

Chapter 2

Summary of the Salary Theory and its Relative Theories

2.1 Salary Theory

Salary is the remuneration to the service of the employee by the employer and a tool of payment in the form of currency. It includes the base and the auxiliary. The former refers to the foundation to determine various allowances, insurances and bonuses. The standards to decide the basic pay consist of the following factors: labor's skills, work experiences, labor intensity, responsibility, work importance in the enterprise strategy, fields, conditions, work years, and diploma, etc. The latter includes allowances, bonuses, free working meals, housing subsidies, etc., of which the bonuses are the remunerations to the extra labor or contributions, and allowances are those to the special labor consumption or to the extra living expenditure in the special working conditions, for example, for the particular post, or positions, or labor time, etc.

The salary theory has been approaching the humanism management from that on productive elements by Jean Baptiste Say (1767–1832) to the modern distribution theory on combining labor with productive elements, from the marginal productivity theory of wages by John Bates Clark, equilibrium price theory of pay by Marshall, collective negotiation pay and the theory of distribution according to work by Karl Marx.

2.1.1 Marginal Productivity Theory of Wages

It was first put forward by John Bates Clark and adopted to explain the pay decision through productivity decrease and was regarded as the natural norms and rules to decide the pay. In the light of Clark's, pay should rely on the marginal productivity. If workers keep being increased, the production volume may increase at first. To a certain degree, tools or equipments allocated to each one may decrease and then the output volume from the labor forces per unit will be decreased than that in the past.

In this way, the newly added worker produces less and less and the productivity from the last new comer increased is the lowest and the wage of the worker will be decided by the marginal output from the worker finally added. In reality, the work of many industries is finished by a batch of worker conjointly and each of them can only get the average marginal output volume whether in the beginning or in their whole career because his contributions to the output can't be determined. So, each one is unable to get what is equal to the marginal production volume. This theory is limited in measuring the inputs and outputs of different staff. Some other industries are competitive each other and staffs get the returns far below their marginal output volume from their inputs. Besides, salary is not only affected by the supplies of the labor forces, but also by the worker's preference to the psychological income. Therefore, the theory can't precisely forecast the short-time change of wages. However, it can concisely do the long-time fluctuation of the wages among industries or professions, which is helpful to decide the flow orientation of resources arrangement.

2.1.2 Equilibrium Price Theory of Pay

It was first proposed by Marshall and expounded the pay decision in the angle of supplies and demands of labor forces. In the aspect of demands, pay depends on the marginal productivity of labor and the pay level willing to be paid by the enterprise is determined by it. In supplies, pay relies on two aspects: productive costs of the labor forces, namely, living expenses supporting workers and their family and training or educational expenditure needed by workers; negative utility or leisure one. Or in another word, the pay level of the labor forces is decided by the equilibrium between supply and demand of the labor elements. This theory is insufficient besides the drawbacks of the marginal productivity theory of wages, for in the labor market, greater viscosity exist in the pay and when the supplies of labor element have changed, the correspondent adjustment in the pay usually lags behind so that supply and demand are difficult to be balanced. The theory is also a reference to the salary design of the book.

2.1.3 Collective Negotiation Pay

It thinks that pay depends on the results of the bargaining between labor and capital. In fact, trade union has not absolute monopoly right to pay decision, because the employer can't accept the demand of high pay initially proposed by it, otherwise, high production costs may happen, which does harm to the competition in the market. During the negotiation, the trade union and the employer both have their own countermeasures: strike is the most powerful weapon for the trade union while closing the factory is the effective one for the employer. In the end, the two parties are obliged to concede and agree to an agreement under the pressure

pressed by the other. Having analyzed the process of the bargaining between the trade union and the employer, John Hexx proposed the Hexx Mode of the collective negotiation: the employer and the trade union are both unwilling to make the enterprise come to a halt for a long time and then a concession by the two parties occurred so as to seek for the correspondent project. Apparently, it seems that the negotiation results rely on the power comparison of the two parties. In substance, it is the economic factor that plays a main role in the bargaining and that restricts the activities of the two parties. So, in designing, pay system should take both the trade union and the employer into consideration.

2.1.4 Distribution Based on the Productive Elements

It was initially proposed by Jean Baptiste Say and insisted that income should come from the market price of land, capital and labor. Their prices depend on supply and demand of them in the market. In recent years, the mainstream economists in the western countries have taken the capacities of the entrepreneur, technology, knowledge, human capital, etc. for the productive element. In the light of these views, the remuneration of various elements is given according to their contribution to the outputs.

