

## The Cadre Evaluation System at the Grass Roots: The Paradox of Party Rule

Susan H. Whiting

The Chinese party-state shares with other large, hierarchical organizations significant agency problems; local agents of the state tend to behave opportunistically, contrary to the interests of their principals.<sup>1</sup> Such agency problems stem from conflicts of interest between principals and agents and from information asymmetries that typically characterize principal–agent relations.<sup>2</sup> State officials in China employ a formal evaluation system (*kaohe zhidu*) to control the behavior of their subordinates. Drawing on principal–agent theory, this paper contends that the nature of the evaluation system helps to explain dysfunctional aspects of policy implementation at the grass roots and that problems with policy implementation, in turn, help to explain subsequent changes in the evaluation system itself. This characterization is consistent with adaptive learning on the part of principals. In the final section, the chapter argues that, paradoxically, even as the evaluation system has exacerbated problems in policy implementation, it has simultaneously contributed to the durability of rule by the Chinese Communist Party (CCP). Indeed, the relative stability of CCP rule, in contrast to the loss of power by communist parties in other former socialist states and contrary to claims of pervasive political decay in China,<sup>3</sup> demands explanation.

<sup>1</sup> Victor Nee and Peng Lian, “Sleeping with the Enemy: A Dynamic Model of Declining Political Commitment in State Socialism,” *Theory and Society*, 23 (1994), pp. 253–296.

<sup>2</sup> Terry M. Moe, “The New Economics of Organization,” *American Journal of Political Science*, 28 (1984), p. 757.

<sup>3</sup> In addition to those studies cited in the introduction to this volume, see also Minxin Pei, “China’s Governance Crisis,” *Foreign Affairs* (September 2002), pp. 96–109; Andrew G. Walder, ed., *The Waning of the Communist State: Economic Origins of Political Decline in China and Hungary* (Berkeley, CA: University of California Press, 1995).

The chapter begins by providing some background on the development of the cadre evaluation system since the initiation of reform in 1978, arguing that changes in cadre evaluation represent an early and important element of political reform in China – albeit not democratic political reform. The next section analyzes the characteristics of the system in terms of principal–agent theory. It demonstrates that the cadre evaluation system has used a combination of specific performance-based measures and high-powered incentives – a combination that is unusual among lower- and middle-level managers in large organizations. This combination has contributed to severe moral hazard problems in certain policy arenas. The concluding section argues that, at the same time, the system has provided substantial rewards for cadres who perform well, thereby enhancing their commitment to the party, and has elicited minimally acceptable levels of performance from other cadres, thereby contributing to the effectiveness of CCP rule.

## BACKGROUND

Although Chinese leadership has become infamous for undertaking economic without political reform, important but often-overlooked changes in the formal system by which local state officials are evaluated were initiated contemporaneously with reforms in the economic system. The process of cadre evaluation began to receive significant attention shortly after the Third Plenum of the 11th Central Committee in December 1978, which signaled the beginning of the reform era. Hua Guofeng addressed the issue briefly in his “Work Report of the Government,” delivered to the Second Session of the Fifth National People’s Congress in July 1979, and, in November 1979, the Organization Department of the Central Committee of the CCP issued a document calling for the establishment of a new evaluation system.<sup>4</sup> This document instructed each jurisdiction to formulate clear and specific content and standards for assessing cadre performance. The system was to be developed on an experimental basis

<sup>4</sup> Organization Department document No. 52 (1979): “Zhonggong zhongyang zuzhibu guanyu shixing ganbu kaohe zhidu de yijian de tongzhi,” in *Renshi gongzuo wenjian xuanbian – ganbu guanli bufen* [Selected Documents on Personnel Work – Cadre Management Section] (Beijing: Laodong renshi chubanshe, 1987), pp. 12–15.

initially, with the goal of instituting a formal system within two to three years. Experiments were to be conducted in counties, communes, party and government organs, and various other government institutions.<sup>5</sup>

The document specified that the methods and content of evaluation should be specific to cadres' positions. With respect to cadres in local leadership positions, the Organization Department directed that evaluations should cover political thought, organizational and leadership abilities, familiarity with substantive issues, and democratic work style, as well as actual achievements (*gongzuo de shiji chengxiao*). According to the document, the evaluation system should specify both material and non-material rewards; consistently poor performance should result in transfer; and the results of evaluations should be taken into account in promotions.

The 1983 National Organization Work Conference built on the foundation put in place in 1979. However, it moved in the direction of placing greater weight on the assessment of concrete achievements rather than political attitudes or work style, and it reiterated the importance of such criteria in determining material rewards and penalties as well as promotions.<sup>6</sup>

The commentary surrounding the process that the 1979 document set in motion is useful in putting the development of a cadre evaluation system in context. Commentators emphasized the importance of moving away from what were seen as subjective evaluations of political attitudes toward specific, measurable, and quantifiable indicators of performance<sup>7</sup>:

Using concrete achievements as the main standard to assess both cadre ability and political integrity will help to negate the phenomenon of cadres who do more

<sup>5</sup> The following paragraphs draw on Susan H. Whiting, *Power and Wealth in Rural China: The Political Economy of Institutional Change* (New York: Cambridge University Press, 2001).

