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The new generation of workers expects higher wages, career development, and stronger employee rights.

A New Labor Era: Higher Costs and Greater Pressures

Recent labor unrest may bring more challenges ahead for foreign companies operating or investing in China.

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A series of labor conflicts erupted in China in 2010. Various foreign-invested factories concentrated in China's coastal areas experienced a string of labor-related protests and strikes. These publicized conflicts may signal the end of an era of low-cost labor and the beginning of a more challenging labor environment for foreign-invested enterprises (FIEs) and other employers in China.

Recent unrest

The most high-profile labor incident last year involved a number of suicides at Foxconn International Holdings, a Taiwan contract manufacturer for foreign consumer electronics companies. Though the precise cause of the suicides at Foxconn's factory in Shenzhen, Guangdong, remains unclear, some advocacy groups and media outlets have pointed to the factory's unfavorable working condi-

tions and, above all, low wages. In response to public criticism and local government pressure, Foxconn raised basic monthly salaries for its production workers from ¥900 (\$137) to ¥2,000 (\$305). The Shenzhen municipal government subsequently increased the city's minimum monthly wages to ¥1,100 (\$168), an average increase of 15.8 percent. In April 2011, Shenzhen raised its minimum wage again to ¥1,320 (\$201). In late June 2010, Foxconn declared it would outsource the management of its worker dormitories and relocate some facilities to Taiwan and China's inland regions, where monthly minimum wages can be as low as ¥600 (\$91) to ¥800 (\$122). In March 2011, the company further announced that it would move 200,000 jobs to inland provinces with lower costs.

In addition to the Foxconn developments, a string of strikes broke out in May 2010 at several other factories in Guangdong and China's coastal regions. The most publicized strikes occurred at Honda Motor Co. factories in several Guangdong cities. In late May, Honda workers in Foshan walked out, demanding higher wages and better working conditions. Honda responded with a 24 percent general pay increase. The Foshan strike then triggered work stoppages at several other facilities in Guangdong: a Honda lock systems supplier, one of Honda's gear-shift suppliers, and Honda's affiliate Nihon Plast Co., Ltd. Because of repercussions from the labor unrest, Honda's sales in China fell 2.7 percent in June, lagging behind China's overall auto industry sales, which increased 23.5 percent from a year earlier.

Sources of labor unrest

Though not widely reported by the Chinese media, observers believe that strikes in China extend beyond the well-publicized incidents at Foxconn and Honda. Several factors suggest that labor unrest may become an increasingly significant aspect of the Chinese manufacturing industry.

Tight labor market

The tight labor market in China's coastal regions is a critical element of the recent labor unrest. China's labor shortages first appeared in Guangdong in 2003 and have since appeared in other major industrial regions, including the Yangzi River Delta around Shanghai. The shortages are in part because of the PRC government's one-child policy and the household registration (*hukou*) system, which discourages the rural population from moving to the cities.

High cost of living

The high cost of living in China's coastal regions is also fueling demands for higher wages. In 2007 and 2008, China's consumer price index rose by 4.8 percent and 5.9 percent, respectively—well exceeding the official annual targets. Though cost of living in cities such as Shenzhen rose significantly in the last decade, some profitable companies have not increased wages to reflect higher prices, spurring worker dissatisfaction.

Several companies involved in the May 2010 strikes were paying the minimum wages required by local law. The wage complaints may have reflected the fact that

Japanese- and Taiwan-owned factories often paid lower wages than comparably sized German-owned facilities and other FIEs, sometimes in the same area.

Greater "rights-consciousness" of workers

The new generation of Chinese blue-collar workers, born during the 1980s and 1990s, are more sensitive to social issues and workplace rights than their parents. Previous generations might have taken any city job available, even for low salaries. But young workers today seek jobs that not only pay well enough to secure a better life for their families, but also provide career development, treat employees with respect, and help them gain a foothold in the cities (see p.20). Furthermore, despite state oversight, Internet access has helped workers learn quickly about strikes, wages, and working conditions at other companies.

Quick Glance

- Worker shortages, higher cost of living, and greater employee attention to workplace rights have caused rising labor unrest in China.
- The PRC government is issuing more labor regulations and promoting state-led unionization and collective bargaining in foreign companies.
- As China's labor environment becomes more challenging, companies should periodically review their employment policies and wages and consider whether they wish to move operations westward to lower costs.

Government interest in labor market regulation

In the early decades of the reform era, the PRC government primarily focused on economic growth—starting with coastal regions, which rose ahead of rural areas. Since 2003, however, the government has begun to shift its focus to include social harmony, political stability, and better income distribution. The new minimum wage law issued in 2004 and the much-touted 2007 Labor Contract Law, which enhances statutory rights for employees and imposes greater obligations on employers, reflect this shift in focus. The government's tolerance of sustained, extensive media coverage of the suicides and strikes at several FIEs may also reflect this new thinking. It remains unclear, however, whether the new approach will extend to wholly and partially state-owned enterprises.

The PRC government is also formulating more labor contract regulations to protect worker rights. In September 2010, the PRC Supreme People's Court issued Interpretations on Several Issues Concerning the Application of

Laws in Labor Dispute Trials (III)—the first set of judicial guidance since the 2007 Labor Contract Law and Labor Dispute Mediation Law. The interpretations contain 18 articles, which focus on procedural issues in court trials, and include important provisions that

- Accept disputes that arise from restructuring the enterprise;

ACFTU has been relatively inactive in the FIE sector so far. At the end of 2006, only 18 percent of FIEs in China had entered into collective wage contracts (such contracts presumably reflect some ACFTU presence in the company). According to media reports, more than 10 million of the 13 million small and medium-sized enterprises in China did not have collective wage bargaining systems as of June 2010.

