

International HR Best Practices Tip of the Month

March 2007

This Month's Challenge

New labor legislation is expected in China later this year.

Best Practice Tip of the Month

Employers with operations in China – or contemplating a move into China – need to take into account the proposed new Labor Contract Law and enhanced enforcement.

Labor Law Landscape In China Set To Drastically Change

It's no secret that a significant amount of manufacturing in recent years has moved overseas, the most visible example being China. Two of the primary reasons that China is one of the most attractive places to manufacture products: cheap labor and relatively unfettered freedom to structure the employer/employee relationship. But those "wild west" (or rather, "wild east") days could all be over soon with the enactment of a proposed comprehensive labor law, known as the Labor Contract Law, which aims (at least on paper) to bring China more in line with the labor laws of other developed nations.

The Legislative Affairs Committee of the National People's Congress (NPC) introduced a first draft of the Labor Contract Law in the fall of 2005. In 2006, it solicited public comments on the law, a rare move for the NPC (usually the public's opinions are not sought). The government received an astounding 191,900 comments on the law, with the majority of the comments coming from ordinary laborers. The second reading of the draft law occurred in late December 2006, and it is the current position of the Chinese Communist Party (CCP) that the law will be enacted at the 17th CCP Congress in autumn 2007.

Western commentators and stake-holders have responded diplomatically and cautiously to the proposed reforms. On the one hand, it is generally seen by western societies as an “enlightened” move for a developing country to start to enact reforms to protect its workers. On the other hand, these same societies may be said to directly benefit from the lax standards and enforcement that are currently in place.

The European Union Chamber of Commerce (EUCC) congratulated the Chinese government for proposing a comprehensive law that in many ways takes its cues from European labor laws. But the EUCC stopped short of directly endorsing the reforms. Instead, they noted that “the key challenge in China remains the compliance and implementation of existing Chinese laws.” Thus, the EUCC proposes that rather than adopting ambitious new labor standards, China should simply start enforcing the few labor laws that it actually does have on the books. One Chinese expert frankly admits that “labor law is weakly implemented and widely ignored by employers in China.” The U.S.- China Business Council (USCBC), which represents over 250 U.S. companies actively engaged in doing business in China, was more forthright: Greater protections offered to Chinese workers, the USCBC opined, could potentially “negatively impact the PRC’s competitiveness and appeal as a destination for foreign investment.” In response to such criticisms, the Chinese government has insisted that its studies show that corporate competitiveness would not be harmed by a strengthening of labor laws.

There is some evidence that enforcement of labor standards is increasing – even without new labor law implementation. One Chinese governmental think-tank calculated that class actions rose between 1993 and 2003 from 10,000 to 60,000, with the number of participants escalating from 730,000 to 3,070,000, and that labor dispute cases increased at 29.6% annually from 1994 to 2005. The actual numbers are believed to be far greater than these official statistics.

What does the new draft Labor Contract Law look like? Here are some highlights:

- Scope: the law would apply to all employees in China, including both public and private employees.
- Written employment contracts: A company must enter into a written contract with the worker within one month of employment. If no contract is in place, then the employee’s treatment should be in compliance with the collective labor contract in place. If no collective labor contract is in place, at the very least, an employer must provide the same rate of pay to employees in equivalent positions.

- **Probation Period:** Employees are entitled to a mandatory probation period, from one to six months, depending on the length of the contract (one month for an employment contract of less than a year to six months if the contract is for an indefinite period of time. During this period, the employer can pay the employee not less than 80% of his contracted salary – but there is no “at will” relationship during the probationary period and an employee can only be terminated for misconduct.
- **Non-Competition Agreements:** The Labor Contract Law allows for certain selected employees to sign noncompete agreements. However, the agreements are limited to senior management personnel, senior technicians, and other employees with knowledge of “trade secrets.” Further, the non-compete period cannot exceed two years.
- **Failure to Pay Wages:** An employee can turn to the “People’s Court” if the employer has failed to pay wages that are owed to the employee. The employer will then bear legal responsibilities in court for failing to pay wages.
- **Trade Unions:** Trade Unions can bring lawsuits and/or compel arbitration against an employer if the employer fails to implement collective bargaining agreements. However, in commenting on the latest draft of the proposed law, Mr. Cheng Siwei, the Vice Chairmen of the NPC, acknowledged that many trade unions were simply alter egos of the employer and that oftentimes they are controlled by the wives or relatives of the company’s control group.
- **“Labor Dispatch” Rules:** Currently, employee placement agencies, called “labor dispatch companies” are very popular in China. Many of the new regulations are aimed at regulating the relationship between the dispatch company, the employee, and the “user company.” For instance, under the new law, the dispatch company will be required to inform the employee about job requirements and pay the employee all necessary wages and any available benefits. Further, dispatch companies are forbidden to sign employees to many successive short term contracts; rather they must determine the applicable employment period according to a reasonable gauge of the user company’s actual business needs.

The above subjects are just a few areas that will be affected by the new labor law; if it is passed and if it is enforced, China’s employment laws will start to look a lot more like the laws of its trading partners. Any multinational with existing or contemplated operations in China would be wise to closely follow the Labor Contract Law’s developments.

* We wish to thank Kan Wang, PhD candidate of the School of Labor and Human Resources of the Renmin (People's) University of China, for his valuable assistance in the preparation of this article.