

# An Urge to Protect is not Enough: China's Labor Contract Law

MIAO Qingqing

## TABLE OF CONTENTS

I. INTRODUCTION .....	161
II. THE LABOR CONTRACT LAW OF 2007 FILLS GAPS IN THE LABOR LAW EFFECTIVE SINCE 1995 .....	163
A. <i>The Labor Law broke the "iron rice bowl" with a new         "contract employment system"</i> .....	163
B. <i>Due to its over-emphasis on general policy, the 1994         Labor Law faces serious problems of implementation ...</i>	164
1. The law only established the general principles for a new employment system.....	164
2. Focusing mainly on the general employment system reform, the law is insufficient to provide practical guidelines for employment practices .....	167
3. Migrant workers' rights lacked protection under the Labor Law .....	167
C. <i>The Labor Contract Law amends the Labor Law to         provide specific guidelines for the formation,         executing and termination of labor contracts</i> .....	169
III. CHINA'S LABOR CONTRACT LAW AIMS AT IMPROVING THE CIRCUMSTANCES OF EMPLOYEES .....	172
A. <i>The new law explicitly requires written labor contracts         and provides penalties for violation</i> .....	173
B. <i>The law establishes a comprehensive termination and         severance pay system to prevent employees from         being unjustifiably discharged</i> .....	174
C. <i>The promotion of open-ended contracts will encourage         long-term and stable labor relationships</i> .....	177
D. <i>The strengthened role of unions will provide more         protection to the workers</i> .....	178

IV. OVERPROTECTION MAY EQUAL NO PROTECTION: CRITIQUE OF THE NEW LAW .....	180
A. <i>The Labor Contract Law Will Substantially Raise         Labor Cost</i> .....	181
B. <i>The Labor Contract Law Creates Trouble for Workers....</i>	184
1. Big companies initiated sudden lay-offs at the dawn of the implementation of the Labor Contract Law. ...	184
2. Large numbers of foreign-invested factories closed down between 2007 and 2008 .....	185
C. <i>The Unusual "Labor Shortage" in the City of Wenzhou:         Migrant Workers' Lives After the Enforcement of the         New Law</i> .....	188
V. SHIFTING GOVERNMENT'S BURDEN TO ENTERPRISES: CASE STUDY ON THE NEW LAW'S IMPACT ON LOCAL PRIVATE BUSINESSES .....	189
A. <i>The questionnaire reveals that the new law does not         just raise the cost for violation</i> .....	190
B. <i>Given China's complex economic structure and social         norm of distrust, the new law is unfairly shifting the         social burden to the enterprises and can hardly do         justice for the public</i> .....	193
VI. WRONGFULLY ASSUMING THAT THE CHINESE ECONOMY WILL KEEP ON GROWING RAPIDLY, THE GOVERNMENT IS IMPLEMENTING A LAW THAT COULD HARDLY BE EFFECTIVELY ENFORCED .....	197
VII. CONCLUSION .....	200

## An Urge to Protect is not Enough: China's Labor Contract Law

MIAO Qingqing<sup>\*</sup>

### I. INTRODUCTION

On June 29, 2007, the 28<sup>th</sup> Session of the Standing Committee of the 10<sup>th</sup> National People's Congress adopted the Labor Contract Law of the People's Republic of China ("Labor Contract Law"). The law took effect on January 1, 2008.<sup>1</sup>

This Labor Contract Law is a milestone in China's path to a comprehensive labor contract system, which began with the adoption of the Labor Law of People's Republic of China ("Labor Law") in 1994.<sup>2</sup> The Chinese legislature enacted the new law to rectify perceived inadequacies of Labor Law and to address the increasing demand for workers' protection. The Labor Contract Law supplements the general principles of the Labor Law by providing specific guidelines for labor contract management. Furthermore, it prescribes more detailed rules on workers' rights and benefits.

The protective provisions in the Labor Contract Law were hotly debated throughout China as it worked its way through China's legislature.<sup>3</sup> Business owners and foreign investors expressed serious concerns and marshaled statistics to show that once enacted the Law would result in sudden and substantial rises in labor costs, as well as additional burdens. A number of Chinese economists also criticized the legislation. They argued that in promulgating the

---

<sup>\*</sup> The Author is a student at Lewis & Clark Law School, J.D. expected 2010; B.A., Peking University, 2007. In this article, the exchange rate between Yuan and US Dollars is 7 to 1. The author would like to give special thanks to Prof. Henry Drummonds for his generous help. The author would like to thank her family for their support, particularly for the comprehensive company data they were willing to share. Finally, a warm thank-you to Bil Elsigner and the editors of Tsinghua China Law Review.

<sup>1</sup> See Labor Contract Law (promulgated by the Standing Comm. Nat'l People's Cong., June 27, 2007, effective Jan. 1, 2008) (P.R.C.) [hereinafter Labor Contract Law].

<sup>2</sup> See Labor Law (promulgated by the Standing Comm. Nat'l People's Cong., July 5, 1994, effective Jan. 1, 1995), translated in Ministry of Commerce, <http://english.mofcom.gov.cn/aarticle/policyrelease/internationalpolicy/200703/20070304475283.html> (last visited Mar. 2, 2009) (P.R.C.) [hereinafter Labor Law].

<sup>3</sup> See Sean Cooney et al., *China's New Labour Contract Law: Responding to The Growing Complexity of Labour Relations in the PRC*, 30 UNIV. NEW S.WALES L. J. 786, 789 (2007).

Labor Contract Law legislators had ignored China's economic foundations and wrongfully presumed that Chinese businesses were capable of bearing the sudden and substantial increase in labor costs that would be caused by the new law.<sup>4</sup> They also argued that by hurting the Chinese businesses, the law will ultimately adversely affect Chinese workers, the intended protected group.<sup>5</sup> Meanwhile, there were concerns that the new law would decrease the bargaining power of both employees and employers by mandating substantive contractual terms and emphasizing administrative scrutiny.<sup>6</sup>

Since the law has come into effect, one of its greatest shortcomings has been in its protection of migrant workers. Despite the Labor Contract Law's intent to protect all workers, their situation has remained largely unchanged.<sup>7</sup> First, a wave of factory closures in the year of 2008 resulted in even less predictability for workers' future. Second, in response to the current global economic slowdown, the Chinese government has slowed the pace of implementing the Labor Contract Law in order to alleviate its impact on both domestic business and foreign investors. The lack of strict enforcement of the new law may render its protections merely aspirational.

This Comment examines the Labor Contract Law's historical background, its general structure and the law's impact on foreign and domestic private businesses. The author-conducted survey of two companies reveals that the new law has raised the labor costs and threatens to worsen the power imbalance between state-owned businesses and private business. With the ongoing global recession, the new law's negative impact on businesses has been magnified. In order to prevent excessive labor cost increases, businesses have had to reduce their workforces or institute hiring freezes. Such

---

<sup>4</sup> Among the well-known Chinese economists, Dr. Steven N.S. Cheung, Ph.D. (张五常) was strongly against the new law because of its potentially destructive effect on labor-intensive industries in China. Dr. Cheung, is a Hong Kong born economist and the former Head of the Department of Economics of Hong Kong University. Dr. Cheung wrote a series of articles on the Labor Contract Law in his official blog. His sharp criticism towards the new law attracted great attention throughout China. Mr. Cheung pointed out in his articles that China's scarce natural resources and dense population make it impossible to become a social welfare state such as Canada or Australia. Currently, China's greatest wealth is its abundant labor resources. Implementation of the new law will raise labor cost immediately. As a result, China will lose its only competitive advantage in the global market. The immediate consequence of the new law will either be the rapid closing of many businesses or under-enforcement of the law. The consequent loss of business will directly hurt the Chinese economy and will ultimately hurt the workers, especially those in labor-intensive industries. See The Official Blog of Steven N.S. Cheung, <http://blog.sina.com.cn/zhangwuchang> (last visited Jan. 26, 2010).

<sup>5</sup> See *id.*

<sup>6</sup> See *id.*

<sup>7</sup> See *The Lives of Migrant Workers in Zhejiang Province After the Implementation of the Labor Contract Law*, ECONOMY REVIEW, Jan. 25, 2008, available at [http://news.xinhuanet.com/employment/2008-01/25/content\\_7493449.htm](http://news.xinhuanet.com/employment/2008-01/25/content_7493449.htm) [hereinafter *Lives of Migrant Workers in Zhejiang*].

practices could ultimately hurt the overall welfare of Chinese workers.

Section I of this comment explores the legislative background of the Labor Contract Law. Section II explains the Labor Contract Law's new protections for employees. Section III discusses the criticisms of the new law. Section IV looks at the law's impact on newly growing small- and medium-sized private businesses based on author-conducted surveys of two privately-owned companies.<sup>8</sup> Section V argues that the legislation is partly based on the NPC's assumption that the economy will continue to grow rapidly. This assumption may undermine the effective implementation of the new law.

## II. THE LABOR CONTRACT LAW OF 2007 FILLS GAPS IN THE LABOR LAW EFFECTIVE SINCE 1995

Before the implementation of the Labor Contract Law, the 1994 Labor Law was the national legislation governing labor relations.<sup>9</sup> The Labor Law established the contract employment system and set out its general principles. However, the provisions of the Labor Law were very general, and it was never effectively implemented. In view of the increasingly complicated labor market and the urge to better protect workers, the Chinese government passed the Labor Contract Law in 2007. The Law seeks to promote a healthy and comprehensive employment system based upon contract.<sup>10</sup>

### A. *The Labor Law broke the "iron rice bowl" with a new "contract employment system"*

China's economy went through fundamental changes prior to the 1994 Contract Law. In 1992, the amended Constitution declared that China practiced a "socialist market economy" rather than the "planned economy" required by the original 1982 version of the law.<sup>11</sup> During the economic transition period, the legislature also began to promote the reform of employment relations.<sup>12</sup> From 1986 to 1987, a series of administrative regulations began to relax the

---

<sup>8</sup> The surveys in Section IV were conducted by the author. The author's family members own and operate the two companies surveyed. All survey documents are on file with author.

<sup>9</sup> See Labor Law, *supra* note 2.

<sup>10</sup> See Cooney, *supra* note 3, at 787.

<sup>11</sup> See Hilary K. Josephs, *Labor Law in A "Socialist Market Economy": The Case of China*, 33 COLUM. J. TRANSN'T'L L. 559, 561 (1995).

<sup>12</sup> See *id.* at 563.

bureaucratic system of labor allocation.<sup>13</sup> The Contract Employment Regulations of 1986 eased the requirement that employers take the employees allocated to them by the local government.<sup>14</sup> As a result of these regulations, employers received authorization to sign fixed-term contracts with employees of their choice. These changes portended the full transition to a market-based labor system in China.

In 1994, the Labor Law was adopted. This Law marked the end of the “iron-rice-bowl”<sup>15</sup> that had been in place for decades, and the beginning of the new labor contract system.<sup>16</sup> The Labor Law was promulgated to “protect the legitimate rights and interests of [laborers], readjust [labor] relationship, establish and safeguard [a labor] system suiting the socialist market economy, and promote economic development and social progress.”<sup>17</sup> It governed all employment relationships and covered all forms of business organizations.<sup>18</sup> It broadly applied to government workers outside of the civil service system, and also applied to all enterprises, both state-owned and private-owned, and any other institutions forming employment relationships within the territory of the People’s Republic of China (PRC).<sup>19</sup> Therefore, the Labor Law replaced most workers’ “iron rice bowls”, which promised lifelong employment and benefits, with labor contracts specifying employment terms and conditions.<sup>20</sup>

*B. Due to its over-emphasis on general policy, the 1994 Labor Law faces serious problems of implementation*

*1. The law only established the general principles for a new employment system*

The Labor Law of 1994 established the fundamental rights and obligations of both workers and employers in a contract employment system. Labor contracts were required to establish an employment

---

<sup>13</sup> See *id.*

<sup>14</sup> See *id.* at 564.

<sup>15</sup> The so-called “iron-rice-bowl” system consists of bureaucratic welfare arrangements for employees, under which the state promised workers life-long employment and benefits. Once hired, an employee could not lose his or her job until retirement except in very exceptional circumstances.

<sup>16</sup> See Labor Law, *supra* note 2.

<sup>17</sup> See *id.* at art. 1.

<sup>18</sup> See Josephs, *supra* note 11, at 566.

<sup>19</sup> See Labor Law, *supra* note 2, at art. 2; Guan Yu Lao Dong Fa Ruo Gan Tiao Wen Shuo Ming [Department of Labor’s Comment on the Labor Law] (The Ministry of Labor, Sep. 5, 1994) (P.R.C.) (the Ministry of Labor was reorganized into the Ministry of Human Resources and Social Security of the People’s Republic of China in 2008).

<sup>20</sup> See Aaron Halegua, *Getting Paid: Progressing the Labor Disputes of China’s Migrant Workers*, 26 BERKELEY J. INT’L L. 254, 273 (2008).

relationship.<sup>21</sup> Workers gained the state-protected right to enter into a labor contract on an equal and voluntary basis.<sup>22</sup> According to the Labor Law, basic worker's rights such as compensation, leave, work safety, social insurance and welfare payment, training, equal employment opportunity, and dispute resolution, etc., must be included in their labor contracts.<sup>23</sup> Workers also had the right to join unions.<sup>24</sup> Employers were obligated to furnish internal company procedures to insure workers' legal rights and guarantee competent performance.<sup>25</sup>

Despite its far-reaching influence on Chinese employment relationships, the Labor Law suffered inadequate enforcement because of its emphasis on policy rather than any detail about the actual formation of labor contracts.<sup>26</sup> Professor Chang Kai from Peking University asserted that the labor law placed undue emphasis on principles, making it difficult to implement the law in daily practice. For instance, the Labor Law required that employment relationships be based upon employment contracts but it did not define what constituted a legally enforceable labor contract.<sup>27</sup> As a result, the Labor Law suffered from routine noncompliance.<sup>28</sup> Since the Contract Law of 1999 did not apply to labor contracts, there was no legal guidance on how to form an enforceable labor contract.<sup>29</sup>

In addition to practical problems with the formation and enforcement of labor contracts, other provisions provided for in the Labor Law proved to be impractical. The main cause for this was the large disparity in workers' education and skill levels combined with the overly-generalized Labor Law principle of "equality, voluntariness and mutual agreement."<sup>30</sup> China's excessive labor supply made "equality and voluntariness" between the employers and employees unrealistic in many cases due to their relative

---

<sup>21</sup> See Labor Law, *supra* note 2, at art. 16.

