Publicly traded companies are the engine behind China’s growth, which raises the question of how CEO compensation works under an interventionist state. This column presents an analysis of executive compensation in China and a comparison to the West. Chinese listed firms have incentive structures similar to those of the US; in this case, effective compensation policies seem to transcend political boundaries.

For many in the West China remains a paradox: a single-party Communist state with a vibrant, thriving economy set to challenge the US in the coming decade. Some have questioned the sustainability of the Chinese growth miracle in the absence of fully-fledged democracy and root-and-branch market reforms. But others point to state-sponsored decentralised market reforms over the past three decades as the key to China's success (Xu 2012).

In the first decade of the 21st century China's GDP grew by 250%. The engine behind its growth was the public listed sector. Output grew nearly eightfold, accounting for 43% of total Chinese GDP by 2010. Yet little is known about CEO compensation in China's listed firms. Using accounting data for all public companies listed on the Shanghai and Shenzhen stock exchanges between 2001 and 2010, we examined trends in cash and bonuses among CEOs and other board executives (Bryson et al. 2014).

In the West the controversy over executive pay has been febrile, with questions raised as to whether those at the top really deserve to be earning so much more than the rest (Piketty 2014). We find cash and bonus compensation has been rising rapidly in China, just as it has been in the West. Although cash and bonus compensation for top executives remains well below what Western executives earn, it has been rising very rapidly, doubling between 2005 and 2010. These earnings are highly sensitive to firm performance and became more so between 2001 and 2010, thus ensuring that CEO fortunes are tied to shareholder interests. The strength of the pay-performance link is similar to that in Europe – even though the country remains a Communist regime with state control of the largest firms. However, the pay-performance sensitivity is lower than in the US.

As in the West, those running the largest firms are paid the most, in accordance with the principles of a market that allocates the most talented people to the job slots where their productivity has the greatest impact. The sensitivity of pay to firm size is of the same magnitude as that found in classic US studies of the 1980s (Rosen 1990). Big differentials between top
executives mimic the ‘tournament’ pay structures in the West, creating strong financial incentives for executives to move up the corporate ladder.

In contrast to the West, the state often plays an important role in China's listed firms, either through its direct ownership stake or via the Communist Party, which plays an important role in the recruitment and promotion of CEOs and other top executives (Li et al. 2007). But this is also changing. China undertook a massive privatisation programme between 2001 and 2010. The percentage of publicly listed firms that were majority state-owned fell by almost half to 45% percent. Executive compensation rose markedly in privatised firms – by around 5% in those firms privatised between 2002 and 2010 relative to those whose ownership did not change – just as it had done during privatisation drives in the West in the 1980s (Wolfram 1998).

Ever since Bebchuk and Fried (2004) argued CEOs are able to exploit their managerial power to extract rents, economists in the West have worried about CEOs' ability to ‘skim’ profits from firms, particularly when there are weak corporate governance structures in place. There have been moves towards better corporate governance in China's listed firms in recent years but it is clear that China's CEOs are able to ‘skim’ company profits when corporate governance is poor. CEOs get a 10% premium if they start sitting on the compensation committee that determines their earnings and they get a similar premium if they become chairman of the board as well as CEO. This role for managerial power in executive pay setting may reflect the recency of the stock market and the regulations underpinning corporate governance.

As Yueh (2011) has argued, future growth in China may depend on the pace of legal and institutional reform. Yet, in so many ways, it would appear that the CEO labour market in China has more similarities with the CEO labour market in the West than differences. For better or worse, some elements of executive compensation seem to transcend national economic, political, and cultural differences.