<sup>6</sup> Organization Department document No. 7 (1988): "Zhonggong zhongyang zuzhibu guanyu shixing difang dangzheng lingdao ganbu niandu gongzuo kaohe zhidu de tongzhi," in *Zhongguo renshi nianjian, 1988–89* [Personnel Yearbook of China, 1988–89] (Beijing: Zhongguo renshi chubanshe, 1991).

<sup>7</sup> Jiang Zhaoyuan, "Xuanba kaocha ganbu yao zhuzhong gongzuo shiji," *Renmin ribao* [People's Daily], July 9, 1985, reprinted in Han Qing and Yue Furong, eds., *Laodong renshi zhidu gaige wenxuan* [Selected Essays on Reform of the Labor and Personnel System] (Changsha: Hunan renmin chubanshe, 1987), pp. 503–5. See also Li Lei, "Shiji shi kaocha ganbu de weiyi biao zhun," *Gongren ribao* [Workers' Daily], September 13, 1985, reprinted in *ibid.*, pp. 506–8; and Yang Bohua, "Jianli yange de ganbu kaohe zhidu," *Beijing ribao* [Beijing Daily], July 15, 1985, reprinted in *ibid.*, pp. 509–13.

and less, who perform well and poorly, all eating from the same “big pot” and the phenomenon of cadres who simply try to make no mistakes but who achieve nothing passing their days in office in mediocrity sitting in an “iron armchair.”<sup>8</sup>

Thus the cadre evaluation system was seen in part as a means to break the paralysis of many cadres following the Cultural Revolution and to actively mobilize cadres to pursue specific goals set by their superiors. Other commentators emphasized the degree to which the new system of cadre monitoring being put in place was a departure from past practice. For example, one commentator in the *Beijing Ribao* highlighted that, since the mid-1950s, evaluations in many locales had not taken place on an annual basis but rather only at the time of appointment or transfer.<sup>9</sup>

In 1988, the CCP Organization Department provided official guidelines for the annual evaluation of party secretaries and government executives at the county level, and it reiterated that the evaluation should provide the basis for rewards and penalties, promotions and demotions.<sup>10</sup> Moreover, the guidelines explicitly sought to encourage competition (*guli jingzheng*) among party secretaries and government executives at the same level of the administrative hierarchy. The guidelines included a format for evaluation by an inspection committee dispatched from the prefectural (municipal) level, a format for collegial evaluation by the leaders of major party and government organs at the county level, and a format for quantitative measures of performance on the main “social, economic, and cultural” targets. These measures ranged from the gross value of industrial output to tax remittances and procurement of agricultural and agricultural subsidiary products, and from realized investment in infrastructure to the population growth rate and the completion rate for nine-year compulsory education. (The complete list of measures is presented in Table 3.1.) These guidelines represented an attempt to standardize and systematize the evaluation of cadre performance on a range of government functions

<sup>8</sup> Jiang Zhaoyuan, “Xuanba kaocha ganbu yao zhuzhong gongzuo shiji,” *Renmin ribao* (People’s Daily), July 9, 1985, reprinted in Han and Yue, *Selected Essays on Reform of the Labor and Personnel System*, pp. 503–5.

<sup>9</sup> Yang Bohua, “Jianli yange de ganbu kaohe zhidu,” *Beijing ribao* [Beijing Daily], July 15, 1985, reprinted in *ibid.*, pp. 509–13.

<sup>10</sup> Organization Department document No. 7 (1988), *Personnel Yearbook of China*, 1988–89.

Table 3.1. *National Guidelines for Performance Criteria of Local Party and Government Leaders*

Category
Gross national product
Gross value of industrial output (not including any output below the village level)
Gross value of agricultural output (not including any output below the village level)
Gross value of output of township- and village-run enterprises
National income per capita
Rural income per capita
Taxes and profits remitted
Fiscal income
Labor productivity of state and collective enterprises
Procurement of agricultural and subsidiary products
Retail sales
Infrastructure investment realized
Natural population growth rate
Grain output
Local budgetary income
Local budgetary expenditures
Forested area
9-year compulsory education completion rate

*Note:* Each category was to be assessed by the relevant government organ, and data on both level and rate of increase were to be provided.

*Source:* Zhonggong zhongyang zuzhibu, “Guanyu shixing difang dangzheng lingdao ganbu niandu gongzuo kaohe zhidu de tongzhi” (“Notice Regarding Implementation of the Annual Job Evaluation System for Leading Cadres of Local Party and Government Organs”), *Zhongguo renshi nianjian* (Beijing: Zhongguo renshi chubanshe, 1991).

at the local level. Similar guidelines were established for township-level cadres.<sup>11</sup>

In June 2000, the State Council issued an “Outline on Deepening the Reform of the Cadre Personnel System.”<sup>12</sup> This document reinforced earlier guidelines while placing greater emphasis on both professional competence and public opinion, albeit without introducing any meaningful democratization.

