

The Impact of China's New Labor Contract Law

It has been a little over six months since China enacted its groundbreaking new Labor Contract Law, which is just enough time to get a preliminary assessment of its impact. The new Labor Law has had a huge impact on how employees are treated in China and on how they view their rights. It also has increased employer costs, but less than publicized. The new Labor Law has caused some companies to go out of business and other companies to move to countries less protective of their workers, but in most cases, those companies that have gone under or left were not terribly profitable in the first place.

The LCL is intended to improve the lot of China's employees:

This Law has been formulated to improve and perfect the labor contract system, to make explicit the rights and obligations of both parties of the labor contract, to *protect the lawful rights and interests of laborers* and to build and develop harmonious and stable labor relationships.¹ (Emphasis added)

Before enactment of the LCL, employee abuse was rampant in China and worsening. Labor disputes in China increased more than thirteen fold between 1995 and 2006 and a large and growing number of these disputes were erupting into public demonstrations.² Most Chinese labor law experts viewed the existing labor laws and regulations as inadequate for solving employer-employee disputes, and viewed employees as lacking legal protection.³ The LCL was designed to give employees greater

¹ See Article 1 of the Zhonghua Renmin Gongheguo Laodong Hetongfa (Labor Contract Law of the People's Republic of China) (promulgated by the Standing Committee of the National People's Congress, June 29, 2008, effective January 1, 2008), English language translation at <http://digitalcommons.ilr.cornell.edu/intl/27/> (last visited on July 30, 2008).

² See "Twelve Years of Eruptive Labor Disputes", available in Chinese at http://www.legaldaily.com.cn/bm/2007-08/19/content_683227.htm (last visited on July 30, 2008).

³ *Id.*

rights and easier enforcement of their rights so as to achieve the ultimate social policy of creating and sustaining a "harmonious society."

The LCL does not bring huge substantive changes to employment relationships in China but it has greatly strengthened legal enforcement by giving workers a private right of action to enforce their own legal rights. In other words, employees may now sue their employers directly, without having to enlist the aid of the state.⁴ Chinese labor departments and agencies still may assign administrative penalties for violations of the new Labor Contract law,⁵ but granting a cause of action to Chinese employees borders on revolutionary. Equipped with new rights, Chinese workers are not hesitating to exercise and protect them by filing complaints and grievances against their employers.

Though companies that previously complied with China's labor laws have seen their labor costs increase due to the new law, those that were not previously complying, but have now realized the risk of non-compliance is too high, are indeed seeing their labor costs skyrocket.

For example, compensation must accompany pre-mature termination of termed employees and employers must pay twice the amount of an employee's salary in order to enforce a non-compete covenant (for the period of non competition).

⁴ See *id.* at Arts. 80--95.

⁵ See LCL, *supra* note 1, Arts. 80, 81, 83, 84, 85, 88, 89.

Labor cases are flooding China's court dockets. Labor disputes have increased in Beijing's Chaoyang District People's Court by 106% as compared to 2007,⁶ by 231% in Nanjing's⁷ Qinhuai District People's Court, 126% in Shenzhen, 132% in Dongguan and 92% in Guangzhou.⁸ This countrywide increase in labor law cases proves the new Labor Contract Law has created new worker rights warranting private enforcement.⁹

Before the LCL was enacted, it was vetted for years in a massive public debate in which hundreds of thousands of people submitted comment. Many China labor centers and workers groups have publicized the law and I have heard from Chinese lawyers who are getting swamped with requests to bring suit under it.

With these new labor rights comes impact on foreign company employers. Many labor-intensive companies that manufactured in China have shut down altogether or have moved to lower labor cost countries like Vietnam, Bangladesh, or Cambodia.¹⁰ Though these closures and moves seem large in terms of the number of companies closing or leaving, the numbers are deceiving. Almost none of the foreign companies that have closed down in China or left China were based out of the West. Most were from Hong Kong, Taiwan or South Korea, many were engaged in very low level manufacturing (imagine a room with 30 workers and no real machinery) and most were operating on the

⁶ See Legal Daily, *Eruption of Labor Dispute Cases Evidences the Power of the New Labor Contract Law*, July 29, 2008, available in Chinese at http://www.legaldaily.com.cn/0705/2008-07/29/content_912173.htm (last visited on July 30, 2008).

⁷ See Legal Daily, *Four Months After the Labor Contract Law's Coming into Effect: Employers Evading the Law Taste the Consequences*, May 10, 2008, available in Chinese at http://www.legaldaily.com.cn/0705/2008-05/10/content_848607.htm (last visited on July 30, 2008).

⁸ See "Labor Disputes Rising in the Pearl Delta Region", available in Chinese at <http://roll.jrj.com.cn/news/2008-06-05/000003729739.html> (last visited on July 30, 2008).

⁹ *Id.*

¹⁰ *Id.*

margins or even illegally before the new labor law came down. Because companies in China have been facing increasingly high and rising inflation, local and regional labor shortages (particularly, skilled workers and managers), a rising Yuan, increased enforcement of environmental laws, and termination of many government subsidies like export tax rebates, it is nearly impossible to isolate the new labor law as the sole cause of any company's shutting down or leaving.

There will always be a race to the bottom in terms of labor costs and China's LCL has probably, at least to a certain extent accelerated that already existing process a bit. But

Profitable Western companies are talking about expanding outside of China (the "China Plus One Strategy"), but they generally are not leaving. The reason for this is simple: China is much better set up for manufacturing all but the least sophisticated products than countries like Vietnam, Bangladesh, or Cambodia.

Though factory closings and moves outside China have been rare, the impact of the new law has been widespread. In reaction to the new labor law, French supermarket giant, Carrefour, required most of its forty thousand strong Chinese employees to sign (or resign) a two-year contract on the eve of the LCL becoming effective.¹¹ Carrefour did this in an effort to circumvent the LCL's provisions requiring indefinite contracts, which make employee termination difficult.¹² Interestingly, many Western companies have welcomed the new law because they see it as requiring their competitors (particularly domestic Chinese companies) to bring their labor standards up to what they themselves

¹¹ See "Carrefour Accused of Evading the New Labor Law by Forcing Its Employees to Re-sign Contracts", available in Chinese at <http://www.xuzhoujob.com/News/632008523133434.html> (last visited on July 30, 2008).

¹² See LCL, *supra* note 1, Art. 13.

had been doing for years. They also like how it has driven out some of their illegally operating competitors.

Since enactment of the LCL, foreign direct investment (FDI) into China has continued to increase; China attracted \$42.78 billion in FDI from January to May 2008.¹³ A recent (post LCL) Ernst & Young survey 44% of world business leaders found China as the best destination for FDI, higher than any other country.¹⁴

On a micro level, the new law has changed the way nearly every company does business in China. Every smart company in China now has a written employment contract, in Chinese, with their employees (both Chinese and foreign) and a written policy manual, also in Chinese, explicitly setting forth the basis for employee termination. The written contract is necessary to avoid potentially huge penalties and the policy manual setting forth grounds for termination is to avoid having lifetime employees.

¹³ See China Daily June 13, 2008, "China Remains an Attractive Destination for FDI", available at http://www.china.org.cn/business/news/2008-06/13/content_15774608.htm (last visited on July 30, 2008).

¹⁴ *Id.*