<sup>22</sup> See *id.* at art. 3.

<sup>23</sup> See *id.* at arts. 12-13.

<sup>24</sup> See *id.* at art. 12.

<sup>25</sup> See *id.* at art. 4.

<sup>26</sup> See Cooney, *supra* note 3, at 787.

<sup>27</sup> See Labor Law, *supra* note 2, at art. 16 (providing that a labor contract is an agreement creating an employment relationship and specifying the rights and interests of the parties).

<sup>28</sup> See Mai Wei, *The WTO and Chinese Labor Rights: An Interview with Chang Kai*, in *THE GLOBAL WORKPLACE: INTERNATIONAL AND COMPARATIVE EMPLOYMENT LAW - CASES AND MATERIALS* 512 (Roger Blanpain et al. eds., 2007).

<sup>29</sup> See Contract Law (promulgated by the Nat'l People's Cong, Mar. 15, 1999), art. 123 (P.R.C.) (providing that "where another law provides otherwise in respect of a certain contract, such provisions prevail").

<sup>30</sup> See Cooney, *supra* note 3, at 788.

bargaining power.<sup>31</sup> Further, because the Labor Law did not provide practical guidelines for remedies,<sup>32</sup> workers' rights could be, and were, routinely violated.<sup>33</sup> Despite the law's requirement of overtime payment, workers often worked far more than forty hours a week without appropriate payment adjustments and their regular wages were often below minimum requirements.<sup>34</sup> Some Chinese workers were forced to pay a large "deposit" to their employer, effectively preventing them from leaving their jobs even when employers violated their rights. Unsafe working conditions were also common.<sup>35</sup>

To fill in the gaps in the Labor Law, the central government enacted various legal instruments such as the Ministry of Labor's official opinions. The local governments also enacted a series of ordinances.<sup>36</sup> These opinions and local ordinances suffered from problems including unclear legal effect and limited jurisdiction as the National People's Congress and its Standing Committee possessed the exclusive right of national legislation.<sup>37</sup> Although the absence of national guidance on labor contracts increased the flexibility of labor contract regulation in each region, that absence also led to inconsistency in enforcement.<sup>38</sup> Since China is constitutionally defined as a unitary state, the significant inconsistencies diminished the prominence of the Labor Law and thus increased the difficulty of its implementation.<sup>39</sup>

<sup>31</sup> See *id.*

<sup>32</sup> See Labor Law, *supra* note 2, at ch. 12 (broadly providing that violations in workers' rights may result in repayment of unpaid wages, fine and criminal punishment).

<sup>33</sup> See Robert J. Rosoff, *Beyond Codes of Conduct*, THE CHINA BUSINESS REVIEW, <http://www.chinabusinessreview.com/public/0403/rosoff.html>; See Labor Law, *supra* note 2, at art. 36 (establishing the eight-hour per day, forty-four-hour per week system).

<sup>34</sup> See *id.*

<sup>35</sup> See *id.*

<sup>36</sup> See, e.g., Wei Fan He Jie Chu Lao Dong He Tong De Jing Ji Bu Chang Ban Fa [Notice on Economic Remedies for Violations of the Labor Law] (Ministry of Labor, Dec. 3, 1994), available at [http://www.molss.gov.cn/gb/ywzn/2006-02/15/content\\_106667.htm](http://www.molss.gov.cn/gb/ywzn/2006-02/15/content_106667.htm) (last visited June 8, 2009) (P.R.C.); Shanghai Shi Lao Dong He Tong Tiao Li [Shanghai Mun. Labor Contract Regulations] (promulgated by the Standing Mun. Comm. of Shanghai People's Cong., Nov. 11, 2001, effective May 1, 2002), available at [http://www.molss.gov.cn/gb/ywzn/2006-04/10/content\\_151362.htm](http://www.molss.gov.cn/gb/ywzn/2006-04/10/content_151362.htm) (last visited June 8, 2009) (P.R.C.); Beijing Shi Lao Dong He Tong Gui Ding [Beijing Mun. Labor Contract Regulations] (promulgated by the Standing Mun. Comm. of Beijing People's Cong.), available at [http://www.molss.gov.cn/gb/ywzn/2006-04/07/content\\_151349.htm](http://www.molss.gov.cn/gb/ywzn/2006-04/07/content_151349.htm) (last visited June 8, 2009).

<sup>37</sup> See Li Fa Fa [Legislation Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong. Mar. 15, 2000, effective July 1, 2000), art. 7, available at [http://www.gov.cn/test/2005-08/13/content\\_22423.htm](http://www.gov.cn/test/2005-08/13/content_22423.htm) (last visited June 8, 2009) (P.R.C.) [hereinafter Legislation Law].

<sup>38</sup> See Sean Cooney, *Making Chinese Labour Law Work: The Prospects for Regulatory Innovation in the People's Republic of China*, 30 FORDHAM INT'L L.J. 1050, 1081-86 (2007).

<sup>39</sup> See Cooney, *supra* note 3, at 789.

*2. Focusing mainly on the general employment system reform, the law is insufficient to provide practical guidelines for employment practices*

The main objective of the Labor Law was promoting employment system reform. However, its drafters failed to foresee the rapid growth in contracting practices that could lead to significant abuses of workers' rights.<sup>40</sup> Since there was no specific requirement for establishing long-term contracts, some employers signed "rolling" short-term labor contracts with the workers in order to evade their obligations to long-term employees.<sup>41</sup> The lack of clear rules for contract modification also created the problem of unilateral changes.<sup>42</sup> Due to the absence of statutory regulations on non-compete clauses, employers tended to bind employees with overly broad non-compete clauses that would substantially limit the employees' employment options.<sup>43</sup>

The Labor Law failed to set out principles governing contracts for contingent workers. As a result, employers often underpaid the contingent workers. According to one report, McDonald's, KFC and Pizza Hut restaurants in Guangzhou paid their part-time workers four yuan (about 60 cents) per hour, 40 percent less than the local minimum wage of seven and a half yuan (about 108 cents).<sup>44</sup>

*3. Migrant workers' rights lacked protection under the Labor Law*

With the rapid urbanization in China, increasing numbers of farmers chose to leave their rural hometowns each year for jobs in the cities. The National Bureau of Statistics in China predicted that the number of migrant workers in 2008 totaled over two hundred million.<sup>45</sup> In China, migrant workers, usually lacking education, money and legal knowledge, are effectively treated as a "subclass."<sup>46</sup> As a result, without effective laws and enforcement, it is easy for employers to violate their rights. Getting paid is a common problem for many migrant workers. Ensuring pay to migrant workers

---

<sup>40</sup> See *id.* at 787.

<sup>41</sup> See *id.*

<sup>42</sup> See Labor Law, *supra* note 2, at art. 18 (addressing when a contract may be terminated).

<sup>43</sup> See Cooney, *supra* note 3, at 787.

<sup>44</sup> See Bryan Bachner & Laney Zhang, 2007 *Chinese Legislation*, 4 AM. U. BUS. L. BRIEF 30, 32 (2008).

<sup>45</sup> See National Bureau of Statistics of China, <http://www.stats.gov.cn/tjfx/fxbg/t20090325402547406.htm> (last visited June 8, 2009) (noting that in 2008, the number of migrant workers reached 225,420,000; *Laws Needed to Ensure Migrant Workers' Wages*, CHINA DAILY, Mar. 9, 2006, <http://www.china.org.cn/english/zhuanti/country/160796.htm>).

<sup>46</sup> See Halegua, *supra* note 20, at 256.

became part of Premier Wen's agenda after his trip to Chongqing in October, 2003.<sup>47</sup> Soon after Premier Wen returned to Beijing, the central government promulgated a Notice Concerning the Timely Payment of Migrant Workers' Wages.<sup>48</sup>

The problem of not getting paid reflected that the Labor Law's inadequate protection. Labor contracts remained unusual outside of state-owned businesses, let alone among migrant workers and their employers.<sup>49</sup> Migrant workers lacked bargaining power vis-à-vis their employers.<sup>50</sup> Many of them could not even ask for a written contract because signing a contract was not the norm and the job positions were very competitive.<sup>51</sup> A survey of 1,000 migrant workers in the city of Harbin, the capital city of Heilongjiang Province,<sup>52</sup> revealed that only 19.58 percent had written contracts, over half only had informal oral agreements and 21.11 percent had never discussed anything about a labor contract.<sup>53</sup>

The Labor Law provided little protection to the migrant workers because the law only protected employees who had formed a "labor contract relationship," which could be only be formed through adhering to the statutory language of the Labor Law.<sup>54</sup> When disputes occurred, employers would simply deny having employment relationships with any workers on the grounds that there were no labor contracts.<sup>55</sup> Although the Ministry of Human Resources and Social Security ("MOHRSS", also known as the Ministry of Labor and Social Security, "MOLSS") emphasized that a written contract was not required to prove the existence of labor relations. In

---

<sup>47</sup> In 2003, Ms. Xiong Deming gained national recognition for telling Premier Wen Jiabao about her migrant worker husband's problem of not getting paid. See Qianfeng Tian, *The Story of Ms. Xiong Deming*, JIANGHUA TIMES, Mar. 6, 2008, <http://epaper.jinghua.cn/html/2008-03/06/content221141.htm>.

<sup>48</sup> See Jie Sun & Huo Huang, *Premier Wen Visited Three Gorges Dam Region and Helped the Migrant Workers to Get Paid*, XINHUA NET, Oct. 27, 2003, <http://news.sina.com.cn/c/2003-10-27/17221001834s.shtml> (explaining Premier Wen's visit to a rural village during which he became aware of the local migrant workers' difficulty with getting paid).

<sup>49</sup> See Halegua, *supra* note 20, at 274.

<sup>50</sup> See *id.* at 276.

<sup>51</sup> See Liu Weifeng, *One Man's Mission to Claim What is Due*, CHINA DAILY, July 1, 2005, <http://english.sohu.com/20050701/n226149507.shtml>.

<sup>52</sup> Harbin is the largest non-municipality city with the second largest population. The Government of Harbin: City Information, <http://www.harbin.gov.cn/zjhrb/csfm/index.php?colorid=1&ddqwa=1&dqwzb=1> (last visited June 8, 2009).

<sup>53</sup> Lihua Tong & Weidong Xiao, *Zhong Guo Nong Min Gong Wei Quan Cheng Ben Diao Cha Bao Gao* [Investigative Report on the Costs for Advocating Migrant Workers' Rights] § III(8) (Beijing Youth Legal Aid and Research Center 2005), available at <http://www.chineselawyer.com.cn/pages/2005-9-29/s31553.html> (last visited June 8, 2009).

<sup>54</sup> See Labor Law, *supra* note 2, at art. 2.

<sup>55</sup> See Halegua, *supra* note 20, at 274.

practice, however, many Labor Arbitration Committees (“LACs”)<sup>56</sup> and courts treated a written contract as the only acceptable evidence of a valid employment relationship.<sup>57</sup>

Also, under the Chinese Civil Procedure Law, the plaintiff is generally expected to produce documentary proof to support their cause of action, even if the evidence is within the defendant’s exclusive control.<sup>58</sup> Court regulations permit the burden of proof to be shifted to the employer in certain employment disputes. Nonetheless, the rule does not explicitly permit burden shifting for the purposes of proving the existence of an employment relationship.<sup>59</sup> Since there are no discovery rules parallel to those used in the United States and because litigants in China do not testify under oath, oral testimony by the parties or supporting witnesses are given little weight.<sup>60</sup> As a result of this gap in the Labor Law, migrant workers were often faced with an impossible task in enforcing employment rights: without written contracts, they could not convince law enforcement agencies that they had formed a valid labor relationship.

*C. The Labor Contract Law amends the Labor Law to provide specific guidelines for the formation, executing and termination of labor contracts*

According to Mr. Yang Jingyu, former Chairman of the Law Committee of the National People’s Congress, the Labor Law’s inadequate protection and China’s rapid economic growth resulted in the number of labor disputes increasing by over 1300 percent between 1995 and 2006.<sup>61</sup> Most of the disputes were related to

---

<sup>56</sup> Parties involved in labor disputes must exhaust arbitration procedures before litigation. See Zhong Hua Ren Min Gong He Guo Qi Ye Lao Dong Zheng Yi Chu Li Tiao Li [Directives for Labor Disputes Resolution] (promulgated by the State Council, July 6, 1993) art. 6 (P.R.C.). Labor Arbitration Committee (LAC) is established under art. 6 of the Directives. Under the Directives, the local government is responsible for setting up the LAC. The LAC consists of officials from the labor departments, employer representatives and union representatives. A three-member arbitration panel resolves labor disputes. The labor department’s office of labor dispute arbitration is the operating body of the LAC that is in charge of daily business.

<sup>57</sup> See Halegua, *supra* note 20, at 274.

<sup>58</sup> See Civil Procedure Law (promulgated by the Standing Comm. Nat’l People’s Cong., Apr. 9, 1991), art. 64, (P.R.C.), translated at <http://www.lehmanlaw.com/resource-centre/laws-and-regulations/civil-proceedings/law-of-civil-procedure-of-the-peoples-republic-of-china-1991.html> (last visited Feb. 1, 2010).

<sup>59</sup> See Guanyu Minshi Susong Zhengju de Ruogan Guiding [Certain Regulations Relating to Evidence in Civil Litigation] (Sup. People’s Ct., Dec. 21, 2001), art. 6, available at <http://www.court.gov.cn/lawdata/explain/civilcation/200303200049.htm> (last visited June 8, 2009).

<sup>60</sup> See Hilary K. Josephs, *Measuring Progress Under China’s Labor Law: Goals, Processes, Outcomes*, 30 COMP. LAB. L. & POL’Y J. 373, 385 (2009).