2.1.5 Karl Marx's Pay Theory

In the late nineteenth century, Karl Marx put forward the concepts of distribution according to the work¹ in his book CAPITAL (volume I) and then made detailed interpretation in his Critique of the Gotha Program. One of his basic views is that abstract labor creates value of commodity and concrete work does its use value. But his theory is unable to solve the problem how to measure labor when the laborer's quality, potential and ability are different. Naturally, the theory can't answer the question how to deploy the work enthusiasm of the laborer. Therefore, it is necessary to absorb the other relative theories to strengthen its feasibility in operation.

2.1.6 Income Distribution Theory Combining Work and Productive Elements

It was proposed with the reform of the ownership structure in China to match the concept of focusing on public ownership and conjointly fostering multi-ownership economy. This theory insists on implementing main distribution on work and

¹ Das Kapital (Excerpt, review), South-West Financial University, August, 2001.

co-existence of multi-distribution modes, on combining the distribution on work with that on productive elements and efficiency first and equity to be concerned, too. Its main forms includes “Distribution on Five Elements like labor forces, capital, managing capacity, technology and land”, “Bonus to the work (pay, partial profits)”, and “Broad Combination of society, enterprise and individual”.

In summary, salary theories have been developing in two main lines: one is the theory on the income distribution from according to the labor forces price to basing on the quantity and quality of the work provided by the individual to the concept of efficiency first and equity also to be concerned in China, which has been liberating the productive forces. The other is the one based on the productive elements like Say's, distribution on productive elements, capacities, knowledge, etc. The book will take the above lines as its theoretic support to make a further study of the distribution theory combining that on work with that on productive elements.

The theory to be studied is a relatively perfect one up to now in income distribution, which is both a supplementary to the theory of work value and a deepening to the distribution concept on the productive elements: productive elements like knowledge, technology, capacities should join in the distribution as work, land and capital. But knowledge, technology, capacities are not the same as work, land and capital. The former three are the incarnation of the human capital and can create more surplus value by work and also the results of the human capital investment. In the knowledge-economy society, the value added from the human capital is far above that from the assets or financial capital. Therefore, knowledge, technology and capacity not only join in the income distribution, but also have the right to share the surplus value as other productive elements when they are input into the productive activities. In this framework, the book explores how to set up harmonious complex salary system effective both to the worker and to the staff with knowledge and technology so as to make the salary system to be designed consensus all to individual, enterprise and society.

To reach the above target, the combination between multi-channel career development of the staff and the salary management should be implemented at first, of which the essence is to provide chances to create achievement for the staff and carry out achievement encouragement and the design of the career development channel ought to be uniform with the correspondent salary system. Particularly, under the guarantee of the salary encouragement institutions, the backbones of the staffs are encouraged to develop toward the cross-specialty; borderline professional and trans-professional posts harmonious with the enterprise strategy so as to further stimulate their innovative spirits.

Then, multivariate and composite salary encouragement system is to be set up. It is based on the multi-expectancy of knowledge and technology-typed staffs such as remuneration, achievement and chances. Therefore, in the course of formulating the encouragement institutions and mechanism inside the enterprise, multivariate and composite ones like salary encouragement, achievement and chances ought to be considered. Especially, in establishing the salary institutions, various encouragement factors like training, promotion, communication, praise, holidays and other welfares, etc. are to be considered and integrated reasonably. And the proportion and weights of knowledge, capacities, and performance are fully taken into account, too.

2.2 Human Resources Management Theory

The salary management is the core model of the human resources management and can't be discussed isolated. It should be studied on the ground of the human resources management. The latter refers to a series of concrete activities: recruit talents, use them rationally, dig out their potentials by encouragement, etc. Its theories include theory X, Y, Z and strategic human resources management theory.

2.2.1 Theory X²

It was first proposed by Taylor from America and thought that man was economic being and born disliking labor. Generally, he worked for the needs of substances and safety and only money could make him work hard. Most men were short of responsibility or pioneering senses and unwilling to responsible for others and incidents. So, someone is designated to lead and manage them under their willing. And forcible and punitive approaches may be adopted to manage workers.

This theory ignores the needs of the staff in self-respect, self-confidence, self-governance, self-discipline and self-development and strangles his creativeness and independence. The theory paves a way for the study of the supervision in the consensus salary system.

2.2.2 Theory Y³

The representative of the theory Y is Maslow and its key views are to regard man as "self-realization one". This theory thinks that it is not the human's nature to be tired of work and the consumption of physical and mental energies in work is a kind of natural phenomenon like rest or game. Everyone has a sense of responsibility and is willing to accept or assume a certain duty in the proper conditions. He is ready to realize the target of the organization by self-management and self-control and much imaginative and creative in solving the problems of his organization, so such enthusiasm of the staff should be fully aroused.