<sup>11</sup> See, for example, He Jizhi, Wei Shixiang, and Lin Luolun, eds., *Xiangzhen gongzuo renyuan gangwei guifan* [Norms for the Positions of Township Staff Members] (Beijing: Zhongguo renshi chubanshe, 1991), pp. 175–82.

<sup>12</sup> “Shenhua ganbu renshi zhidu gaige gangyao” [“Outline on Deepening the Reform of the Cadre Personnel System”], in *Guowuyuan gongbao* [State Council Bulletin], No. 29 (2000), pp. 5–11.

## THE FUNCTIONING OF THE CADRE EVALUATION SYSTEM AT THE LOCAL LEVEL

This section describes the characteristics of the cadre evaluation system at the local level in terms of the choice of performance measures and reward functions. It draws on data collected during field work in the two county-level units of Jiading and Songjiang in suburban Shanghai and in the county of Hezheng in Gansu during the 1990s.

### Performance-Based Measures

Local versions of the cadre evaluation system reflected the central guidelines outlined herein but did not follow them precisely. The office of management and administration, the county-level organ responsible for setting performance criteria and overseeing implementation, used the evaluation system to convey local priorities to subordinate townships within the broader context of central guidelines. Nevertheless, local versions shared certain core characteristics of the central guidelines – namely, they used highly specific performance measures to evaluate a diverse array of governance tasks. The suburban counties of Shanghai began experimenting with the cadre evaluation system in the mid-1980s. Jiading County established a formal system for evaluating township cadres on a provisional basis in 1986, with the explicit goal of linking performance to remuneration.<sup>13</sup> Relatively complete data are available for Jiading for the year 1989; Table 3.2 reproduces the performance criteria for township party secretaries and township government executives.

The emphasis on township and village industry is reflected in the first set of indicators, which assigns highest priority to increases in the gross value of industrial output (GVIO) and industrial profits. The second set of indicators focuses on state procurement of agricultural and agricultural subsidiary products and the marketing of pork; it assigns highest priority to the sale of grain to the state. The third set of indicators covers party building; this refers to Communist Party functions, including

<sup>13</sup> Jiading Party document No. 8 (1989): Zhonggong jiadingxian wei jiadingxian renmin zhengfu, “Guanyu wanshan 1989 nian xiangzhen dang zheng jiguan ganbu kaohe jiangli banfa de tongzhi,” [Notice Regarding Improvement of the Methods of Evaluation and Reward for Cadres in Township Party and Government Organs for 1989] *Jiading nianjian, 1988–1990* [*Jiading Yearbook 1988–1990*], pp. 44–5.

Table 3.2. *Performance Criteria for Township Government Executives and Party Secretaries, Jiading County, Shanghai, 1989*

Category	Points	County-level Unit Responsible for Evaluation of Target Fulfillment*
Township- and village-run industry	33	
Increase in gross value of industrial output	10	Rural Industry Bureau
Increase in industrial profits	10	Rural Industry Bureau
Increase in profit rate on gross value of output	5	Rural Industry Bureau
Township ranking by profit rate on total capital	4	Rural Industry Bureau
Increase in total value of exports	4	Rural Industry Bureau
Agriculture	30	
Sales to the state of grain and vegetables	15	Grain Bureau–Vegetable Office
Sales to the urban market of pigs	10	Animal Husbandry Bureau
Sales to the state of oil-bearing crops	3	Grain Bureau
Sales to the state of leather and cotton	2	Supply and Marketing Cooperative
Party building	21	
Building of party organizations	7	CCP Organization Section
Building of party spirit and discipline	7	Discipline Inspection Committee
Education of party members	7	CCP Propaganda Section
Education	9	
Completion rate for compulsory education	3	Education Committee
Participation rate for worker training	3	Education Committee
Scale of funds dedicated to education	3	Education Committee
Family planning	7	
Family planning compliance rate	7	Family Planning office
Public order	**	Politics and Law Leadership Small Group
Total	200	

\* In most cases, this unit performs the actual evaluation. The county Statistical Bureau is also involved in the evaluation of fulfillment of all targets for industry and agriculture. The county party committee's Policy Research Office oversees the compilation of data at the end of the year.

\*\* According to the document, "the performance of township party and government cadres with respect to their public order responsibilities is to be evaluated separately by the county's 'politics and law leadership small group.'"

Source: Jiading party document [Jiaweifa (1989), No. 8], promulgated on March 3, 1989.

the recruitment and education of party cadres, the maintenance of party discipline and exemplary behavior among party members, and the organization of activities for nonmembers that inculcate party values. The fourth set addresses education and includes both the completion rate for compulsory education and an indicator of investment in education. The fifth performance indicator is the family-planning compliance rate. The final indicator is public order, which was to be assessed separately by the Politics and Law Leadership Small Group.<sup>14</sup> With the exception of public order, performance on other indicators was to be determined by the relevant county-level bureau, as indicated by the table.

Similarly, Songjiang County used a core set of indicators to evaluate the performance of township party secretaries and township government executives. As of 1995, these indicators were:

- (1) gross value of agricultural and industrial output (GVAIO),
- (2) gross domestic product,
- (3) industrial profits (of local public firms only),
- (4) tax revenue (value-added and corporate income taxes only), and
- (5) realized foreign and domestic investment in productive fixed assets.<sup>15</sup> Each item was evaluated on both the level and the rate of increase over the previous year.