<sup>61</sup> Amy L. Sommers, Esq. and Michael E. Burke, Esq., *Reporting on Developments in the Four Legal Systems of Greater China*, 3 China L.Rep. 4, 1 (2007).

unpaid wages. Another problem identified was that an estimated 60 percent of employers would only sign short-term contracts with their employees.<sup>62</sup> Because of these problems, the Chinese legislator declared that the Labor Law needed improvements to better protect workers' rights.<sup>63</sup>

On March 31, 2006, the government initiated a plan entitled "Three-Year Action Plan to Promote a Labor Contract System."<sup>64</sup> The plan set out a goal for employers' compliance with the labor laws. The target compliance rate was set at 80 percent by 2006, 90 percent by 2007, and 100 percent by 2009.<sup>65</sup> The plan also proposed to accelerate the legislative process towards developing and implementing new labor contract law that could supplement the old Labor Law.<sup>66</sup>

In May 2007, media reported the use of child labor and brutal torture of laborers at illegal brick kilns in Shanxi Province.<sup>67</sup> The "black brick kiln scandal" involved 53,036 migrant workers, including under-aged laborers and 720,000 yuan (approximately \$103,000 USD) in unpaid wages.<sup>68</sup> The reported treatment of workers shocked the entire nation and accelerated the passage of the new law.<sup>69</sup> The Labor Contract Law was passed with full votes (145:0) on June 29, 2007 after rounds of debate and revisions.<sup>70</sup>

The new law represents an effort to elaborate upon particular sections of the 1994 law.<sup>71</sup> It intends to further improve Chinese labor contract system by building on 10 years of experience with the Labor Law.<sup>72</sup>

The Labor Contract Law consists of eight chapters, covering: 1) general principles, which largely mirrors the first chapter of the

---

<sup>62</sup> See *id.*

<sup>63</sup> See Zhe Zhu, *Protection of Workers' Rights Urged*, CHINA DAILY, Dec. 26, 2008, [http://www.chinadaily.com.cn/bizchina/2008-12/26/content\\_7342287.htm](http://www.chinadaily.com.cn/bizchina/2008-12/26/content_7342287.htm).

<sup>64</sup> See Erika C. Collins, Marjorie R. Culver & Laura Marino, *Developments in Employment Law Around the World 2006*, 41 INT'L LAWYER 541, 541 (2007).

<sup>65</sup> See *id.*

<sup>66</sup> See *id.*

<sup>67</sup> See *30 Minutes on Economy: The Birth of The Labor Contract Law - The Disclosure of "Black Brick Plant" Helped the Passage of the Labor Contract Law* (CCTV television broadcast Dec. 27, 2007), transcript available at <http://news.sina.com.cn/c/2007-12-28/012814617273.shtml> (last visited June 8, 2009).

<sup>68</sup> See *id.*

<sup>69</sup> See *id.*

<sup>70</sup> See *id.*; Zhong Hua Ren Min Gong He Guo Zhu Xi Ling Di Liu Shi Wu Hao [Exec. Order No. 65] (2007) (P.R.C.), available at [http://w1.mohrss.gov.cn/gb/zt/2007-09/29/content\\_198892.htm](http://w1.mohrss.gov.cn/gb/zt/2007-09/29/content_198892.htm) (last visited June 8, 2009).

<sup>71</sup> See Josephs, *supra* note 60, at 380.

<sup>72</sup> See Xiaoyu Guo, *Form and Develop A Legal Framework for Harmonious and Stable Labor Relationships: An Interview with Mr. Yang Jingyu, Chair of the NPC Law Comm.*, RULE OF LAW DAILY, Aug. 20, 2007, [http://www.npc.gov.cn/npc/zt/2007-08/20/content\\_370354.htm](http://www.npc.gov.cn/npc/zt/2007-08/20/content_370354.htm).

Labor Law; 2) the formation of labor contracts; 3) contract performance and modification; 4) contract termination; 5) specific rules for collective labor contracts, labor dispatching agencies (third-party vendor companies that provide temporary workers for employers) and temporary employees; 6) compliance supervision and inspection; 7) liabilities and penalties; and 8) supplementary rules concerning exemptions and the law's non-retroactive effects.<sup>73</sup> Existing labor contracts are grandfathered.<sup>74</sup>

Unlike the Labor Law that left undefined when an employment relation starts, the Labor Contract Law explicitly states that the employment relationship is formed as soon as the workers start performing the required work.<sup>75</sup> The Labor Contract Law also provides rules on when the parties must sign the labor contract. Section II, Part A of this comment will discuss this issue in detail.

As a supplement to Article 20 of the Labor Law, the Labor Contract Law contains specific rules governing different types of labor contracts.<sup>76</sup> Three types of labor contracts are identified: fixed-term, open-ended and contingent contracts that end upon the completion of the work.<sup>77</sup> The Labor Contract Law also sets out rules for temporary employment contracts.<sup>78</sup> Temporary workers are workers paid by the hour and work less than four hours per day and twenty-four hours per week for the same employer.<sup>79</sup> The temporary employment contracts are similar to at-will employment where either party can terminate the labor contract at anytime without incurring compensation.<sup>80</sup> Employers cannot include probationary period in temporary labor contracts. In addition, they must pay a wage not lower than the local minimum wage.<sup>81</sup>

Compared with the overly-generalized Labor Law, the Labor Contract Law provides a more comprehensive list of required contract terms. For example, labor contracts must include detailed information about the identity of the contracting parties.<sup>82</sup> The contracts must explicitly declare that employees are entitled to comprehensive social insurance benefits, as is discussed in detail within Section III, Part A of this comment.<sup>83</sup> The additional

---

<sup>73</sup> See Labor Contract Law, *supra* note 1.

<sup>74</sup> See *id.* at art. 97.

<sup>75</sup> See *id.* at art. 7.

<sup>76</sup> See *id.* at arts. 12-15.

<sup>77</sup> See *id.*

<sup>78</sup> See *id.* at arts. 68- 72.

<sup>79</sup> See *id.* at art. 68.

<sup>80</sup> See *id.* at art. 71.

<sup>81</sup> See *id.* at arts. 71-72.

<sup>82</sup> See *id.* at art. 17; Labor Law, *supra* note 2, at art. 19.

<sup>83</sup> See *id.*

contractual terms are intended to specify workers' rights at work and to make it easier to locate the contracting parties in case of labor disputes.<sup>84</sup>

The Labor Contract Law also sets forth a specific scheme on severance pay.<sup>85</sup> In addition to the general rules on lay-offs provided by Article 27 of the Labor Law, employers must follow specified procedures for mass lay-offs.<sup>86</sup>

The Labor Contract Law also establishes rules governing non-compete clauses.<sup>87</sup> The law permits the use of non-compete clauses but limits their duration to two years and restricts their application to high-level managers, senior technicians or employees who are contractually obligated to keep the company's information confidential.<sup>88</sup>

In sum, the Labor Contract Law effectively fills in the legislative gaps of the Labor Law. Given the growing Chinese economy and the ever-expanding labor market, the Labor Contract Law is a necessary and timely supplement to the existing legislation. After thirteen years from the establishment of the labor contract system, the Labor Contract Law finally provides a nationally applicable set of guidelines for labor contracts.

### III. CHINA'S LABOR CONTRACT LAW AIMS AT IMPROVING THE CIRCUMSTANCES OF EMPLOYEES

Working from the assumption that employees are the vulnerable party in labor relations, the labor contract system put in place by the Chinese legislature is intended to be favorable for workers.<sup>89</sup> It was also believed that better protections for workers would contribute to higher productivity and a more stable society.<sup>90</sup> To achieve these goals, the legislature invited wide public involvement in the drafting of the Labor Contract Law. The government expressed strong willingness to listen to the public, which was unusual in the legislative drafting process in China.<sup>91</sup> The drafters received 191 800 separate documents via the Internet, the mail and other modes of

---

<sup>84</sup> See Labor Contract Law, *supra* note 1, at art. 17.

<sup>85</sup> See *id.* at art. 46.

<sup>86</sup> See *id.* at art. 41. See also Section II, Part B *infra* for a detailed discussion on this rule.

<sup>87</sup> See *id.* at art. 24.

<sup>88</sup> See *id.* at art. 24.

<sup>89</sup> See Interview with Sun Baoshu, Deputy Minister of Ministry of Human Resources and Social Security of the People's Republic of China (June 29, 2009), available at [http://w1.mohrss.gov.cn/gb/zt/2007-07/01/content\\_197479.htm](http://w1.mohrss.gov.cn/gb/zt/2007-07/01/content_197479.htm) (last visited June 8, 2009) [hereinafter Baoshu Interview].

<sup>90</sup> See *id.*

<sup>91</sup> See Owen D. Nee Jr. & Winston Zhao, *Ensuring Compliance with China's New Labor Laws* 153, 157 (Corporate Law and Practice Course Handbook Series PLI Order No. 14705, 2008).

communications during the one-month comment period.<sup>92</sup> These comments contributed to substantial amendments to the original draft.<sup>93</sup> These commentaries aided the drafters of the legislation in their attempts to balance the interests of employers and employees under the new law.<sup>94</sup>

The implementation of the new law also shows a positive influence on workers' wages. According to a recent survey conducted by Guangdong Province Ministry of Human Resources and Social Security in the spring of 2008, the average wage for entry-level workers was about 1,160 yuan (about \$ 175) per month, a 13 percent increase from a year earlier.<sup>95</sup> Workers also started using the new law to advocate their rights. In Shenyang, the capital city of Liaoning Province, Ms. Wang, who was employed as an accountant at a local advertising company, was awarded double wages by a court because her employer did not sign a contract within one month of her employment. This was the "First Labor Contract Law Case" in the City of Shenyang.<sup>96</sup> On January 2, 2008, fifty-four workers in Chengdu, the capital city of Sichuan Province, sued their employers for not returning their "security deposits" after terminating their labor contracts. The lower court awarded all the workers their deposits together with economic damages.<sup>97</sup>

*A. The new law explicitly requires written labor contracts and provides penalties for violation*

The Labor Contract Law provides that labor contracts must be in writing and must be signed within one month after employees start working.<sup>98</sup> To ensure compliance, the law specifically prescribes substantive remedies for failure to secure written contracts. According to Article 82, employers must pay double wages for up to eleven months if they failed to sign a written contract. If no written contract is signed within one year of employment commencing, the employer is deemed to have signed an open-ended contract with the

---

<sup>92</sup> See *id.* at 155.

<sup>93</sup> See *id.*

<sup>94</sup> See Baoshu Interview, *supra* note 89.

<sup>95</sup> See Survey by Guangdong Province on the Implementation of the Labor Contract Law, THE RULE OF LAW DAILY, May. 4, 2008, [http://www.npc.gov.cn/npc/zt/2008-05/04/content\\_1427337.htm](http://www.npc.gov.cn/npc/zt/2008-05/04/content_1427337.htm).

<sup>96</sup> See *The Worker Won in the "First Labor Contract Law Case" in Shenyang*, LIAOSHEN EVENING DAILY, Apr. 23, 2008, [http://news.xinhuanet.com/employment/2008-04/23/content\\_8033869.htm](http://news.xinhuanet.com/employment/2008-04/23/content_8033869.htm). In China, case decisions are not binding and there is no case reporter system. Only the Supreme Court has its own reporter. The transcripts of court decisions are not always available to the public.

<sup>97</sup> See Jiahui Wu, *First Labor Contract Law Case in Chengdu: Workers Won Their Claims for "Security Deposits"*, TIANFU MORNING DAILY, Aug. 26, 2008.

<sup>98</sup> See Labor Contract Law, *supra* note 1, at art 10.

employee.<sup>99</sup> An open-ended contract has no specific termination date and thus employers can only terminate it with severance pay in most circumstances.<sup>100</sup> The penalties effectively deter violations by raising the cost of noncompliance. According to a report issued by the NPC Standing Committee, as of September 2008, in six targeted provinces, 93 percent of employees in companies with annual revenues of more than five million yuan (approximately \$714, 300 USD) have signed written labor contracts, an increase of 2.3 percent over the prior year.<sup>101</sup>

There is one exception to the written contract rule. Curiously, this exception is addressed in Article 69 of the Labor Contract law, four chapters apart from the mandatory written contract provision. According to this article, temporary employment contracts need not be in writing. These contracts are for temporary workers, who are part-time workers paid by the hour.<sup>102</sup> This exception may give employers an incentive to hire more part-time workers while cutting off the full-time workforce, which would likely adversely affect a number of employees, including the primary breadwinners in some families.<sup>103</sup> Furthermore, this exception actually contradicts Article 10 of the Labor Contract Law because Article 10 requires a written labor contract without indicating any exception.

Nevertheless, the Labor Contract Law makes great strides in promoting written labor contracts. The positive result of the aforementioned NPC survey in 2008 demonstrates the significant improvement brought by the new law.<sup>104</sup>

*B. The law establishes a comprehensive termination and severance pay system to prevent employees from being unjustifiably discharged*

To avoid unjustifiable discharge, the Labor Contract Law provides comprehensive guidelines for contract termination. Employers can unilaterally terminate a contract without advance notice only when: 1) the employee cannot perform competently during the probationary period; 2) the employee materially breaks the employer's administrative rules; 3) the employee is guilty of gross misconduct or dereliction of duty; 4) the employee impermissibly forms a new business/employment relationship

<sup>99</sup> See *id.* at art. 14.

<sup>100</sup> See *id.* at arts. 14, 39, 46. See Section II, Part B, *infra*, for details on open-ended contracts.

<sup>101</sup> Zhu, *supra* note 63.

<sup>102</sup> See Labor Contract Law, *supra* note 1, at art. 68.

<sup>103</sup> See Roger Blanpain et al., THE GLOBAL WORKPLACE: INTERNATIONAL AND COMPARATIVE EMPLOYMENT LAW - CASES AND MATERIALS 300-01 (2007).