The theory Y is dynamic and shows us the possibility of growth and development of the human being. It emphasizes to choose adaptive demands to the individual and not to simply control him severely. From it the principle of merging can be derived: it is dynamic and shows us the possibility of growth and development

² Chen Y, Chen Q, Human Resource Development and Management, China Statistic Press, July, 2001, p. 90.

³ Chen Y, Chen Q, Human Resource Development and Management, China Statistic Press, July, 2001, p. 91.

of the human being. It also emphasizes to choose the adaptive demands to the individual and not to simply control him severely. So, the principle of merging can be derived from it: organization ought to foster an atmosphere in which the individual can realize his own aim in being engaged in reaching the organization's target.

2.2.3 Theory Z⁴

Theory Z is typical of modern human resources management, of which the core is that man is a whole unification. It thinks that man can believe in each other and that man is subtle and affable. Based on it, people may understand and trust each other. The enterprise and the staff should build a condition where they can trust mutually. But if communication is insufficient, they may fall into a deadlock and different exchange approaches can lead to various effects. Man has a sense of love: once psychological contract has been set up, he is ready to contribute for others. Therefore, the enterprise should make a full use of these intrinsic merits in its human resources management to serve itself by adopting the suitable encouraging methods.

2.2.4 Theory of the Strategic Human Resources Management

This theory means that to reach its target, the organization will systematically plan and manage its human resources and the strategic human resources management is an organic and obliged part of the organizational strategy. It is characteristic of strategic resources, successive management and systematic integration, etc.

Professor Shuming Zhao in Nanjing University sums up the strategic human resources management into six operational cells: evaluation system based on the quality model, vocational conduct test system on the job qualification, assessment system on the key performance indicators, salary distribution system on the performance and ability and training development system on the career.

The strategy human resource management focuses on the human and regards the people as capital. It emphasizes the dynamic and psychological development and arrangement to them so as to reach the aim of the systematization between the people and the business and maximize the economic and social benefits. It is also the important part of the operational strategy of the organization and contributes to it by promoting its sustainable development in the long run. It consists of various constructive measures in the organization, culture and management system. The integration of strategy, organization and system by way of culture can ensure the implementation of the strategy and push the long, stable growth of the enterprise. In the angle of the strategy, the strategy human resource management actively

⁴ Chen Y, Chen Q, Human Resource Development and Management, China Statistic Press, July, 2001, pp. 91–92.

analyzes and diagnoses the actual situation of the human resources, provides the exact and timely valuable data for the decision-maker and assists him in formulating the action plan of the human resource management and supports the realization of the strategic target of the enterprise. It can give a comprehensive systematic theoretic guide in the management to the consensus salary system.

2.3 Theory of Labor Costs and Transaction Ones

(1) Labor costs mean the reward to the employee's labor paid by the enterprise. They include the direct labor cost for the production, salary for the administrative people and for the salesman, etc. It is one of the main targets for modern enterprises to seek for the efficiency, which is the ratio between the input and the output. To raise the efficiency, it is necessary to control the input and to plan and manage the resources input. In planning the human resources, guided by the modern management theory and aimed at digging out the human resources and raising the economic efficiency, the labor cost management is the key and it consists of series of activities in the production and operation like fixing the components of the labor cost, building its indicator system, laying down its standard, determining its control target, designing its system and institutions, normalizing its statistic approaches and strengthening its alert institutions, etc. The competitive result among various enterprises depends on the strength comparison and cost rival. In the same conditions of technique and crafts, the cost, exactly the labor cost, is the decisive forces to decide the competition. With the market opening, the difference of the material cost has been shrunk gradually. Especially pushed by removing the obstacle of the trade protection, the enterprise must intensify the management to the labor cost, for it has become one of the most useful tools in sharpening the competitive forces.

The labor cost is an important part of the total costs and the target to control it is to increase the profit and strengthen the competitive forces in the market of the enterprise at home and abroad. The labor cost and the profit restraint mutually, but they both affect the newly-increased value of the product and can change in the same orientation. The adjustment to the labor cost doesn't mean increasing the profit only by reducing the employee's income, but refers to controlling the structure of the aggregate costs or strives to raise the value added by way of coordinating the profit and the employee's income. The aim to control the labor cost is to increase the employee's income and the profit of the enterprise at the same time.