Because performance criteria were tailored to reflect local interests and priorities, they varied somewhat across jurisdictions. Performance criteria for township officials in Hezheng County, a nationally designated poor county in Gansu, for example, reflected the particular developmental challenges of an agricultural county still striving to meet the basic needs of its residents. In 1996, township officials were evaluated according to the following criteria:

- (1) local tax receipts (specifically those under the jurisdiction of the township Public Finance Bureau, such as the agriculture tax),

<sup>14</sup> The performance criteria for township officials in Yongqing County, Hebei, fall into similar categories, including economic performance (in both industry and agriculture), with specific indicators for township and village industry, party building, family planning, and public order.

<sup>15</sup> Author's interview, August 13, 1996. This research draws on interviews with a range of county, township, and village-level officials in the counties of Jiading and Songjiang in suburban Shanghai and Hezheng County in Ganbu. Interviewee's names are not provided in order to protect their identities.



- (2) education surcharge receipts,
- (3) area of land terraced or regraded,
- (4) compliance rate for compulsory education,
- (5) annual per capita income for rural residents,
- (6) compliance rate for family planning, and
- (7) upgrading of road surfaces within the township.<sup>16</sup> These indicators clearly reflect the particular development and governance challenges faced by local leaders.

### High-Powered Incentives

In each locale, performance on these criteria was used to determine the bonuses of state cadres (*guojia ganbu*) and the total salaries of collective cadres (*jiti ganbu*).<sup>17</sup> In theoretical terms, the incentives contained in the cadre evaluation system were “high powered.”<sup>18</sup> In other words, positive performances generated large payoffs for agents. Incentive pay accounted for a large portion of cadres’ total incomes, and it created relatively large differentials among cadres in the same locale.

<sup>16</sup> Author’s interview, September 18, 1997.

<sup>17</sup> State cadres (*guojia ganbu*) are those official state employees who are authorized to be on the state payroll (*guojia bianzhi*); their base salaries are set according to rank and are guaranteed by the formal state budget. Collective cadres (*jiti ganbu*) are official state employees whose salaries are not guaranteed by the formal state budget; their salaries are typically financed by “off-budget” (*yusuanwai*) revenues.

<sup>18</sup> “High-powered incentives” have been defined in a variety of ways in the literature. Oliver Williamson uses the term to refer specifically to residual claimant status, whereas others, such as George Baker et al., use it more broadly to refer to reward systems that structure compensation so that an agent’s expected utility, typically expressed in monetary terms, increases with observed performance. This chapter employs the latter sense of the term. See Oliver E. Williamson, *The Economic Institutions of Capitalism* (New York: Free Press, 1985), p. 132; and George P. Baker, Michael C. Jensen, and Kevin J. Murphy, “Compensation and Incentives: Practice vs. Theory,” *Journal of Finance*, 43 (July 1988), pp. 593–616, esp. p. 594. See also George P. Baker, “Incentive Contracts and Performance Measurement,” *Journal of Political Economy*, 100, No. 3 (1992), pp. 598–614, esp. p. 609; Pascal Courty and Gerald R. Marschke, “Moral Hazard Under Incentive Systems: The Case of a Federal Bureaucracy,” in Gary D. Libecap, ed., *Advances in the Study of Entrepreneurship, Innovation, and Economic Growth: Reinventing Government and the Problem of Bureaucracy* (Greenwich, CT: JAI Press, 1996), p. 157; Francine LaFontaine and Margaret E. Slade, “Retail Contracting: Theory and Practice,” *Journal of Industrial Economics*, 45 (March 1997) pp. 1–25; and Bengt Homstrom and Paul Milgrom, “The Firm as an Incentive System,” *American Economic Review*, 84 (September 1994), pp. 972–991.

For example, in Songjiang County in 1995, the leading cadres of the town with the strongest performance on the five core indicators enumerated earlier received the highest official salary of 17,500 yuan, whereas the leading cadres of the town with the weakest performance received the lowest salary of 6,000 yuan. A comparison of income differentials among township leaders in this single Chinese county and among managers of a single large manufacturing firm may help to put this difference in perspective. According to Baker et al., in a large manufacturing firm with several thousand managers, those “ranking lowest on the performance-rating scale are paid only 7.8 percent less than those ranking highest.”<sup>19</sup> In contrast, among township leaders in Songjiang, the lowest-ranking township head was paid 66 percent less than the highest-ranking township executive. However, according to representatives of the county Office of Management and Administration, which oversaw the implementation of the evaluation system, the 6,000 yuan paid to the leaders of the lowest-performing town did not even fully reflect the penalties stipulated for poor performance. In this case, there appeared to be greater willingness on the part of county officials in Songjiang to employ positive as opposed to negative incentives. Even so, income differentials were relatively large, and strong performers received large payoffs.