<sup>104</sup> See Zhu, *supra* note 63.

causing substantial losses to the employer or refuses to terminate such an improper relationship upon the employer's warning; 5) the employee commits fraud or threatens the employer to offer employment; or 6) the employee commits a crime.<sup>105</sup> Unless one of these circumstances exists, an employer is liable for severance fees or any other applicable compensation when they terminate a labor contract.<sup>106</sup> When employers terminate labor contracts upon mutual agreements with their employees, they must pay severance fees.<sup>107</sup>

Other grounds for discharge include: 1) worker's disease or work-related injuries that render the worker incompetent for his/her job; 2) incompetent performance after necessary training in the post-probationary period; or 3) a material change in employer's circumstances. Discharges on these grounds require the employer to give thirty-day written notice and pay one-month additional wages.<sup>108</sup> The employer must also provide severance pay.<sup>109</sup>

The new law also specifies rules on mass lay-offs.<sup>110</sup> The documentary "West of The Tracks" has provided a vivid picture of the catastrophic effect of the downsizing for workers' families and communities.<sup>111</sup> The Labor Contract Law specifically aims at mitigating the financial hardships of the affected families and workers. Mass lay-offs are lay-offs involving at least twenty employees or 10 percent of the workforce.<sup>112</sup> The employer must provide thirty-day notice to all the employees or the workers' unions and consult them with the lay-off plan.<sup>113</sup> After the consultation, the employer must report the lay-off plan to local labor departments before taking any further action.<sup>114</sup> In addition, the employer must first retain "priority persons" such as those who have long-term or open-ended contracts, or those who have unemployed family members or dependants in the household.<sup>115</sup>

Unless the employee's situation falls under the discharge conditions specified under Article 39, the employer cannot terminate labor contracts if the employee: 1) was exposed to hazardous substance and has not yet received a full physical examination; 2)

<sup>105</sup> See Labor Contract Law, *supra*, note 1, at art. 39.

<sup>106</sup> See *id.* at art. 46.

<sup>107</sup> See *id.* at arts. 36, 46.

<sup>108</sup> See *id.* at art. 40.

<sup>109</sup> See *id.* at art. 46.

<sup>110</sup> See *id.* at art. 41.

<sup>111</sup> See Josephs, *supra* note 60, at 388; Jeannette Catsoulis, *Casualties of China's Transformed Economy*, N.Y. TIMES, Apr. 18, 2007, available at <http://movies.nytimes.com/2007/04/18/movies/18trac.html> (last visited June 8, 2009).

<sup>112</sup> See Labor Contract Law, *supra* note 1, at art. 41.

<sup>113</sup> See *id.*

<sup>114</sup> See *id.*

<sup>115</sup> See *id.*

was partially or fully disabled due to the work-related disease or injury; 3) was diagnosed for non-work-related disease and was still during the observation period; 4) was in her maternal period; 5) has worked for the same employer for over fifteen years and is less than five years away from retiring age; or 6) fits in other qualified situations prescribed by relevant laws and regulations.<sup>116</sup>

According to Article 46, employers are required to pay a severance fee under most circumstances, including mass lay-offs and terminations governed by Article 38, Article 36 and Article 40.<sup>117</sup> Severance pay must equal the employee's monthly wage multiplied by years of employment (up to twelve years).<sup>118</sup> In considering the employers' reasonable economic interests, the legislature adopted this severance pay formula instead of the draft law formula (monthly wage multiplied by years of employment multiplied by 12).<sup>119</sup> For high-income employees whose monthly wages are three times greater than the local average income of the preceding year, the severance pay is equal to 3 times the average monthly income multiplied by years of employment.<sup>120</sup> This formula is intended to protect employers from paying excessive severance fees to high-income employees. The employer must pay double severance pay when he or she is found guilty of unjustifiable discharge and reinstatement is not plausible.<sup>121</sup>

Compared to the protections under the Labor Law, the rules on termination and severance pay make it difficult for employers to discharge employees. Compared to the rules for employers, the rules for terminations by employees are lenient. Employees can terminate employment contracts at any time upon a written thirty-day notice (three-day notice for probationary workers) or upon mutual agreement with their employers.<sup>122</sup> Employment can be terminated immediately when an employer: 1) breaches the labor contract; 2) fails to pay full wages on time; 3) fails to pay full insurance; 4) establishes internal policies that are against the policy of labor laws and regulations; 5) induces workers into employment relations; or 6) commits any other violations according to the relevant laws.<sup>123</sup> The Labor Contract Law's different treatment of employers and

<sup>116</sup> See *id.* at art. 42.

<sup>117</sup> See *id.* at art. 47.

<sup>118</sup> *Id.*

<sup>119</sup> See Ronald C. Brown, *Recent Development: China's New Labor Contract Law*, 3 China L. Rep. 4, 8 (2007), available at [http://lawprofessors.typepad.com/china\\_lawprofblog/files/chinalawreporterno.%208.pdf](http://lawprofessors.typepad.com/china_lawprofblog/files/chinalawreporterno.%208.pdf), (last visited Feb. 16, 2010).

<sup>120</sup> See Labor Contract Law, *supra* note 1, at art. 47.

<sup>121</sup> See *id.* at art. 87.

<sup>122</sup> See *id.* at arts. 36-37.

<sup>123</sup> See *id.* at art. 38.

employees helps to ensure workers' job security without limiting their freedom to choose employers.

*C. The promotion of open-ended contracts will encourage long-term and stable labor relationships*

Open-ended contracts have no expiration date and will automatically renew on their term.<sup>124</sup> This feature of the Labor Contract Law promotes job security by reducing uncertainties arising from having to renew labor contracts. Since an open-ended contract will never expire, workers are guaranteed extra wage and severance pay if their employer terminates their contract of employment (unless the employees substantially fail their duties as provided under Article 39).<sup>125</sup> When a merger and acquisition occurs, employers must first retain employees with open-ended contracts.<sup>126</sup>

At the same time, these employees enjoy the same level of freedom in terminating their labor contracts.<sup>127</sup> Employers can, however, require employees to reimburse off-site training costs if the employee leaves during the life of the open-ended contracts.<sup>128</sup> This rule helps employers retain employees with highly marketable skills and minimizes the costs of turnover.<sup>129</sup>

In specified circumstances, the Labor Contract Law requires open-ended contracts.<sup>130</sup> An employer must sign an open-ended contract with an employee who has signed two fixed-term contracts consecutively with the same employer or has worked continuously for the same employer for ten years.<sup>131</sup> Employees at newly reformed state-owned institutions or reorganized state-owned factories will automatically obtain open-ended contracts if they have worked for the same employer for ten straight years and are less than ten years away from the compulsory retirement age.<sup>132</sup>

These rules will effectively prevent employers from using successive short-term contracts to avoid legal obligations.<sup>133</sup> By requiring open-ended contracts as the default rule for long-term employees, the Labor Contract Law encourages long-time labor

---

<sup>124</sup> See *id.* at art. 14.

<sup>125</sup> See *id.* at art. 40, 46.

<sup>126</sup> See *id.* at art. 41.

<sup>127</sup> See *id.* at art. 37.

<sup>128</sup> See *id.* at art. 22.

<sup>129</sup> See Josephs, *supra* note 60, at 388.

<sup>130</sup> See Brown, *supra* note 119, at 10.

<sup>131</sup> See Labor Contract Law, *supra* note 1, at art. 14.

<sup>132</sup> See *id.* at art. 14.

<sup>133</sup> See Cooney, *supra* note 3, at 787.

relations while maintaining worker mobility. Nonetheless, experience from other developing Asian countries suggests that this rule may disproportionately benefit workers with higher skill-levels and education.<sup>134</sup> As a substantial number of low-skilled and female workers are temporary workers who are unable to stay with one employer for long enough time or who can not get two consecutive renewals that will lead to open-ended contracts, the open-ended contract provision can hardly benefit them.<sup>135</sup>

Despite the possibility of unequal protection for low-level workers, open-ended contracts will reward workers for their loyalty and competent performance with job security.

*D. The strengthened role of unions will provide more protection to the workers*

The Labor Contract Law grants labor unions a more important role in representing employees.<sup>136</sup> The Labor Contract Law elaborates on the abstract union role established under Article 7 of the Labor Law by requiring the union to assist the employees in issues related to labor contracts.<sup>137</sup> Unions may act as workers' representatives in disputes on contract termination.<sup>138</sup> The law requires a trilateral labor dispute resolution mechanism that involves unions, local labor authorities and the employers.<sup>139</sup> The union must be consulted concerning any mass lay-offs.<sup>140</sup> The union will represent the workers in signing collective contracts.<sup>141</sup> When employer violations occur, the union is entitled to urge compliance and to request an economic remedy.<sup>142</sup> Labor unions are entitled to represent the workers in negotiation, arbitration or in litigation for disputes involving collective labor contracts.<sup>143</sup>

Even though the union has gained more powers, its lack of independence remains a problem. According to the Trade Union Law, the All China Federation of Trade Union (ACFTU) is the exclusive trade union in China.<sup>144</sup> The ACFTU has a close policy

<sup>134</sup> *Id.* at 797-98.

<sup>135</sup> *Id.*

<sup>136</sup> See Marisa Anne Pagnattao, *International Labor Law Fundamentals: China* (American Bar Association Section of Labor and Employment Law Annual Conference Paper, 2007).

<sup>137</sup> See Labor Contract Law, *supra* note 1, at art. 6.

<sup>138</sup> See *id.* at art. 43.

<sup>139</sup> See *id.* at art. 5.

<sup>140</sup> See *id.* at art. 41.

<sup>141</sup> See *id.* at art. 51.

<sup>142</sup> See *id.* at art. 56.

<sup>143</sup> *Id.*

<sup>144</sup> The Trade Union Law is enacted to ensure the status of trade unions in the political, economic and social life of the State, to define their rights and obligations and to bring into play their role in the drive

relationship with the Communist Party of China (CPC), even though the CPC has stepped back somewhat from seeking to directly influence micro-market decisions of the ACFTU's management.<sup>145</sup> Among the seventeen core members of the ACFTU, sixteen are CPC members. The Chairman of the ACFTU is also a member of Political Bureau of the Central Committee of the CPC.<sup>146</sup> In addition to its basic responsibility of safeguarding workers' rights, the ACFTU must "concentrate on the focus of economic construction, adhere to the socialist road."<sup>147</sup> The workers' right of free union is not explicitly specified by the Labor Contract Law. According to the International Confederation of Free Trade Unions' (ICFTU) comment letter to President Hu on the draft Labor Contract Law, the Chinese government failed to ratify the two fundamental principles in the International Labor Organization (ILO) Conventions: the worker's freedom of association; and the right to organize and to bargain collectively.<sup>148</sup> Further more, the law does not grant workers the right to strike.<sup>149</sup> Managers are also not explicitly prohibited from joining the union under the Trade Union Law.<sup>150</sup> In China, it is not uncommon for managers to become union members and even union officers.<sup>151</sup>

Because it remains closely tied to government and management, the effectiveness of the ACFTU at advocating for workers can legitimately be called into question.<sup>152</sup> As Mr. Mao Yushi stated at Lingnan Forum, instead of strengthening workers' right to association and to free bargain, the Labor Contract Law has in fact strengthened the government's power to interrupt labor relations.<sup>153</sup>

---

to socialist modernization. See Trade Union Law, (Gong Hui Fa) (promulgated by the Nat'l People's Cong. Apr. 3, 1992), art. 11, *translation available at* [http://www.gov.cn/english/laws/2005-10/11/content\\_75948.htm](http://www.gov.cn/english/laws/2005-10/11/content_75948.htm) (last visited June 8, 2009) (P.R.C.).

<sup>145</sup> See Ronald C. Brown, *China's Collective Contract Provisions: Can Collective Negotiations Embody Collective Bargaining?*, 16 DUKE J. COMP. & INT'L L. 35, 35 (2006).

<sup>146</sup> See The All China Federation of Trade Unions Leader Directory, <http://www.acftu.net/>.

<sup>147</sup> See Trade Union Law, *supra* note 144, at arts. 4, 6.

<sup>148</sup> See Proposed new Draft Contract Law Fails to Guarantee Fundamental Rights: Letter from International Trade Union Confederation to President Hu Jintao, <http://www.ihlo.org/IS/250507.html>.

<sup>149</sup> See Josephs, *supra* note 59, at 391.

<sup>150</sup> See Nee, *supra* note 91, at 172.

<sup>151</sup> See *id.*

<sup>152</sup> See *id.*

<sup>153</sup> See Mao Yushi, On the Creation and Allocation of Wealth, Lecture at Lingnan Forum (Mar. 6, 2009), *transcript of question and answer session available in* GUANGZHOU DAILY, Mar. 10, 2009, at B4.

#### IV. OVERPROTECTION MAY EQUAL NO PROTECTION: CRITIQUE OF THE NEW LAW

As it was discussed in Section I and II, the Labor Contract Law prescribes specific workers' rights. Nonetheless, many employers vigorously protested the law as soon as the first draft was announced. Employers feared that the law was overly protective, and that it would raise labor costs and would unduly burden especially small-to-median sized private companies. Several well-known Chinese economists publicly criticized the new law for its negative effect on the Chinese job market and on private businesses, which they believed would ultimately hurt the Chinese workers.<sup>154</sup> Mr. Zhang Weiying, Professor from Peking University, said that economists evaluate a law by its actual effects on workers and the economy rather than on its legislative intent.<sup>155</sup>

When the draft Labor Contract Law was first proposed in 2006, some large multinational corporations expressed concern that the new rules would revive some aspects of the former "iron rice bowl" system that promised life-long employment, housing and health coverage.<sup>156</sup> The American Chamber of Commerce in Shanghai (AmCham Shanghai) sent in a lengthy letter of objection to the draft.<sup>157</sup> The AmCham Shanghai denounced the Draft Labor Contract Law as a "step backwards for Chinese economic reforms."<sup>158</sup>

<sup>154</sup> Steven N.S. Cheung, Mao Yushi, Wang Yijiang, Zhang Weiying, Zhou Tianyong, and others all openly expressed their worries of the new law's negative impact on Chinese economy. See Steven N.S. Cheung, *The Essence of Contract*, The Official Blog of Steven N.S. Cheung, Feb. 12, 2008, [http://blog.sina.com.cn/s/blog\\_47841af701008hmj.html](http://blog.sina.com.cn/s/blog_47841af701008hmj.html); Mao Yushi, On the Creation and Allocation of Wealth, Lecture at Lingnan Forum (Mar. 6, 2009), transcript of question and answer session available in GUANGZHOU DAILY, Mar. 10, 2009, at B4; Yijiang Wang, *Petition to Exempt Small-to-median Sized Companies from the Labor Contract Law*, ECONOMIC OBSERVER, Feb. 17, 2008, available at <http://finance.sina.com.cn/economist/jingjixueren/20080217/04444511473.shtml> (last visited June 8, 2009); Zhang Weiying: China's Choices in Policymaking During the Global Recession, Speech at Yabuli Economist Forum (Feb. 8 -10, 2009), partial transcript available at <http://business.sohu.com/20090208/n262114995.shtml> (last visited June 8, 2009); Zhou Tianyong: *The Cold Winter of Chinese Businesses* (Interview with Mr. Zhou Tianyong), XIAO KANG [BETTER LIFE], July 31, 2008, available at <http://news.sina.com.cn/c/2008-07-31/091916034631.shtml> (last visited June 8, 2009).