Management is the productive forces, of which the core is the cost control. In managing the cost, with the market being perfected, the materialized cost has been becoming harder and harder to be reduced while the room to be improved in the labor cost is becoming larger and larger. Hallet, an expert in the management in the USA, puts forward that 80 % of what an enterprise does today can also be done by its rivals, for most resources are open to all. Whether an organization succeeds or fails in its business relies on 20 % of its work, namely, the management of its people. As a part of the enterprise cost, the labor one plays a more and more

important role in raising its economic benefits and the key to sharpen its competitiveness. How to raise the benefits of the enterprise by managing the labor cost is just the issue to be discussed. So, the book attempts to intensify the management and supervision of the people by setting up the consensus salary model.

(2) Transaction cost theory. Narrowly speaking, the transaction cost means the time and energy spent in doing business. Broadly speaking, it refers to series of institutional costs like negotiation, the formulation and implementation of a contract, the definition and control of a property right, supervision and the change of the institutional structure. Or all the costs don't directly occur during the production.

The transaction cost includes the following:

The first is the expenditure happening in the market investigation before signing the contract, namely, the expenses paid in seeking for the information of the commodity and various relative productive elements like price, quality, geographical distribution, etc.; those investigating the buyer and the seller in the target market; those to gather the rival's information and to understand the concerned policy, law and stipulations of the government and the sector.

The second is the cost happening in signing the contract, for example, the drawing, discussion and determination of the contract, inputs in bargaining, etc.

The third is the expenses paid after the signature of the contract. They include the following: supervision costs, namely those paid in supervising whether the contract has been carried out in the fixed term or not; litigation costs for the indemnity against the contract, that's to say, various expenses occurred when the damaged claims for the indemnity from the party against the contract in the court; the expenditure paid in formulating the regulations and institutions for all the parties signing the contract to do their own duties and for ensuring their rights. In the operation of the enterprise, all these costs have to be paid, but their degree can be controlled and cut down. It is a problem obliged to be solved how to control and reduce these expenses. In this book, we would like to take it into consideration from their origin. In the light of the new institutional economy, in the pretext of "Economic Man", they are originated in the following: opportunistic tendency, bounded rationality and asset specificity.

In the conditions of opportunistic tendency and bounded rationality, "adverse selection" and "moral hazard" may happen. All these phenomena and the asset specificity lead to series of transaction costs. Therefore, their control and reduction should be made by restraining the human opportunism, solving the bounded rationality, normalizing the people's conduct and rationally regulating the input of the asset or the human capital.

First, according to Douglass·C·North, economic benefits are the outcome of the conjoint actions between the institutions and the ideology, which may solve the problems like reducing the transaction and the opportunism, etc. Besides, some informal restraint measures like culture, value and concept can be adopted.

Second, the information, institutions and process in the operation can be helpful in cutting down the frequency and uncertainty of the transaction cost inside and outside the enterprise.

Third, perfect encouragement mechanisms are the effective tool to control the transaction cost. The enterprise exists in the form of contract, which can't keep away from the labor, knowledge, ability, arts and operational decision of the people. Like the other productive elements, they are essential for the production and operation of the enterprise and play different roles. But they all come from the same origin, namely, the human capital, which has the same issue like the property ownership as the other element. The ownership of the human capital naturally belongs to the individual who can only be encouraged and restrained to play his role for the enterprise, but not deprived. Just because of this feature of the human capital, some things remain to be solved when the enterprise signs the contract with individuals. In this aspect, the enterprise has to establish a complete set of encouragement and restraint mechanism to regulate the incident to happen at times. Appropriate encouragement and restraint can have the effect that one plus one surpasses two. Otherwise, the moral hazard will happen and the insufficiency of "efforts" may cause the increase of the transaction cost invisibly.

2.4 Theory of Pareto Optimal State

The Pareto optimal state refers to the one of any resource arrangement set and no Pareto improvement exists any more. That's to say, in this state, any change can't make at least one party become better and any other one worse, which is called Pareto optimal state.⁵ This kind of state means the economic efficiency. The resource arrangement that can satisfy the Pareto optimal state is the one with economic efficiency. The state is the top target for the consensus salary model in the book to strive for. It is necessary to point out here: the consensus salary system to be studied in the book is to be made in the sphere of the Pareto Improvement, which refers to a state of the resource arrangement that can make at least one party become better and not any other one worse by a change or changes.

The consensus salary model in the book is just the one based on the Pareto Improvement. It says how to maximize the encouraging role of the limited salary resources by an effective arrangement in order to make the salary management effective either to the individual or to the enterprise or to the society.

⁵ Gao Hongye, *Western Economy* (1), China Economy Press, December, 1998, p. 379.

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