Like its counterpart at the county level, the township Office of Management and Administration set the criteria used to evaluate both village leaders and collective enterprise managers, and, in this way, incentives created at the county level were ramified down through the administrative hierarchy.<sup>20</sup> Village leaders were usually collective cadres, who received no base salary from the state. For them, the performance criteria determined their entire incomes. In the seven villages for which data are available (from 1991, in this case), GVIO and industrial profits were the key targets in determining the incomes of village leaders. The case of a village party secretary in Jiading County illustrates how contract incentives were structured. According to his contract for 1991, his starting salary was linked to the level of industrial output achieved in the village that year; because the village’s total output value exceeded a 2-million-yuan threshold,

<sup>19</sup> Baker et al., “Compensation and Incentives,” p. 595.

<sup>20</sup> This section draws on Susan H. Whiting, “Contract Incentives and Market Discipline in China’s Rural Industrial Sector,” in John McMillan and Barry Naughton, eds., *Reforming Asian Socialism: The Growth of Market Institutions* (Ann Arbor, MI: University of Michigan Press), pp. 63–110.

he received a starting salary of 5,100 yuan. (Less successful village leaders received lower starting salaries; the minimum possible starting salary was 2,800 yuan.) In addition, this party secretary received 50 yuan for every 10,000 yuan of profit over and above the village's target level of 1.85 million yuan. Village enterprises produced total profits of 2.5 million yuan; therefore, he received a profit bonus of 3,250 yuan. Like township leaders, village leaders in Jiading were evaluated on a range of performance indicators, but their incomes were most closely linked to industrial output and profits. Performance on other, nonindustrial measures was typically linked only to small increments added to or subtracted from the bonus derived from industrial performance. In this case, the bonus for industrial output and profits accounted for the lion's share (about 85 percent) of the leader's income, which totaled 9,960 yuan.<sup>21</sup> In contrast, Baker et al. report that, in the typical large corporation in the United States, "explicit financial rewards in the form of transitory, performance-based bonuses" seldom account for a large percentage of the compensation packages of lower- and middle-level managers.<sup>22</sup>

Although cadres benefited from strong economic performances, they also paid a high price for weak economic showings. Moreover, a leader's remuneration was contingent upon the performance of other township or village leaders, thus pitting local cadres in competition with one another. Strong performance in one township or village tended to drive up target levels for the others. This characteristic of the evaluation system encouraged cadres to adopt policies intended to improve their performance relative to others. In two of the seven villages for which detailed data are available, village leaders' remuneration declined in light of declining relative performance and failure to meet rapidly increasing targets. A village in suburban Shanghai offers an example of the importance of this link. The village had been ranked third in the township in terms of output in 1989, but by 1991 it had fallen to ninth. The income of the village party secretary, who failed to meet his industrial targets, fell by several thousand yuan to 2,950 yuan, while higher-ranked village party secretaries earned more than 6,000 yuan each in 1991. Similarly, the leader of a village

<sup>21</sup> Other case study evidence produces similar findings. Yan Yunxiang reports that bonuses constituted 80 percent of village leaders' incomes in Xiajia Village, Heilongjiang. Yan Yunxiang, "Everyday Power Relations: Changes in a North China Village," in Walder, ed., *The Waning of the Communist State*, p. 227.

<sup>22</sup> Baker et al., "Compensation and Incentives," p. 595.

in another township presided over a period of declining economic performance relative to other villages in the township. As a result, his 1991 income of 4,046 yuan was 20 percent less than his 1988 income of 5,040 yuan, achieved three years earlier. Clearly, there were very real costs to failure to achieve the norms set by the cadre evaluation system.

Not only were the incomes of township and village leaders determined by their performance in rural industry, but their tenure in office and opportunities for advancement were to some extent as well. According to an official of the Shanghai Suburban Industry Management Bureau, which governed township- and village-run industry, during the 1990s, county leaders appointed township executives and party secretaries with the intention that they would participate directly in decision making with respect to this sector of the economy. As this official put it, they “rise or fall on the basis of economic success.”<sup>23</sup> Similarly, published accounts of earlier evaluations by officials in Jiading County indicate that, on the basis of the results of cadre evaluations for 1989, 70 out of 327 township party secretaries, township executives, and leaders of county-level party and government organs were transferred out of their positions in 1990.<sup>24</sup>

### The Impact of the Cadre Evaluation System on Policy Implementation: Dysfunctional Outcomes

As the preceding section has demonstrated, local versions of the cadre evaluation system combined specific performance-based measures with high-powered incentives. Formal principal–agent models predict that this combination will cause severe moral hazard problems<sup>25</sup> or what Baker et al. (1988) refer to as “gaming the system”:

<sup>23</sup> Author’s interview, February 10, 1992. Susan Shirk identifies a similar phenomenon at the provincial level: “Under the post-1980 incentive structure, the political ambitions of individual local officials became closely identified with the economic accomplishments of their domains. . . . Whether officials aimed to climb the ladder of success to Beijing or to become leading figures on the local scene, their reputation was enhanced by industrial growth and local building projects.” Susan L. Shirk, *The Political Logic of Economic Reform in China* (Berkeley, CA: University of California Press, 1993), pp. 189–90.