<sup>155</sup> See Weiying Zhang: China's Choices in Policymaking During the Global Recession, Speech at Yabuli Economist Forum (Feb. 8 -10, 2009), partial transcript available at <http://business.sohu.com/20090208/n262114995.shtml> (last visited June 8, 2009).

<sup>156</sup> See David Barboza, *China Drafts Law to Boost Unions and End Abuse*, N. Y. TIMES, Oct. 13, 2006, available at <http://www.nytimes.com/2006/10/13/business/worldbusiness/13sweat.html> (last visited June 8, 2009).

<sup>157</sup> See *id.*

<sup>158</sup> See *Comments on the Draft Labor Contract Law* (American Chamber of Commerce in Shanghai, Mar. 2006), available at <http://www.amcham-shanghai.org/amchamportal/mcms/presentation/GovernmentRelationsPages/GRArticle.aspx?guid=4748B648-89E7-432C-AD8E-05E682B27710> (last visited Feb. 1, 2010).

According to a survey conducted by the *Chinese Entrepreneur* in early 2008, over 70 percent of the enterprises surveyed expressed such worries and wished to amend the newly enacted law.<sup>159</sup> This one-month survey received forty-five replies, 70.73 percent of which were from privately-owned enterprises. Among the surveyed enterprises, 41.6 percent were manufacturing companies and 29.27 percent were labor-intensive services. Based on the survey, only 12.2 percent of the respondents felt that no further adjustments of the law would be necessary. Regarding the area respondents most desired to amend, 30 percent of the respondents wished to amend the open-ended contract rule; 28 percent wished to change the severance pay rule; and 18 percent wished to amend the lay-off compensation rule.<sup>160</sup>

While employers were worried about the sudden and substantial raise of the overall labor costs, some employees started to face an increasingly competitive job market because of the new law's chilling effect on employers' recruitment plans. The sudden departure of foreign investors in 2008 also created additional worries of the new law.<sup>161</sup> This section will elaborate on some of the major concerns of the Labor Contract Law.

#### A. The Labor Contract Law Will Substantially Raise Labor Cost

According to the Andreas Lauffs, a Hong Kong-based lawyer practicing at the international law firm of Baker & McKenzie, some American companies considered the proposed labor contract law too costly and restrictive.<sup>162</sup> "It is not easy to get rid of someone now, but under these rules it would be impossible."<sup>163</sup>

Although the final rule reduced severance pay significantly, as discussed previously in Section II, Part B, the termination rules are still very strict. Under the severance fee rules, many workers will be paid one more month's wage each year because when their labor contracts are terminated they would normally receive severance fee, which equals to the year of employment multiplied by monthly wage.<sup>164</sup> Consider as an example Nanjing, the capital city of Jiangsu Province in the east coast of China, where the minimum

---

<sup>159</sup> Survey: Over Seventy Percent of Enterprises Wishes to Amend The Labor Contract Law, CHINESE ENTREPRENEUR, Feb. 2008, <http://www.cnemag.com.cn/zzlm/fmgs/2008-07-24/173848.shtml>.

<sup>160</sup> *Id.*

<sup>161</sup> See Lee Huafang, *Why did Foreign Investment Suddenly Leave?*, EAST MORNING DAILY, Feb. 2, 2008, available at <http://opinion.people.com.cn/GB/6854582.html> (last visited Feb. 17, 2010).

<sup>162</sup> See Barboza, *supra* note 156.

<sup>163</sup> See *id.*

<sup>164</sup> See Labor Contract Law, *supra* note 1, at art. 47.

monthly wage is 850 yuan (\$122 USD).<sup>165</sup> Thus, in most cases, the employers in Nanjing have to pay at least an extra 850 yuan (\$122 USD) to each of their employees.<sup>166</sup> The amount is 2,550 yuan (\$364 USD) for high-income employees.<sup>167</sup>

The Labor Contract Law also explicitly emphasizes that enterprises must pay “full insurance” for all the employees or else the employees are entitled to terminate such labor relation.<sup>168</sup> Full insurance was first specified in the State Council’s Interim Order on Social Insurance Pay of 1999. Originally, full insurance only included health insurance, retirement insurance and unemployment insurance.<sup>169</sup> Subsequent local ordinances added work-related injury insurance and maternity insurance.<sup>170</sup> Thus, the full insurance is now commonly known as “five insurances” (*Wu Xian*).<sup>171</sup> In municipalities like Chongqing, employers are responsible for 70 percent of insurance payment.<sup>172</sup> Similarly, in the City of Nanjing, employers must pay 70 percent of the employees’ insurance.<sup>173</sup> Since the “five insurances” are legally mandated, employers and employees must include these into labor contracts.

Currently, most labor-intensive factories cannot fully meet this requirement mainly because of the companies’ limited resources and the inadequacy of rule enforcement.<sup>174</sup> According to an official from the Department of Labor of Guangdong Province, even in highly developed areas such as Pearl-River Delta, compliance rate is roughly 50 percent.<sup>175</sup>

<sup>165</sup> See *Study on Cost Increase After the Promulgation of the Labor Contract Law*, CHINA YOUTH DAILY, Feb. 11, 2008, available at [http://news.xinhuanet.com/newscenter/2008-02/11/content\\_7586657.htm](http://news.xinhuanet.com/newscenter/2008-02/11/content_7586657.htm) (last visited Feb. 17, 2010) [hereinafter *Cost Increase Due to Labor Contract Law*].

<sup>166</sup> See *id.*

<sup>167</sup> See Labor Contract Law, *supra* note 1, at art. 47.

<sup>168</sup> See *id.* at art. 17(G), 38(C).

<sup>169</sup> See *She Hui Bao Xian Fei Zheng Jiao Zan Xing Tiao Li* [Interim Order on Social Insurance Pay] (promulgated by the State Council, Jan. 14, 1999), art. 2.

<sup>170</sup> In the Municipality of Chongqing, work injury insurance is required under Chongqing Gong Shang Bao Xian Shi Shi Zan Xing Ban Fa [The Municipality of Chongqing’s Interim Order on Work Injury Insurance Pay of 2003] (promulgated by the Standing Comm. Chongqing People’s Cong. 2003), available at [http://fj.cq.gov.cn/wmfw/news/2008-3/200\\_2711.shtml](http://fj.cq.gov.cn/wmfw/news/2008-3/200_2711.shtml) (last visited Feb. 17, 2010) (P.R.C.). Maternity insurance is required under Chongqing Zhi Gong Sheng Yu Bao Xian Zan Xing Ban Fa [The Municipality of Chongqing’s Interim Order on Maternity Insurance Pay of 2005], (Standing Comm. Chongqing People’s Cong., 2005), available at <http://www.cq.gov.cn/zwgk%5Czfjw/20050722503.HTM> (last visited Feb. 17, 2010) (P.R.C.).

<sup>171</sup> See *Cost Increase Due to Labor Contract Law*, *supra* note 165.

<sup>172</sup> Data on file with author.

<sup>173</sup> See *Cost Increase Due to Labor Law*, *supra* note 171.

<sup>174</sup> See Yingchuan Huang, *The City of Dongguan Proposes to Postpone the Enforcement of The Labor Contract Law*, SOUTHERN CHINA NEWS.COM, Nov. 6, 2008.

<sup>175</sup> See *id.*

Mr. Ma, a manager of a 5000-worker textile factory in Guangdong Province, said that he had to pay an extra 300 yuan (\$42 USD) every month to each worker in order to pay in full the “five insurances.” Before the Labor Contract Law was enacted, he had been paying each workers 1,500 yuan (\$210 USD) per month including room and board. With the increased cost in accommodation and the newly imposed insurance requirement, the worker’s monthly wage will jump to 2,000 yuan (\$285 USD), an increase of about 30 percent, which would raise the cost for each clothing item by 3 percent.”<sup>176</sup> This increase will drive many factories out of business because their profits are based upon very narrow margin (10 to 45 cents per item).<sup>177</sup>

To help the businesses survive, the local government of Dongguan City in Guangdong Province expressed its intent to postpone the implementation of the Labor Contract Law.<sup>178</sup> This proposal can never be done through legal channels because local government cannot lawfully make rules that are in conflict with the national law.<sup>179</sup> The way to achieve such goal will be to relax the enforcement standards within the region, which is not unusual in China. When it comes to the issue of local economic interest, some local governments are prioritizing the financial interests over their obligations to the national law.

The national government publicly scolded the local government’s initiative.<sup>180</sup> As to the complaints about cost increases, the national government simply blamed the employers for not paying the “five insurances” before 2008.<sup>181</sup> Nonetheless, the low compliance rate throughout China is an existing fact, however unpleasant it is. Thus, the new law’s strict insurance requirement will result in a 30 percent cost increase for most Chinese enterprises. Although better insurance will benefit workers in the long run, a sudden and sharp cost increase may more likely result in employers’ immediate reactions to avoid insurance payment. Closures and lay-offs before the implementation of the new law are often the employers’ preferred choices.

---

<sup>176</sup> *Id.*

<sup>177</sup> See Huang, *supra* note 174. See also *The Embarrassing Situation in Wenzhou Created by the Labor Contract Law*, XINHUA NET, Mar. 18, 2008, <http://news.xinhuanet.com/focus/2008-03/18/content7728259.htm> [hereinafter *The Embarrassing Situation in WenZhou*].

<sup>178</sup> See Cost Increase Due to Labor Law, *supra* note 171.

<sup>179</sup> See Legislation Law, *supra* note 37, at art. 63 (providing that local governments may set up rules that are consistent with national laws); *id.* at art. 79 (providing that national law is superior to local law).

<sup>180</sup> *Id.*

<sup>181</sup> See Baoshu Interview, *supra* note 89.

## *B. The Labor Contract Law Creates Trouble for Workers*

### *1. Big companies initiated sudden lay-offs at the dawn of the implementation of the Labor Contract Law*

In fear of further increases in labor costs and the difficulty in terminating labor contracts under the new law, some large companies reacted with sudden lay-offs near the end of 2007.

On October 22, 2007, Wal-Mart employee Mr. Hu was informed that his labor contract would expire on November 30<sup>th</sup>, 2007 and he must return his badge and company-issued credit card within the same day. Meanwhile four Chinese branches of Wal-Mart Sourcing Centers issued lay-off notices. The total lay-offs would be more than 12,000, roughly 15 percent of Wal-Mart's workforce in China. The company did not give any explanation for its sudden laid-offs. According to the employees, the principle of the sudden lay-off was "no principle at all."<sup>182</sup>

Wal-Mart officially denied that its action was for the purpose of evading the Labor Contract Law. It insisted that this round of layoffs was merely part of Wal-Mart's global reorganization plan. Nonetheless, ever since the announcement of draft Labor Contract Law, Wal-Mart's sourcing center had started to move from China to other Asian countries that promised lower labor costs.<sup>183</sup> A human resource manager from another big corporation said that the Labor Contract Law would inevitably raise the labor costs by a large scale, and that it was very likely that Wal-Mart's sudden layoff at this particular time was to avoid the new law.<sup>184</sup>

The Labor Contract Law requires employers to sign open-ended labor contracts with workers who have continuously served the employer for at least ten years.<sup>185</sup> Reluctant to sign open-ended contract, the Chinese IT-giant Huawei started a big round of "voluntary resignations" in 2007.<sup>186</sup> Huawei, an employer of over 60,000 employees worldwide, is a China-based international company that provides next generation telecommunication networks.<sup>187</sup>

---

<sup>182</sup> See *Walmart's Sudden Layoffs: Ignore Any Principles Just to Avoid the Labor Contract Law*, TWENTY-FIRST CENTURY BUSINESS REPORT, Nov. 3, 2007, <http://business.sohu.com/20071103/n253034202.shtml>.

<sup>183</sup> *Id.*

<sup>184</sup> *Id.*

<sup>185</sup> See Labor Contract Law, *supra* note 1, at art. 14.

<sup>186</sup> See Huihui Qiu, *Huawei's Employees are Free to Leave: Strategy Against the Labor Contract Law*, TWENTY-FIRST CENTURY BUSINESS REPORT, Oct. 27, 2007, <http://tech.sina.com.cn/t/2007-10-27/00181817070.shtml>.

<sup>187</sup> See Corporation Profile of Huawei, <http://www.huawei.com/policy/normalcat.do?id=-1002&type=abouthw> (last visited Feb. 17, 2010).

Around the fall of 2007, Huawei started to require all the employees who had been working in the company for over eight years to “voluntarily” resign.<sup>188</sup> After “voluntary resignation,” the employees could reapply for their old jobs and get a new three or four-year fixed-term contract.<sup>189</sup> This “voluntary resignation” involved over 7,000 employees.<sup>190</sup> For workers who chose to leave Huawei, the company offered an “N+1” compensations package. “N” referred to the year of employment. The compensation was “N+1” multiplied by the worker’s pre-tax monthly income. This package offered workers more severance pay than would be provided under the Labor Contract Law. Like Wal-Mart, Huawei denied its motive was to avoid the Labor Contract Law.<sup>191</sup> Instead, it insisted that the “voluntary resignation” was to promote the principle of Labor Contract Law by creating a competitive and dynamic working environment.<sup>192</sup>

There should be a more reasonable explanation to this incident. As a high-tech IT company, Huawei makes a high demand upon worker’s energy and creativity and thus is not willing to renew all the long-time labor contracts without considering the particular worker’s remaining value after ten years of service at the company.<sup>193</sup> In order to avoid the unpredictable issues created by the new open-ended contract requirement, Huawei would rather pay one billion yuan (\$1,450 million USD) and risk its reputation to “wipe off” the old employees’ employment history.<sup>194</sup>

## *2. Large numbers of foreign-invested factories closed down between 2007 and 2008*

From October, 2007 to January 1, 2008, five hundred Taiwan companies moved out of the city of Dongguan, manufacturing center in Guangdong Province.<sup>195</sup> Before this, about a thousand shoe factories, mostly Taiwanese companies (Investment from Hong

---

<sup>188</sup> See Qiu, *supra* note 186.

<sup>189</sup> *Id.*

<sup>190</sup> See Qiu, *supra* note 186.

