy recommendations and all project reports; and submit it to the executing and implementing agencies and ADB.
- (vi) Assist in organizing workshops, identifying resource persons, and identifying key issues to be covered. The specialist will deliver sessions at workshops with appropriate presentation materials, and disseminate the knowledge product at workshops.

3. **Public sector management specialist (government institutions) and team leader** (national, 7.5 person-months). The specialist should have professional knowledge and experience in public sector management, particularly a compensation system for the public sector. The expert must be knowledgeable about the PRC's current compensation systems of central and local government institutions. The specialist will undertake the following:

- (i) Work closely with other consultants, the executing and implementing agencies, and ADB; and be responsible for overall management of TA implementation and coordination between international and national consultants and the implementing agency.
- (ii) Based on advice from the international expert, review the PRC's current compensation systems of central and local government institutions. The compensation systems include salaries and various allowances; related regulations will also be reviewed. Key areas to be analyzed include (a) an administrative mechanism and process to determine the salaries and allowances, and related authority and responsibility, (b) the consistency in budget allocation for personnel costs and actual expense, (c) wage structures, (d) regional salary differences, and (e) incentive mechanisms. The specialist will draft a technical report, circulate it to team members, the implementing agency, and ADB; and submit the completed report to the executing and implementing agencies and ADB.
- (iii) Collect needed data and information about the PRC's public sector compensation systems, particularly central and local government institutions, and circulate them to team members, the implementing agency, and ADB.
- (iv) Lead discussions with other consultants and the implementing agency to identify key issues to be covered during workshops. Identify resource persons and prepare background materials for the workshops, and deliver sessions.
- (v) Assist the international expert in drafting, finalizing, and submitting the inception report and final report.

4. **Public sector management specialist (public service units of education and research institutions)** (national, 7 person-months). The specialist should have professional knowledge and experience in public sector management, particularly a compensation system for the public sector. The expert must be knowledgeable about the PRC's current compensation system for public service units of education and research institutions. The specialist will undertake the following:

- (i) Work closely with other consultants, the executing and implementing agencies, and ADB.
- (ii) Based on advice from the international expert, review the PRC's current compensation system of public service units of education and research institutions. The compensation system includes salaries and various allowances; the related regulations will also be reviewed. Key areas to be analyzed include (a) an administrative mechanism and process to determine the salaries and allowances, and related authority and responsibility, (b) the consistency in budget allocation for personnel costs and actual expense, (c) wage structures, (d) regional salary differences, and (e) incentive mechanisms. The specialist will draft a technical report, circulate it to team members, the implementing agency, and ADB; and submit the completed report to the executing and implementing agencies and ADB.
- (iii) Collect needed data and information about the PRC's compensation system for public service units of education and research institutions, and circulate them to team members, the implementing agency, and ADB.

- (iv) Assist in organizing workshops, identifying resource persons, and identifying key issues to be covered. Deliver sessions at workshops with appropriate presentation materials.
- (v) Assist the international expert in drafting, finalizing, and submitting the inception report and final report.

5. **Public sector management specialist (public service units of medical institutions)** (national, 6 person-months). The specialist should have professional knowledge and experience in public sector management, particularly a compensation system for the public sector. The expert must be knowledgeable about the PRC's current compensation system for public service units of medical institutions. The specialist will undertake the following:

- (i) Work closely with other consultants, the executing and implementing agencies, and ADB.
- (ii) Based on advice from the international expert, review the PRC's current compensation system of public service units of medical institutions. The compensation system includes salaries and allowances; related regulations will also be reviewed. Key areas to be analyzed will be (a) an administrative mechanism and process to determine the salaries and related authority and responsibility, (b) the consistency in budget allocation for personnel costs and actual expense, (c) wage structures, (d) regional salary differences, and (e) incentive mechanisms. The specialist will draft a technical report; circulate it to team members, the implementing agency, and ADB; and submit the completed report to the executing and implementing agencies and ADB.
- (iii) Collect needed data and information about the PRC's compensation system for the public service units of medical institutions, and circulate them to team members, the implementing agency, and ADB.
- (iv) Assist in organizing workshops, identifying resource persons, and identifying key issues to be covered. The specialist will deliver sessions at workshops with appropriate presentation materials.
- (v) Assist the international expert in drafting, finalizing, and submitting an inception report and a final report.

6. **Reporting requirements.** The consultant team will submit the following reports to the executing and implementing agencies and ADB:

- (i) inception report by the international public sector management specialist with inputs of all experts,
- (ii) knowledge product (technical report on international practice with policy recommendations) by the international public sector management specialist,
- (iii) technical report on the review of the PRC's current compensation system for central and local government institutions by the national public sector management specialist (government institutions),
- (iv) technical report on the review of the PRC's current compensation system of public service units of education and research institutions by the national public sector management specialist (public service units of education and research institutions),
- (v) technical report on the review of the PRC's current compensation system for public service units of medical institutions by the national public sector management specialist (public service units of medical institutions), and
- (vi) final report by the international public sector management specialist with inputs from all experts.