<sup>24</sup> Wang Weifang, “Ganbu kaohe he tiaozheng lingdao banzi,” in *Jiading Yearbook, 1988–1990*, p. 62.

<sup>25</sup> According to Thrainn Eggertsson, “Moral hazard arises in the enforcement of contracts when the performance of an agent is too costly to be observed as a whole and is measured at only one or a few margins. This may induce an agent to neglect various aspects of his or her assignments and concentrate on performing well [only] in the measured

Large monetary incentives generate unintended and sometimes counterproductive results because it is difficult to adequately specify exactly what people should do and therefore how their performance should be measured. . . . Mis-specifying the performance measure in an objective system results in resourceful employees “gaming the system” by optimizing with respect to actual instead of intended measures.<sup>26</sup>

Drawing on the insights of formal principal–agent models, I argue that the nature of the cadre evaluation system in China led to certain dysfunctional aspects of policy implementation at the grass roots. At the same time, however, superiors in the party-state hierarchy have shown sensitivity to this moral hazard problem by adjusting certain performance criteria and by avoiding others.

In the economic realm, moral hazard problems contributed to the development of overcapacity in many Chinese industries and led to the wasteful production of large quantities of useless products. With the introduction in the mid-1980s of specific performance indicators linked to personal income, GVIO took center stage as the indicator of industrial performance that received the most weight. Indeed, output value was prominently featured in the central guidelines issued in 1988 (Table 3.1), as it was in the cadre evaluation systems that initially emerged in both Songjiang and Jiading counties.<sup>27</sup> During the middle to late 1980s, township officials oversaw the rapid expansion of new and existing factories, even as existing factories accumulated large inventories of unmarketable products. This duplication of capacity resulted in heavy financial losses and the inability to repay the bank loans that had financed both fixed and working capital for the factories involved.<sup>28</sup> Local officials explicitly identified the use of output value as the key performance indicator as the culprit in eliciting such undesirable behavior – expansion without attention to the efficiency of the production process or to market demand for

dimensions.” Thrainn Eggertsson, *Economic Behavior and Institutions* (New York: Cambridge University Press, 1990), pp. 44–45.

<sup>26</sup> Baker et al., “Compensation and Incentives,” p. 597.

<sup>27</sup> It was also the case in other locales. See, for example, He Baoshan et al., on Jiangsu Province. He Baoshan, Gu Jirui, Yan Yinglong, Bao Zongshun, eds., *Jiangsu nongcun feinonghua fazhan yanjiu [Research on the Non-agricultural Development of Rural Jiangsu]* (Shanghai: Shanghai renmin chubanshe, 1991), p. 121.

<sup>28</sup> *Shanghai gongye jingji bao [Shanghai Industrial Economy]*, June 15, 1989, p. 1. See also Wang Xiaolu, “Capital Formation and Utilization,” in William Byrd and Lin Qingsong, eds., *China's Rural Industry* (New York: Oxford University Press, 1990), p. 241.

or saleability of the products. This problem prompted officials in Jiading to modify the performance indicators. They incorporated profit into the indicators of industrial performance for the first time beginning in 1989, supplementing “increase in GVIO” with “increase in industrial profits,” “increase in profit rate on gross value of output,” and “township ranking by profit rate on total capital” (Table 3.2).<sup>29</sup> Similar problems were identified in Songjiang as well. As a representative of a township government in Songjiang noted, “Up to now, leaders have only worried about output value, but that’s not what counts. What counts is profit.”<sup>30</sup> In response to this problem, officials in Songjiang, like those in Jiading, added a measure for industrial profits to the existing measure of output value, as reflected in the 1995 performance indicators discussed herein.

Sensitivity to a potential moral hazard problem led some county-level supervisors to *avoid* using tax collection as an explicit performance indicator for the township officials they supervised, despite its inclusion in national guidelines. From the mid-1980s through the mid-1990s, local fiscal revenues were governed by a fiscal contracting system (*caizheng baoganzhi*) in which all tax revenues were shared with higher levels. Because of the sharing requirement, county officials sought to avoid revealing greater fiscal capacity to higher levels, which might result in an increase in the amount of revenue owed to higher levels. Rather, they preferred to tap the same revenue base locally through nontax levies, which were not subject to sharing.<sup>31</sup> Thus, the sensitivity to potential gaming behavior in the case of tax collection at the local level reflected strategic considerations in interactions between higher and lower levels. For these reasons, Songjiang County did not use tax receipts as an explicit performance indicator for township officials.<sup>32</sup> County-level supervisors did not wish to create incentives for township officials to concentrate their efforts on maximizing or gaming this particular dimension of their professional responsibilities.

<sup>29</sup> Jiading Party document No. 8 (1989): “Zhonggong jiadingxian wei jiadingxian renmin zhengfu, ‘Guanyu wanshan 1989 nian xiangzhen dang zheng jiguan ganbu kaohe jiangli banfa de tongzhi,’” in *Jiading nianjian, 1988–1990* [*Jiading Yearbook 1988–1990*], pp. 44–5.