<sup>191</sup> See Huawei Insisted that “Resignation Gate” was its Normal Operation - not for Evading Labor Contract Law, YANGCHENG EVENING DAILY, Nov. 3, 2007, <http://tech.sina.com.cn/t/2007-11-03/15571831092.shtml>.

<sup>192</sup> See The ACFTU Investigates Huawei “Resignation Gate,” CHINA ECONOMY NET, Nov. 11, 2007, <http://business.sohu.com/20071107/n253101719.shtml> (last visited Feb. 16, 2010).

<sup>193</sup> See Qiu, *supra* note 186.

<sup>194</sup> See Dan Han & Hui Ma, *A Look at Huawei “Resignation Gate,”* ECONOMY OBSERVANT, Nov. 9, 2007, [http://jjckb.xinhuanet.com/gdpc/2007-11/09/content\\_73373.htm](http://jjckb.xinhuanet.com/gdpc/2007-11/09/content_73373.htm) (last visited Feb. 16, 2010).

<sup>195</sup> See *The Implementation of Labor Contract Law: 500 Taiwan Companies Left Dongguan*, SOUTHERN METROPOLITAN DAILY, Jan. 21, 2008, available at [http://news.xinhuanet.com/legal/2008-01/21/content\\_7460471.htm](http://news.xinhuanet.com/legal/2008-01/21/content_7460471.htm) (last visited June 8, 2009).

Kong or Taiwan is counted as foreign investment, although Hong Kong and Taiwan are officially within the territory of People's Republic of China), closed down during the first three quarters of 2007.<sup>196</sup> In Dongguan, there are about 5,600 Taiwanese enterprises, mainly labor-intensive factories. The total investment is about four billion dollars, about one-third of Dongguan's overall foreign investment.<sup>197</sup>

Small businesses were not the only entities involved in the round of closures and departures that started in the fall of 2007. On December 30, 2007, Changdeng Shoes Co. closed down its Dongguan plant after paying off the unpaid wages to all the workers, which was forty million yuan (\$3.71 million USD). This 4000-worker factory had been in Dongguan for over twenty years at the time of its closure. Much worse than this, in January 2008, a Taiwanese factory owner shut down his furniture company and escaped with eight million yuan (\$1.11 million USD) unpaid wages.<sup>198</sup>

Similar to the closures in South China, North China suffered from a wave of sudden closures initiated by Korean companies. By January 21, 2008, one hundred and three Korean companies had left Shandong Province, a coastal province in Northeast China. Like the companies in Dongguan, these Korean companies were mostly labor-intensive. The Korean media observed that the implementation of the Labor Contract Law would result in a 50 percent increase in labor costs.<sup>199</sup>

Despite the sudden departures of foreign investors in 2008, Foreign Direct Investment (FDI) increased by 24 percent over 2007 and totaled a record high amount of \$92.4 billion USD.<sup>200</sup> Nevertheless, FDI started to decline in August 2008.<sup>201</sup> According to the spokesman of the Ministry of Commerce, in January 2009 the number of newly established foreign companies was 1,496, a decrease of 48.73 percent compared with the amount in January 2008.<sup>202</sup> This January was also the fourth month of continuous decline in China's actual use of FDI.<sup>203</sup>

---

<sup>196</sup> *Id.*

<sup>197</sup> *Id.*

<sup>198</sup> *Id.*

<sup>199</sup> See Lee, *supra* note 161.

<sup>200</sup> See Bin Zhang, *Ministry of Commerce: The Actual Use of the FDI in January Decreased by 32.6%*, ECONOMIC OBSERVER, Feb. 16, 2009, available at <http://www.eeo.com.cn/Politics/beijingnews/2009/02/16/129468.shtml> (last visited June 8, 2009).

<sup>201</sup> *Id.*

<sup>202</sup> *Id.*

<sup>203</sup> *Id.* Foreign direct investment is measured as the amount of money a foreign company deposits to the bank, which has been examined by a certified public accountant. Foreign investors sign tentative

It would be an oversimplification to conclude that the Labor Contract Law was the only cause of the sudden closure of foreign companies. The global recession, stricter environmental regulations and the appreciation of the yuan all contribute to the substantial increases in labor costs.<sup>204</sup> At the same time, the energy and raw material prices went up while tax benefits for exportation were substantially reduced. These factors all negatively affected the exporting companies' marginal profits.<sup>205</sup> Nonetheless, the almost simultaneous plant closures in Northern and Southern China in the fall of 2007 indicate that the new law exacerbated and deepened investors' worries about the Chinese labor market.<sup>206</sup> Some people suggested that the rise of labor cost marked the transition of Chinese labor market from labor-intensive to intelligence-intensive.<sup>207</sup> In reality, however, this suggestion finds little support. In the Pearl-River Delta which houses a significant number of labor-intensive factories, even though the government was attempting to "improve the industrial structure" in this area for many years, the attempt has not been very successful so far.<sup>208</sup>

China will ultimately benefit if its market evolves from labor-intensive into knowledge-intensive.<sup>209</sup> This evolution, however, will not occur unless there is a fundamental change in Chinese economy structure. Currently, the Chinese labor market largely consists of worker with little education or low skills. The workers' fortune will not get better simply by legislation.<sup>210</sup> The market in China will continue to remain a labor-intensive for a long time, and a law that overlooks this undeniable fact may impose undue burdens on the employers and will inevitably hurt a large number of Chinese workers who make their livings in labor-intensive industries.<sup>211</sup>

---

investment agreements when they negotiate a deal. The amount of money in a tentative agreement is not the actual amount of foreign direct investment ultimately deposited.

<sup>204</sup> See Lee, *supra* note 161.

<sup>205</sup> See Zhou Tianyong: *The Cold Winter of Chinese Businesses (Interview with Mr. Zhou Tianyong)*, XIAO KANG [BETTER LIFE], July 31, 2008, available at <http://news.sina.com.cn/c/2008-07-31/091916034631.shtml> (last visited June 8, 2009) [hereinafter Tianyong Interview].

<sup>206</sup> See Caiqiang Zhan, *A Huge Wave of Departures at the Pearl River Delta: Thousands of Shoe Factories Closed Down, Over Ten Thousand Hong Kong Factories Planning to Leave*, SOUTHERN METROPOLITAN DAILY, Jan. 22, 2008, available at <http://business.sohu.com/20080122/n254814329.shtml> (last visited June 8, 2009) (citing a shoe factory owner who claimed the Labor Contract Law helped the investors to make up their mind to leave China).

<sup>207</sup> See Lee, *supra* note 161.

<sup>208</sup> See Zhan, *supra* note 206.

<sup>209</sup> See Lee, *supra* note 161.

<sup>210</sup> See Yijiang Wang, *Petition to Exempt Small-to-median Sized Companies from the Labor Contract Law*, ECONOMIC OBSERVER, Feb. 17, 2008, available at <http://finance.sina.com.cn/economist/jingjixueren/20080217/04444511473.shtml> (last visited June 8, 2009).

<sup>211</sup> See Steven N.S. Chueng, *The Critical Error in Chinese Economic Reform*, Official Blog of Steven N.S. Chueng, Jan. 29, 2008, [http://blog.sina.com.cn/s/blog\\_47841af701008cwn.html](http://blog.sina.com.cn/s/blog_47841af701008cwn.html).

*C. The Unusual "Labor Shortage" in the City of Wenzhou: Migrant Workers' Lives After the Enforcement of the New Law*

Wenzhou is a typical "light industry" center of China. Located at the east coast, Wenzhou manufactures 25 percent of Chinese-made shoes, 80 percent of eyewear, 60 percent of razors and 80 percent of buttons. There are 3.32 million migrant workers in Wenzhou, and two million of them are working on the production lines in light manufacturing.<sup>212</sup>

The manufacturing factories in Wenzhou suffered a serious slowdown in 2008. On March 1, 2008, a 300-worker textile factory had only fifty workers working. Normally, March is the rush season for these textile factories. One factory owner said that they had no choice but to close down the factory if the new law were to be strictly enforced. With the new law taking effect, his factory had to reject orders that only offered narrow marginal profit. At the same time, the owner had to reduce the workforce in order to survive. During that time, many of the clothing factories in Wenzhou did not hire as many workers as they previously did. One factory owner said that in the past, even during the off season, they were able to pay off the workers by taking orders with very low or even no profit. This, however, would never happen under the new law. "The more low-profit orders we take, the more we lose."<sup>213</sup> Also, because of the economic consequences of firing workers, the factory owners were reluctant to hire new workers.<sup>214</sup>

At the same time, strangely enough, many migrant workers were hesitant to sign labor contracts because of the worry of losing freedom.<sup>215</sup> Typical small- and medium-sized factory hiring was based on an oral agreement between workers and employers. Workers were free to leave at any time, and the employers enjoyed great discretion in firing incompetent workers. Under this model, Wenzhou managed to maintain its advantage in low labor costs. As the workers said, "There is no such thing as signing a contract, we work for a day and get paid for it. It is as simple as that."<sup>216</sup> The new law, however, outlaws the hiring procedure that the workers were most familiar with. Written contract is an effective legal weapon for some migrant workers. Nonetheless, to some migrant workers, a written contract will restrain their mobility and makes it difficult for them to pursue a different job. Migrant workers tend to

<sup>212</sup> See The Embarrassing Situation in Wenzhou, *supra* note 177.

<sup>213</sup> *Id.*

<sup>214</sup> *Id.*

<sup>215</sup> *Id.*

<sup>216</sup> See Lives of Migrant Workers in Zhejiang, *supra* note 7.

treat their positions as temporary and are always ready for better employment opportunities.<sup>217</sup> Although the media and the government have spent lots of time promoting the Labor Contract Law, the migrant workers are not very well informed about the law.<sup>218</sup> Most of the migrant workers still believe that asking for a written contract will prevent them from getting a job. “It is hard to find a job. There is no need to fight against the boss.”<sup>219</sup> The workers believe that as long as they know who their boss is and where the boss lives they will be able to collect their wages. Rarely do these workers think about legal weapons, although the Labor Contract Law gives workers the express right to sue directly in court for unpaid wages.<sup>220</sup>

The workers’ unchanged life after the Labor Contract Law is partially attributed to the workers’ ignorance of the law. The lack of knowledge also indicates the realistic hardship of strict enforcement with the law. The sudden and fundamental change of labor practices would inevitably cause misunderstandings among both employees and employers. Without solid support from both sides, the law will likely become a piece of paper that provides ideal but unrealistic protections to workers.

#### V. SHIFTING GOVERNMENT’S BURDEN TO ENTERPRISES: CASE STUDY ON THE NEW LAW’S IMPACT ON LOCAL PRIVATE BUSINESSES

In order to provide a close and candid insight into the Labor Contract Law’s effect on businesses, the author conducted surveys of two private companies.<sup>221</sup> One company is a 176-employee local IT company (Company A) with a registered capital fund of 38 million yuan (\$5.43 million USD), located in the Municipality of Chongqing. The other is a 250-employee company (Company B) located in the Special Economic Zone of Shenzhen specialized in plastic tooling and molding and related services.<sup>222</sup> The surveys include one basic questionnaire on the labor contract law’s effect on labor cost and follow-up email interviews with the managers about their personal views of the law.

---

<sup>217</sup> See The Embarrassing Situation in Wenzhou, *supra* note 177.

<sup>218</sup> See Lives of Migrant Workers in Zhejiang, *supra* note 7.

<sup>219</sup> *Id.*

<sup>220</sup> See Labor Contract Law, *supra* note 1, at art. 30.

<sup>221</sup> Each company is owned by author’s family members.

<sup>222</sup> All the surveys are on file with author. In order to protect the privacy of each company and to encourage candid opinions, the author chose not to provide the real names of two companies. For details about the company identities, please contact the author at qingqing@lclark.edu.

*A. The questionnaire reveals that the new law does not just raise the cost for violation.*

According to the government, for companies who already paid “five insurances” for their employees, the new law will not further increase their labor cost.<sup>223</sup> Nevertheless, the two companies experienced cost increases from 2007 to 2008 even though companies were paying “five insurances” before the new law took effect.

Company A’s response indicates that the company experienced a noticeable labor cost increase from 2007 to 2008. Company A is a leading local IT service provider and integrator. As a result of its high-tech background, Company A’s employees are mostly young or middle-aged, and 50 percent of them hold a bachelor degree or higher. Before 2008, engineers and middle or high level management personnel normally have three-year fixed term contracts with a monthly salary ranging from 3,000 yuan (\$478 USD) to 10,000 yuan (\$1,428 USD), “five-insurances,” sponsored training, reimbursement for cell phone use and transportation, birthday bonus, and paid leave. Assistants, secretaries and front desk receptionists received a one-year contract with monthly salaries from 800 yuan (\$114 USD) (probationary workers) to 2,500 yuan (\$357 USD) and “five insurances.” Before 2008, Company A did not sign contracts with probationary workers.

In 2007, Company A had 150 employees and it spent 4.08 million yuan (\$582, 857 USD) on wages and 516, 000 yuan (\$73,714 USD) on insurance. In 2008, which was the year when the Labor Contract Law was enacted, the number of employees went from the highest 220 to 176. Company A spent a total amount of 6.76 million yuan (\$965,700 USD) on wages and 1.274 million yuan (\$182, 000 USD) on insurance. Including wages and insurance, the average annual cost per employee went from 30,640 yuan (\$4,377 USD) to 45,640 yuan (\$6,520 USD). In Company A, the average wages rose by 16.33 percent from 2007 and 2008, higher than the national average for workers at private sectors. The national wage increase for workers in private and foreign businesses was 15.6 percent.<sup>224</sup> Including workers in state-owned businesses and

<sup>223</sup> See Interview with Chewei Zhang, Vice director of Research Center of Population and Labor Economy, Chinese Academy of Social Science, *transcript available at* Ministry of Human Resources and Social Security of the People’s Republic of China (MHRSS), [http://w1.mohrss.gov.cn/gb/zt/2008-03/05/content\\_227816.htm](http://w1.mohrss.gov.cn/gb/zt/2008-03/05/content_227816.htm) (last visited June 8, 2009).