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- Place the burden of proof on employees to show they worked overtime but penalize employers that refuse to produce the same evidence; and

- Generally recognize employment agreements as valid and binding, provided that they do not violate mandatory provisions of laws or regulations or involve fraud, coercion, or exploitation.

China is drafting new national regulations on wages with the aim of guaranteeing wage payments and salary increases. The proposed regulations would, among other things, clarify that

- Local legally required minimum wages do not include overtime payment or social security fees;
- Salary security funds must be set up to prevent late salary payments; and
- Cost of living increases should be factored in when determining wages.

In February 2011, the PRC National People's Congress revised the Criminal Law to make it illegal for companies to intentionally withhold employee wages if

- The company has the means to pay the wages;
- The company willfully withholds payment by refusing to pay or by transferring assets to escape the obligation to pay; and
- The situation or its effects are "serious."

These regulations and revisions may increase labor costs for some companies, but much depends on how the PRC government implements and enforces the rules.

Government interest in promoting ACFTU

The PRC government has long desired to install the All-China Federation of Trade Unions (ACFTU), the official state union system, in the FIE sector. ACFTU functions largely as an arm of, or "transmission belt" for, the state by supporting government policies and promoting workplace stability. In many regions, the local government selects ACFTU representatives. In addition, nearly all ACFTU officials and personnel are members of the Chinese Communist Party.

The government has taken several measures in recent years to boost ACFTU's presence in FIEs.

- In 2008, the PRC Ministry of Human Resources and Social Security issued a "Rainbow Plan," for the stated purpose of encouraging the establishment of collective bargaining systems in companies in eastern and central China by the end of 2010 and expanding the system to all of China by 2012.

In May 2010, ACFTU and two other central-government agencies issued a notice regarding implementation of the Rainbow Plan, which aimed for all companies to be covered by collective wage bargaining agreements by the end of 2012, including 60 percent coverage by the end of 2010 and 80 percent coverage by the end of 2011.

- ACFTU and Shenzhen's local government in early 2010 jointly announced that they would push for collective agreements in 120 Fortune 500 companies that have operations in Shenzhen.

- The Shanghai government in early 2010 issued new regulations on collective labor contracts, setting out procedural and substantive requirements for such agreements.

The government initiatives are bearing some fruit. For example, KFC Corp. and Pizza Hut, Inc.—both owned by YUM! Brands, Inc.—in June 2010 signed collective wage contracts with their employees in Shenyang, Liaoning. The contracts marked the company's first collective agreement with employees in China.

Because many workers reportedly distrust ACFTU, it is unclear whether ACFTU initiatives or the recent publicized labor unrest will lead to greater ACFTU penetration of FIEs. Many of the FIEs in which large-scale strikes took place in 2010 did not have unions; even where unions were present, they were bypassed by the protestors. For example, although Foxconn had unions at group company levels, the unions did not function at the plant level. Moreover, even in companies that had local factory union representatives (such as in Honda's Foshan facility), the striking workers sought a new election of union representatives as one of their strike demands.

Implications for FIEs

FIEs operating in China will face a more challenging labor environment and increasing costs. Given the recent labor unrest, companies may need to consider boosting employee compensation and benefits and improving work hours and supervisor-employee relationships. Though methods for achieving these goals vary, companies should

FIEs should at least consider whether they wish to maintain wage parity with other comparably sized foreign manufacturers in the region to avoid being singled out by workers and the local government. Employers may also wish to consider wage parity between FIEs operating in the same industry and region as an overarching policy.

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consider paying fair wages based on commonly accepted practices and developing better communications systems with employees.

Periodic review of labor regulation compliance

FIEs in China should periodically review their employment policies and practices to ensure full compliance with all applicable labor rules and regulations. Companies operating in China should expect expanded state regulation and promotion of the collective wage-bargaining system, particularly in FIEs. Foreign companies should also extend their compliance review to their supply chains, because labor compliance problems in upstream or downstream companies may negatively affect the FIE's costs and operations. Furthermore, most labor disputes filed in China's mediation and arbitration councils involve failure to issue an employment contract, though required by the PRC Labor Contract Law, and failure to pay promised wages, which is now deemed a crime under the revised Criminal law. Carefully reviewing contract manufacturers' payroll practices can reduce these causes of disputes.

Consider proactive posture on wages and unions

FIEs should consider whether they wish to take a proactive posture on wages and relations with ACFTU. These steps may have drawbacks if they are not carefully executed, however. For example, increasing wages to keep pace with inflation is one way of eliminating an oft-mentioned cause of worker discontent, but it may also stoke demands for ever-increasing pay levels. Likewise, entering into a relationship with ACFTU, possibly with local-government help, may stem labor protests but may also invite an arm of the state onto the shop floor.

Consider moving westward

When pressed by increasing labor costs in coastal cities and provinces—including traditional manufacturing bases such as the Pearl River Delta and the Yangzi River Delta regions—FIEs in labor-intensive industries may wish to consider relocating their operations to inland provinces, especially to traditionally less-developed central and western regions. Minimum wages in China vary widely by region (see p.30). Under the recent Western Development Strategy issued by the central government, companies—including FIEs—in central and western regions may enjoy benefits that are no longer available in the coastal regions, such as reduced income taxes and low land prices and labor costs.

Challenging road ahead

This is a challenging time for China's manufacturing sector and for FIEs that own, operate, or source from facilities in China. Close review of existing practices and strategic planning to avoid future problems can help companies navigate the difficult waters. Whether the labor disputes will rise in number and importance depends on several factors, including how migrant workers are treated by their employers and the courts, whether wages sufficiently keep up with inflation, whether manufacturing remains a low-labor cost sector, and the overall economy in China. 完

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