<sup>30</sup> Author’s interview, April 17, 1992.

<sup>31</sup> Susan H. Whiting, *Power and Wealth in Rural China: The Political Economy of Institutional Change* (New York: Cambridge University Press, 2001).

<sup>32</sup> Author’s interview, April 22, 1992.

It was only beginning in 1995 that tax revenue was used as an important performance measure in Songjiang County. The inclusion of tax revenue thus represents an important change from past practice. This change was motivated by the major fiscal reform instituted in 1994, which replaced the old fiscal contracting system with the new tax assignment system (*fen-shuizhi*). Under the new system, taxes are designated as central or local tax types, with the revenues assigned to the level of government indicated. Only the value-added tax is shared, with 75 percent of the revenue going to the center and 25 percent going to the locality. Following this change, township officials in Songjiang began to be evaluated for the first time on the basis of collection of local tax types.

### Expanding the Array of Performance-Based Measures: The Problem of Multitasking

Although middle-level supervisors manipulated performance criteria in the context of strategic interactions between higher and lower levels, the central party-state continued to use performance criteria to try to control local official behavior. As local officials increased their reliance on non-tax revenues and allowed nontax levies to proliferate, citizens began to protest against excessive financial burdens placed on them by the local state. The central state responded by adding new elements to the performance criteria for local officials. According to Central Party Document no. 13, which deals with the proliferation of nontax levies in rural areas,

Leadership must be strengthened, and top party and government executives must bear responsibility for reducing burdens [on farm households and TVEs]. They must attend to this personally and take overall responsibility – level by level. Reducing burdens will be used as an important criterion in the appointment and evaluation (*renyong he kaohe*) of leaders at each level, especially at the county and township levels. County and township leaders must ensure that within their jurisdictions (a) total burdens on farm households do not exceed five percent of household income on average in any village, (b) there are no levies violating central regulations or increasing burdens, and (c) no serious incidents or cases [of unrest] occur as a result of farmers' burdens. Agencies at every level, especially central agencies, must take the lead in implementing relevant regulations on reducing burdens, ensure uniform implementation of central directives, and strictly enforce all orders and prohibitions. Leaders of relevant agencies must take responsibility and manage their administrative hierarchies effectively. From this date, the core leader of any locality or agency that increases burdens will be held strictly responsible. Any cadre who is subject to disciplinary action for increasing

burdens will not be eligible for promotion or appointment to an important position for the period specified.<sup>33</sup>

Thus, new measures continued to be added to the array of performance-based measures on which local officials were evaluated.

The sheer number and variety of tasks evaluated through performance-based measures posed additional problems. Specifically, multiple indicators were not necessarily mutually compatible. For example, performance on industrial profits and public order were at times in conflict. Whereas increasing industrial profits at times required laying off redundant workers, the maintenance of public order necessitated retaining redundant workers in their jobs. Higher-level officials addressed this problem by further classifying performance criteria into primary and secondary sets of indicators. In some locales the primary performance criteria were termed *fouding zhibiao* (loosely translated as critical targets) or *ying zhibiao* (translated as hard targets). These targets had to be met for overall performance to be considered adequate. Targets considered to be critical during the latter 1990s typically included tax receipts, public order, and family-planning compliance.<sup>34</sup>

#### CADRE EVALUATION AND THE DURABILITY OF CCP RULE

The continued reliance on performance-based measures and high-powered incentives is puzzling in light of the severe moral hazard problems and multitask coordination problems encountered during the implementation of the cadre evaluation system at the local level in China. It is also puzzling in light of findings from empirical studies of large organizations in other settings, which suggest that the “problems associated with determining and modifying objective performance measures and the dysfunctional behavior induced by resourceful employees faced with

<sup>33</sup> Central Party and State Council document No. 13 (1996): “Guanyu qieshi zuohao jianqing nongmin fudan gongzuo de jue ding,” in *Guowuyuan gongbao [State Council Bulletin]*, No. 12 (1997), p. 563–8.

<sup>34</sup> Author’s interviews, August 13, 1996 and September 18, 1997. Kevin O’Brien and Lianjiang Li report similar findings. Kevin O’Brien and Lianjiang Li, “Selective Policy Implementation in Rural China,” *Comparative Politics*, 31 (January 1999), pp. 167–186; See also Maria Eden, “State Capacity and Local Agent Control in China: CCP Cadre Management from a Township Perspective,” *China Quarterly* 173 (March 2003), pp. 35–52, esp. p. 39.



such measures lead organizations to *avoid* pay-for-performance systems based on objective performance evaluation.”<sup>35</sup> Paradoxically, however, continued reliance on the cadre evaluation system may have contributed to the durability of CCP rule. Indeed, recent documents on refining the cadre management system explicitly identify it as an important means for ensuring competence and checking corruption.<sup>36</sup> In developing this argument, I draw on Victor Nee and Peng Lian’s model of “declining political commitment in state socialism” to suggest why high-powered incentives and performance-based measures may be useful in securing political commitment. As they suggest, “analysts need to pay attention to the organizational health of the communist party.”<sup>37</sup>