<sup>224</sup> See *The Average Wage for Urban Workers is 16,675 yuan in the First Three Quarters of 2007*, National Bureau of Statistics of China, Oct. 29, 2007, [http://www.stats.gov.cn/was40/gjtjj\\_detail.jsp?channelid=19761&record=119](http://www.stats.gov.cn/was40/gjtjj_detail.jsp?channelid=19761&record=119).

government, the average wage increase for urban workers in the first three quarters of 2007 was 18.8 percent.<sup>225</sup>

According to the Company A's Human Resource manager, the requirements of signing a contract within the first month of employee's work and severance pay were the two main contributors to higher labor costs.<sup>226</sup> Even though Company A bought full insurance for the employees before 2008, it did not buy insurance for probationary workers because Company A did not sign contracts with probationary workers. After the new law took effect, the company had to buy insurance for every worker once they started working. Severance pay provision requires the company to pay workers at least half-month's extra wage when terminating their contracts. During 2008, forty-four employees left the company and most of them received severance fees.

Besides, the Labor Contract Law's rigid implementation of the after-hour rate prescribed in the Labor Law created a big problem for Company A.<sup>227</sup> The Labor Law of 1994 required the employers to pay 150 percent of workers' regular wages for any work done beyond the eight-hour period during workdays.<sup>228</sup> The Labor Contract Law strengthens this requirement by imposing fines for noncompliance.<sup>229</sup> The law does not provide any exemptions for professionals or high-level managers. The Human Resource manager wrote in her response that the engineers and middle or high-level managers were invaluable to the company and they frequently worked more than eight hours per day. Before the new law was enacted, an after-hour rate was built into the salary package. Under the new law, however, any after-hour work must be paid at the after-hour rate set up in the Labor Law.<sup>230</sup> If the company lowered these workers' salaries to offset the after-hour rate, the workers would be free to leave the company with severance pay.<sup>231</sup> In order to avoid this overly rigid rule, Company A had to petition the Labor Bureau of Chongqing to register all the high-level employees as workers on flexible schedules. By doing so, these workers will not be subject

---

<sup>225</sup> *Id.*

<sup>226</sup> See Labor Contract Law, *supra* note 1, at arts. 10, 47.

<sup>227</sup> See *id.* at art. 85. See also Labor Law, *supra* note 2, at art. 36 (providing the eight-hour per day, forty-four-hour per week system), art. 41 (providing that overtime cannot be more than three hours per day or thirty-six hours per month), and art. 44 (providing that over-time must be paid at an after-hour rate).

<sup>228</sup> See Labor Law, *supra* note 2, at art. 44.

<sup>229</sup> See Labor Contract Law, *supra* note 1, at art. 85.

<sup>230</sup> See Labor Law, *supra* note 2, at art. 44.

<sup>231</sup> See Labor Contract Law, *supra* note 1, at art. 46.

to the standard eight-hour per day or forty-hour weekly limit.<sup>232</sup> Nonetheless, this rule does not allow workers to work over the maximum hours within each month (8 hours multiplied by 20.83 days).<sup>233</sup> Instead, the rule actually only allows regular payments to workers on rolling shifts. In practice, however, the Bureau of Labor is acquiescing by allowing companies to take advantage of this rule.

In order to minimize the negative impacts of the new law, Company A reduced its recruitment plan. Considering the high severance pay, Company A increased the wages of some employees who were willing to take more responsibilities by 500 yuan (\$71 USD) to avoid hiring new employees.

Company B has 250 employees and 70 percent of them are the frontline workers. The workers are officially unionized by the community association (*Jie Dao*) but the organization does not have any real activities. Before the new law was enacted, most employees preferred one-year contracts. Companies could fire workers for poor performance at any time without economic liabilities. After the implementation of the Labor Contract Law, Company B chose to sign five-year contracts with the workers in order to avoid the second renewal that leads to open-ended contracts.

With regards to insurance, the manager of Company B mentioned that most workers were reluctant to pay for insurance because Chinese people generally prefer to rely on their own savings.<sup>234</sup> Before 2008, the company thus would not force workers into buying insurance if the workers were personally against insurance. Under the new law, however, workers can refuse to work or even bring lawsuits against a company because of failure to buy insurance. Company B, now, under the new law, has to buy insurance regardless of the workers' wills. According to the manager of Company B, from 2007 to 2008, the total number of employees increased by 15 percent, and the total labor cost increased by 30 percent. New workers are getting a higher starting salary, 1,000 yuan (\$143 USD) a month for twenty workdays and eight hours per day. This better salary package irritated many long-term workers

---

<sup>232</sup> See Chongqing Bureau of Human Resources and Social Security's Notice on Wages art. 7, Mar. 13, 2008, available at [http://www.cnss.cn/ztzx/zcfg/dfzc/200804/t20080414\\_185692.html](http://www.cnss.cn/ztzx/zcfg/dfzc/200804/t20080414_185692.html) (last visited June 8, 2009).

<sup>233</sup> *Id.*

<sup>234</sup> The insurance premium is shared by both employers and employees. Employers are typically responsible to pay the majority of the premium. The local government determines specific payment obligations. See *She Hui Bao Xian Fei Zheng Jiao Zan Xing Tiao Li* [Interim Order on Social Insurance Pay] (promulgated by the State Council, Jan. 14, 1999), art. 6 and art. 29; and *Guang Yu Cheng Zhen Zhi Gong Ji Ben Yang Lao Bao Xian Can Bao Jiao Fei You Guan Wen Ti Chu Li Yi Jian de Tong Zhi* [Notice Concerning Payment Measure of Retirement Insurance of 2009] ((Promulgated by Chongqing Municipal Ministry of Human Resources and Social Security Bureau, Apr. 30, 2009) (P.R.C.)).

because they did not receive such benefits when they first entered. Company B is also more cautious with hiring workers because the new law makes it difficult to fire workers, and at the same time gives workers great freedom to leave the company. According to the manager, in Company B, there are always workers who unilaterally terminate their labor contracts. The new law does not protect employers from the unilateral termination by the employees but restricts the employer's freedom to terminate labor contracts.

From the survey, it is clear that labor costs are increased for both companies even though these two companies complied with the insurance rules before 2008.

*B. Given China's complex economic structure and social norm of distrust, the new law is unfairly shifting the social burden to the enterprises and can hardly do justice for the public*

The follow-up questions asked for the employer's personal opinions of the new law. Because of the author's close family ties with the company owners, the opinions are authentic and candid as compared to information provided by the closely scrutinized mainstream Chinese media.

The response from Company A mostly expressed the manager's concern with the unfairness between private enterprises and state-owned companies, which had been exacerbated by the new law. The response from Company B focused on the infeasibility of the new law because of the absence of the Due Process in Chinese society.

According to the manager of Company A, his biggest concern was that the insurance requirement in the new law shifted too much social burden onto the private enterprises without even furnishing a comprehensive system for social security fund management. This would result in a sudden growth of state wealth and the exploitation of private businesses. Company A is paying roughly 70 percent of the workers' total insurances. In 2008, the monthly insurance per worker was 420.13 yuan (\$60 USD), and the company was responsible for 291.08 yuan.<sup>235</sup> The insurance money is uniformly collected by the local tax bureaus or authorized labor departments and kept as the social security fund in state-owned banks.<sup>236</sup> Because of China's large working population, the size of the social

---

<sup>235</sup> The 2008 spread sheet for monthly insurance pay is on file with author.

<sup>236</sup> See She Hui Bao Xian Fei Zheng Jiao Zan Xing Tiao Li [Interim Order on Social Insurance Pay] (promulgated by the State Council, Jan. 22, 1999), art. 6 and 14 (P.R.C.).

security fund is considerable.<sup>237</sup> Due to lack of public scrutiny, the local governments and high level government officials virtually enjoy unfettered power over this fund.<sup>238</sup> The prevailing misuse of the social welfare fund in various levels of governments has been an “open secret.”<sup>239</sup> Liangyu Chen, former Mayor of Shanghai received an eighteen-year sentence for embezzlement, bribery, and misuse of the social security fund for high risk investment.<sup>240</sup> Mr. Chen’s case is a typical example of government’s inability of effectively safeguarding the social security fund. Without a comprehensive checks and balances system, the correct use of the social security fund is left at the mercy of individual local officials. Enterprises are bearing major responsibilities in contributing to the social security fund. Nevertheless, without a convincing mechanism either to safeguard or to expand employees’ benefits, the enterprises’ burdens will only result in a rapid growth of state assets rather than a better social insurance system.

The manager of Company A was also worried that the government increased its role in labor relations by imposing the Labor Contract Law. He feared that the government was taking more control over the employers and employees by forcing them to adopt contracts that reflect government’s will. Unlike the National Labor Relations Act (NLRA) of the United States, which ensures workers’ rights to free association and to collective bargaining, China’s Labor Contract Law mandates contract terms without emphasizing the worker’s collective bargaining rights.<sup>241</sup> Under the new law, there are nine mandatory contract terms, basically covering the full spectrum of labor relationship.<sup>242</sup> Experience from the United States and European nations suggest that reasonable labor relations should be based on free bargain.<sup>243</sup> In China, workers’ right to organize is not well protected by the existing law and the political structure. With strong administrative power over both

---

<sup>237</sup> See *Frequent Misuse of “Lifeguarding Money” Reveals the Non-transparency of the Social Security Fund Management*, ECONOMY REVIEW, Sep. 15, 2006, available at [http://news.xinhuanet.com/newmedia/2006-09/15/content\\_5093429.htm](http://news.xinhuanet.com/newmedia/2006-09/15/content_5093429.htm) (last visited June 8, 2009).

<sup>238</sup> *Id.*

<sup>239</sup> *Id.*

<sup>240</sup> See *Chen Liangyu was Sentenced to 18 Years of Prison for Bribery and Misuse of Power*, XINHUA NEWS AGENCY, Apr. 11, 2008, [http://www.gov.cn/jrzq/2008-04/11/content\\_942494.htm](http://www.gov.cn/jrzq/2008-04/11/content_942494.htm).

<sup>241</sup> See 29 U.S.C. § 151 (1947) (providing that the National Labor Relations Act protects workers’ rights to associate, self-organize, and designate their own representatives for the purpose of negotiating the terms and conditions of their employment or other mutual aid or protection).

<sup>242</sup> See Labor Contract Law, *supra* note 1, at art.17.

<sup>243</sup> See 29 U.S.C. § 151 (1947) (providing that the right to bargain and associate freely will protect workers and facilitate commerce). See also Yijiang Wang, *The Experience from the Western World in Workers’ Protection*, GLOBAL FINANCE, Jan. 1, 2009, at 42.

parties, the labor relations could never be really balanced.<sup>244</sup> When government imposes a law that interrupts free bargaining, the tension between employers and employees will be exacerbated.<sup>245</sup> Increased tensions between employees and employers will negatively affect overall productivity and social stability. The employees will eventually become victims of the government-initiated tensions.<sup>246</sup>

In addition, the manager of Company A criticized the law for failing to pay enough attention to the private business' interests. The legislator assumed that all the employers were in the same situations as big state-owned companies that have abundant resources and bear few risks.<sup>247</sup> To the contrary, in Chinese economy, small and medium-sized businesses and workers are two vulnerable groups.<sup>248</sup> The manager of Company A feared that the new law would worsen the existing inequality between private and state-owned businesses. He pointed out that the inequality exists in three major areas.

First, the Chinese law provides different levels of protections for private assets and state assets. The Chinese Constitution established that public property, which includes state-owned companies, is solemn and superior.<sup>249</sup> Private assets will only be protected when it is "lawful."<sup>250</sup> Chinese economic policy generally discriminates against domestic private businesses and favors state-owned and foreign businesses.<sup>251</sup>

Second, the market share of these two types of companies is statutorily unequal. State-owned enterprises can enter into any industries, whereas private enterprises are barred from entering into critical industries such as energy, electricity, telecommunications, etc. According to a government report, in 2007, state-owned

<sup>244</sup> See Zhixu Mo, *It is Time to End the Lose-Lose Situation for Employees and Employers*, JINYANG NET, Feb. 11, 2009, [http://www.ycwb.com/sp/2009-02/11/content\\_2062309.htm](http://www.ycwb.com/sp/2009-02/11/content_2062309.htm).

<sup>245</sup> *Id.*

<sup>246</sup> See Steven N.S. Cheung, *The Essence of Contract*, The Official Blog of Steven N.S. Cheung, Feb. 12, 2008, [http://blog.sina.com.cn/s/blog\\_47841af701008hmj.html](http://blog.sina.com.cn/s/blog_47841af701008hmj.html).

<sup>247</sup> See Jingjing Liu, *Challenges to the Labor Contract Law*, CAIJING, Jan. 5, 2009, <http://magazine.caijing.com.cn/2009-01-03/110066570.html>.

<sup>248</sup> See Yijiang Wang, *Labor Contract Law Will Essentially Affect Small-to-median sized Businesses*, TWENTY-FIRST CENTURY ECONOMIC REPORT, Apr. 5, 2008, <http://www.ldht.org/Html/news/news/230573895.html>. (interview with Wang Yijinag).

<sup>249</sup> See Zhonghua Renmin Gongheguo Xian Fa [Constitution of the People's Republic of China], arts. 12-13., 2004. The official English version struck out the word "solemn." Compare Constitution of the People's Republic of China, arts. 12-13, available at <http://english.gov.cn/2005-08/05/content20813.htm> (last visited June 8, 2009) (English), with Constitution of the People's Republic of China, arts. 12-13, available at [http://news.xinhuanet.com/ziliao/2004-09/16/content\\_1990063\\_2.htm](http://news.xinhuanet.com/ziliao/2004-09/16/content_1990063_2.htm) (simplified Chinese) (last visited June 8, 2009).

<sup>250</sup> *Id.*

<sup>251</sup> See Zhou Tianyong, *On Social Justice*, TWENTY-FIRST CENTURY BUSINESS REPORT, Mar. 4, 2007 (interview with Mr. Zhou Tianyong).

company contributed to 96.9 percent of the oil industry's revenue and 90.8 percent of the revenue generated from electricity and heat industry.<sup>252</sup>

Third, economic resources are unequally allocated between the state-owned companies and the private companies. State-owned enterprises are getting huge subsidies from the government regardless of operating conditions. National loans are also mainly serving the state-owned companies. Currently, Chinese banks have over seven billion yuan (\$1 billion USD) of private savings, two thirds of which is left unused.<sup>253</sup> Even so, banks are still reluctant to loan money to the private businesses.<sup>254</sup> They would rather loan money to state-owned companies that are on the edge of bankruptcy than loan money to well-operating private companies because the loan policy for state-own companies is very lenient and the central government will often cover the bad assets of collapsing state-owned companies.<sup>255</sup> The banks have fairly strict rules on business loans for private companies.<sup>256</sup> Generally, big national banks will not provide business loans to private small companies.<sup>257</sup> To obtain business loans from a bank, the manager of Company A has to provide his own private properties including houses and apartments as security collaterals in order to get loans. This in fact creates unlimited liabilities for the private company owners. Although the government has started to loosen the stringent mortgage policy for the private small- and medium-sized business since November 2008, banks are still very reluctant to provide business loans to private business.<sup>258</sup>

Company A's manager also stated that because of the prevalence of bribery, when labor disputes occur, private companies have to spend time and money to please the local labor departments even where the employees were clearly at fault and had illegally harassed

---

<sup>252</sup> See *Economic Structure has Gone Through Significant Transitions During the Three Decades of China's Reformation*, The Central People's Government of the People's Republic of China, Nov. 12, 2008, [http://www.gov.cn/test/2008-11/12/content\\_1146738.htm](http://www.gov.cn/test/2008-11/12/content_1146738.htm).

<sup>253</sup> See *Analysis on the "Three Difficulties" for Private Companies to Obtain Loans*, NEW BUSINESSMEN OF CHONGQING, Oct. 16, 2007, <http://www.cqgcc.com.cn/2007-10-16/1192549655143.html>.

<sup>254</sup> *Id.*

<sup>255</sup> *Id.*

<sup>256</sup> *Id.*

<sup>257</sup> See Tianyong Interview, *supra* note 205.

<sup>258</sup> See *Small-to-Median Sized Business Having Trouble Obtaining Loans Even After the Government Loosens the Loan Policy*, CHINA TIMES, Nov. 15, 2008, <http://news.hexun.com/2008-11-15/111260961.html>.

the company. Since the LACs<sup>259</sup> are run by the government, strengthened workers' right in arbitration actually grants the government officials more power to take economic and political advantages over the private small- and medium-sized companies.<sup>260</sup>

On the other hand, the manager of Company B felt that the lack of the due process provided for under P.R.C. law was the major hurdle of effectively implementing the Labor Contract Law. He stated that unlike the comparatively structured Western social scheme, the modern social scheme in China still remain at a largely premature level. Social norms of a market economy and the idea of a fair bargain are not well established in Chinese society. There is little mutual trust between employees and employers. Constant violation of workers' rights and the frequent employee fraud regarding their resumes and diplomas provide flagrant examples. The manager of Company B also mentioned that when the new law was first enacted, many unqualified lawyers blindly encouraged workers to sue their employers. This problem was particularly serious in Guangdong Province. In 2008, the number of labor dispute charges from January to August increased 260 percent, resulting in a total of 176,000 charges.<sup>261</sup> The manager of Company B, lots of strikes took place in Guangdong and many companies closed down as a result of the tide of meritless lawsuits in 2008. Thus, in the absence of a basic foundation for justice and rule of law, a law intended to be achieve fairness may eventually result in unfairness to companies with limited resources.

#### VI. WRONGFULLY ASSUMING THAT THE CHINESE ECONOMY WILL KEEP ON GROWING RAPIDLY, THE GOVERNMENT IS IMPLEMENTING A LAW THAT COULD HARDLY BE EFFECTIVELY ENFORCED

The initial draft of the labor contract law came out in 2006. This was when China was enjoying its highest GDP growth in the eleven years.<sup>262</sup> It was reasonable for the government to promulgate a law that would better allocate the social resources when the nation was

---

<sup>259</sup> See Zhong Hua Ren Min Gong He Guo Qi Ye Lao Dong Zheng Yi Chu Li Tiao Li [Directives for Labor Disputes Resolution] (State Council of PRC, July 6, 1993) art. 6. Labor Arbitration Committees (LAC) is established under art. 6 of the Directives.

<sup>260</sup> See Labor Contract Law, *supra* note 1, at art. 77 (providing that employees have the right to arbitrate disputes over employers' violations of the new law). The new law provides more causes of action for the employees and thus strengthens the workers' rights.

<sup>261</sup> See Qian Liu, *Labor Right Advocacy in the Pearl River Delta Creates "Black Lawyers,"* NANFANG DAILY, Oct. 27, 2008, [http://www.nfdaily.cn/gd/v3sz/content/2008-10/27/content\\_4671517.htm](http://www.nfdaily.cn/gd/v3sz/content/2008-10/27/content_4671517.htm) (in Chinese, so-called "black lawyers" are unqualified, greedy and dishonest).

<sup>262</sup> See Binglan Xu, *China's GDP grows 10.7% in 2006, Fastest in 11 Years,* CHINA DAILY, Jan. 26, 2007, [http://www.chinadaily.com.cn/china/2007-01/26/content\\_793128.htm](http://www.chinadaily.com.cn/china/2007-01/26/content_793128.htm).

enjoying a high GDP growth (10.7 percent in 2006) and low inflation rate (below 2 percent).<sup>263</sup> Nonetheless, the government failed to recognize that the rapid GDP growth might not last forever and that rapid GDP growth in a highly centralized market might not mean high profit for enterprises. According to Prof. Zhiwu Chen from Yale University, the actual speed of China's GDP growth should only be half of its announced number. In the past twelve years, the national revenue has increased by 570 percent. This increase should bring a 16 percent increase in per capita disposable income per year. However, in cities, the number is only 8 percent. In rural China, the number is only 6.8 percent.<sup>264</sup> As a result, the new law's presumption that all the companies are making profits and are financially capable to implement the law is not necessarily correct.

Strict protection of workers' rights will be rendered meaningless when enterprises go bankrupt because economic development was the premise for higher employment rate and better working conditions.<sup>265</sup> The legislators failed to realize that even though China's overall GDP growth is on top of the world list, its GDP per capita is only one hundredth.<sup>266</sup> As Mr. Cheung discussed in his article series on Labor Contract Law, the Chinese economy is still relying on "low level" manufacturing even though the government is reluctant to admit this. Real development of the entire Chinese economy relies on an increase in farmers' income.<sup>267</sup> Since such an increase would be most likely the result of farmers participating in migrant work, the new law's effect on labor-intensive factories may have an even further negative effect on China's GDP and market growth.<sup>268</sup>

Currently, because of the global recession's significant impact, the central government shifted its focus from strict implementation of the Labor Contract Law to maintaining China's GDP growth and

---

<sup>263</sup> *Id.*

<sup>264</sup> See Zhiwu Chen, Lecture on GDP Growth and People's Income at Yanshang Da Jiang Tang [Yanshan Forum], Aug. 2, 2008, transcript available at <http://chenzhiwu.blog.sohu.com/96573564.html> (last visited June 8, 2009).

<sup>265</sup> See Steven N.S. Cheung, *On The Labor Contract Law II*, Official Blog of Steven N.S. Cheung, Jan. 8, 2008, [http://blog.sina.com.cn/s/blog\\_47841af7010086cg.html](http://blog.sina.com.cn/s/blog_47841af7010086cg.html).

<sup>266</sup> See *China's Per Capita GDP Ranks 100<sup>th</sup> — High Overall GDP Merely Reflects the Speed of Economic Growth*, LIAOWANG NEWS WEEKLY, Feb. 10, 2006, [http://news.xinhuanet.com/politics/2006-02/10/content\\_4160431.htm](http://news.xinhuanet.com/politics/2006-02/10/content_4160431.htm).

<sup>267</sup> See Steven N.S. Cheung, *The Initial Impact of the Labor Contract Law*, Mar. 11, 2008, Official Blog of Steven N.S. Cheung, [http://blog.sina.com.cn/s/blog\\_47841af701008r06.html](http://blog.sina.com.cn/s/blog_47841af701008r06.html); Yijiang Wang, *Petition to Exempt Small-to-median sized Companies from the Labor Contract Law*, ECONOMIC OBSERVER, Feb. 17, 2008, <http://finance.sina.com.cn/economist/jingjixueren/20080217/04444511473.shtml>.

<sup>268</sup> See Cheung, *supra* note 265.

current employment rate.<sup>269</sup> One November 17, 2008, the MOHRSS issued a notice to suspend adjustments to minimum wages.<sup>270</sup> The notice also granted certain businesses, including high-tech companies that provided outsourcing services, with more freedom on extending working hours without paying the after-hour rate.<sup>271</sup> On December 20, 2008, the MOHRSS, the Ministry of Revenue (MOR) and the State Administration of Taxation announced a notice entitled “Notice on Taking Active Measures to Alleviate Burdens of the Businesses and to Maintain a Healthy Employment Rate.”<sup>272</sup> The notice allowed companies that were experiencing financial trouble to suspend their insurance payments upon individual approval by their highest-level local government.<sup>273</sup> The notice also permitted companies to defer severance fee payment when lay-offs occurred due to extreme economic hardship.<sup>274</sup> In the reply to the author-conducted surveys, the manager of Company B expressed her disappointment in the government’s decreased enforcement of the new law. She believed that “soft” enforcement would put companies which were complying with the law in a disadvantageous position and thus created disincentives against compliance. Some proponents for the Labor Contract Law also lamented that the government had forgotten its own statements of effectively enforcing the law only one year after implementing the new law.<sup>275</sup>

Besides the Labor Contract Law, the government is decreasing enforcement of other laws as well.<sup>276</sup> In December 2008, Xinji’s Bureau of Environment indicated that it would lower its

<sup>269</sup> Company B complete survey, on file with author.

<sup>270</sup> See *MOHRSS: Suspend Adjustments to Minimum Wages within Companies*, XINHUA NEWS AGENCY, Nov. 18, 2008, available at [http://news.xinhuanet.com/fortune/2008-11/18/content\\_10373162.htm](http://news.xinhuanet.com/fortune/2008-11/18/content_10373162.htm) (last visited Feb. 17, 2010).

<sup>271</sup> See *id.* (providing that local government must direct qualified businesses to adopt flexible working hours and schedules).

<sup>272</sup> Guan Yu Cai Qu Ji Ji Cuo Shi Jian Qing Qi Ye Fu Dan Wen Ding Jiu Ye Ju Shi You Guan Wen Ti De Tong Zhi [Notice on Taking Active Measures to Alleviate Burdens for Businesses and Maintain a Healthy Employment Rate] (Promulgated by the Ministry of Human Resources and Social Security, Dec. 20, 2008) available at <http://www.law-star.com/cacnew/200902/235031320.htm> (last visited Feb. 17, 2010) [hereinafter Notice to Maintain Employment Rate] (P.R.C.).

<sup>273</sup> The highest level of local government is the provincial government or its equivalent: a municipality or autonomous region.

<sup>274</sup> See Notice to Maintain Employment Rate, *supra* note 272.

<sup>275</sup> See Ge Liu, *Should the Labor Contract Law be Suspended?*, SINO-INTERNATIONAL MANAGEMENT, Mar. 1, 2009, <http://finance.sina.com.cn/leadership/mrlzy/20090323/11346011173.shtml>.

<sup>276</sup> See *A Great Migration into the Unknown*, THE ECONOMIST, Jan. 29, 2009, available at [http://www.economist.com/research/articlesbysubject/displaystory.cfm?subjectid=478048&story\\_id=13012736](http://www.economist.com/research/articlesbysubject/displaystory.cfm?subjectid=478048&story_id=13012736) (last visited June 8, 2009).

environmental guard by simplifying certification procedures in order to address the impact of global recession.<sup>277</sup>

Relaxed enforcement of the Labor Contract Law would prevent the workers from receiving adequate protections. With the job market tightening, the risks of claiming benefits and compensation under the new law are even higher. Mr. Huang, a migrant worker, tried to protect himself with the law but paid a high price for his action. In June 2008, Mr. Huang decided to claim his unpaid overtime pay after reading some newspaper articles about the new law. In order to win his case, Mr. Huang quit his job, thinking that he would get a job after receiving his full remedy. Nonetheless, after spending six months on his case, he only received 2,300 yuan (\$329 USD), which was not even enough to cover his attorney's fee, because the court only awarded unpaid overtime salaries incurred in 2008. Worse still, Mr. Huang found that it was increasingly difficult for him to get another job during the second half of 2008.<sup>278</sup>

## VII. CONCLUSION

The 2007 Labor Contract Law supplements the 1994 Labor Law by implementing specific guidelines for the practice of the labor contract system. The new law prioritizes the workers' interests by prescribing specific rules on workers' protection.

Nonetheless, the legislature ignored China's fundamental economic condition when implementing this new law. Given the fact that most Chinese companies were not complying with the Labor Law, the Labor Contract Law may cause sudden and substantial increase of the labor cost. Already, a large number of factories closed down or significantly reduced their workforce. Substantial cost increases also hurt foreign investors' confidence in Chinese market. The sudden departures of foreign companies inevitably hurt local economy and left more workers jobless. In order to alleviate the negative economic impact, one local government publicly considered postponing the implementation process of the Labor Contract Law. The only way to achieve such goal would be to decrease implementation of the law. The new law may face the same fate of inadequate enforcement as the 1994 Labor Law.

---

<sup>277</sup> *Id.*

<sup>278</sup> See Qiong Zhou, *The Hard Times for "The Manufacturing Center of the World,"* FINANCE, Jan. 19, 2009, available at <http://magazine.caijing.com.cn/2009-01-17/110066602.html> (last visited June 8, 2009).

Based on the author-conducted survey, the law raised labor costs for employers regardless of whether they were in compliance with existing labor laws before 2008. The new law especially burdens private small-to-median sized businesses that have limited resources and thus worsens the existing inequality between the state-owned and private enterprises. Furthermore, without the foundation of mutual trust and social justice, the new law could exacerbate social tensions without benefiting the workers.

The Labor Contract Law reflects the government's intent to protect the workers. Nevertheless, a law that ignores objective economic conditions will never provide real protections to workers because workers' benefits largely are ultimately dependent upon profitable businesses. Protecting the workers with an administrative instrument at the price of businesses will ultimately cause more job losses and will deprive both employees and employers of their bargaining power. Right now, due to the global recession, the government has shifted its attention to maintaining economic growth and creating new employment opportunities. The effective implementation of the Labor Contract Law is no longer on the government's priority list. It is possible that this new law will suffer the same fate as other legislation drafted too much on abstract ideals and too little on concrete fact. Ultimately, a good piece of legislation requires more than just an urge to benefit the people.