According to Nee and Lian, “the penetration of market institutions – both informal and formal, domestic and international – increases the incentive for opportunism [on the part of cadres] at the same time that accompanying institutional change weakens the monitoring and enforcement capacity of the party.” They attempt to show how the resulting increase in opportunism and concomitant decline in commitment to the party can lead to its collapse as an effective political organization; they do so by modeling cadres as agents in a multiagent repeated game, in which agents must choose whether to commit to or defect from the party. Agents defect if

$$bh + (1 - b)l > m,$$

where  $b$  is the probability that opportunism goes undetected (as a result of inadequate monitoring),  $h$  is the payoff for opportunism,  $l$  is the punishment for unsuccessful opportunism, and  $m$  is the payoff for commitment.<sup>38</sup> The significance of high-powered incentives in this context is

<sup>35</sup> Baker et al., “Compensation and Incentives,” p. 599.

<sup>36</sup> “Shenhua ganbu renshi zhidu gaige gangyao” [“Outline on Deepening the Reform of the Cadre Personnel System”], in *Guowuyuan gongbao* [State Council Bulletin] No. 29 (2000), pp. 5–11.

<sup>37</sup> Nee and Lian, “Sleeping with the Enemy,” p. 255. The authors define opportunism as “market-oriented entrepreneurship and rent-seeking” (p. 268). This line of argument is similar to that of Andrew Walder, who has also argued that the party-state has experienced significant decay. He attributes it to the economic reforms. See Andrew G. Walder, “The Quiet Revolution from Within: Economic Reform as a Source of Political Decline,” in Walder, ed., *The Waning of the Communist State*, pp. 1–24.

<sup>38</sup> Nee and Lian conceptualize payoffs primarily in terms of personal, material gain. However, they recognize three types of party cadres: true believers, middle-of-the-roads, and pure opportunists. Their model is most relevant to the latter two types of cadres,

that they can result in relatively high material payoffs for commitment ( $m$ ) for an important core of cadres who are performing well on the most heavily weighted performance measures. Nee and Lian's model fails to account for this aspect of  $m$ . Rather, they assume  $m$  to be the same for all cadres who are committed to the party.<sup>39</sup> In contrast, the empirical findings presented in this chapter suggest that successful, committed cadres can obtain relatively high payoffs by working within the system, thereby decreasing the likelihood that they will defect, even when faced with "market temptations."

Nee and Lian also indicate that the monitoring capacity of the party is critically important to the durability of party rule. The cadre evaluation system, in which local officials are systematically supervised and evaluated on an ongoing basis, may contribute to the stability of the CCP regime through its contribution to more active monitoring. In terms of the model, the cadre evaluation system reduces  $b$ , the probability that opportunism goes undetected. As just demonstrated in the aforementioned empirical discussion, the cadre evaluation system holds local officials responsible for providing a specified level of public goods in addition to promoting economic growth within their communities. In Jiading County, for example, township leaders were explicitly evaluated on the scale of funds dedicated to education and the completion rate for compulsory education. In Hezheng County, township leaders were evaluated on the upgrading of road surfaces as well as on the completion rate for compulsory education. These measures most likely did not preclude corruption (such as the diversion of public funds away from public goods provision), but they increased the likelihood that those officials who failed to provide a minimum acceptable level of key public goods were discovered and faced real consequences, whether in terms of income, tenure, or promotion. In this way, the cadre evaluation system provided a check on public spending in certain key policy areas, such as education and infrastructure development. Furthermore, spending in these areas likely contributed to productivity growth in the formal economy. Finally, although false reporting may occur, the competitive framework in which cadres are evaluated may help to expose false reports to superiors over time.

who are susceptible, to a greater or lesser degree, to the lure of personal, material gain. Nee and Lian, "Sleeping with the Enemy," pp. 274–5.

<sup>39</sup> It "equals the total payoff minus the payoff to opportunists divided by the number of committers." Nee and Lian, "Sleeping with the Enemy," p. 269.

## CONCLUSION

The evidence presented in this chapter suggests that, in the post-Mao period, specific performance criteria have been developed to mobilize local cadres around specific policy goals. Although these goals reflect the main concerns of the central government, they also reflect the interests and priorities of officials at the lower levels of the administrative hierarchy. County-level officials appear to adjust performance criteria for township officials in response to several factors, including changes in the broader policy environment and strategic interactions with higher levels, changes in the economic environment, and problems of contractual design such as those involving coordination among multiple tasks and moral hazard problems.

Further research is required to assess the relative importance of the cadre evaluation system in local governance. Local cadres are embedded in formal administrative structures and in informal networks, both of which likely affect their opportunities for reward and advancement and therefore their behavior. This chapter suggests that performance criteria (*kaohé zhibiao*) elicit minimal acceptable levels of performance on the part of local officials through annual evaluations in the context of competition with other officials at the same administrative level in the same region. However, the formal system also operates in tandem with informal relationships that introduce alternative criteria into the calculus of local cadres. Nevertheless, the relatively high-powered incentives contained in the cadre evaluation system, as applied to local party and government executives, help to reinforce commitment to party goals, thereby contributing to the durability of CCP rule.