



## IMPLICATIONS OF RECENT LABOR UNREST FOR MNCs OPERATING OR INVESTING IN CHINA

A series of labor conflicts that erupted in China earlier this year may signal the end of an era of cheap labor and the beginning of a more challenging labor environment for foreign-invested enterprises (“FIEs”). The most high-profile situation involved a spate of suicides at a significant contract manufacturer for U.S. computer companies.

In addition to the suicides at the contract manufacturer, a string of strikes broke out in May at a number of factories in southern China’s Guangdong Province and other coastal regions, many of which were Japanese-owned or Taiwanese-owned. The strikers were seeking higher pay and better working conditions.

### SOURCES OF LABOR UNREST

A number of factors suggest that labor unrest may become an increasingly important feature of manufacturing in China’s coastal region.

**Tight Labor Market.** An important factor is the tight labor market in China’s coastal region. Labor shortages were first apparent in Guangdong in 2003 and now have appeared in other major industrial regions, including the Yangtze River delta around Shanghai. These shortages are, in turn, effects of China’s one-child policy and the government’s household registration (“hukou”) system, which discourages movement to the cities by denying rural migrant workers urban citizenship and accompanying social services.

**High Cost of Living.** The high cost of living in China’s coastal regions is fueling demands for higher wages. In 2008 and 2009, China’s CPI went up by 4.8 percent and 5.9 percent, respectively, well exceeding the official targets for the years. Cost of living in cities hiked significantly in the last decade. Some profitable companies, however, have not increased wages to reflect higher prices, which is a common spur to worker disaffection. A number of the companies involved in the May strikes were paying the minimum

wages required by local law, thus effectively requiring their employees to work significant overtime. These wage complaints were exacerbated by the fact that Japanese-owned and Taiwanese-owned factories were often paying lower wages than comparably sized German-owned facilities and other FIEs, sometimes in the same region. The failure of Japanese-owned facilities to maintain wage parity with other FIEs recently emerged as an agenda item in high-level Japan–China talks in late August 2010.

**Greater “Rights-Consciousness” of Workers.** The new generation of Chinese blue-collar workers, born after the 1980s and 1990s, are more sensitive to issues of lifestyle and workplace rights than are their parents, who might grab any city job available to them even for low salaries. Apart from making money to secure for their families a better life, the young workers also want to change their fates, be treated with respect, achieve career development, and gain a foothold in the cities. The relatively easy access to internet has also helped the workers learn quickly about strikes, wages, and working conditions at FIEs in other cities.

**Government Interest in Labor Market Regulation.** In the past, the Chinese state was principally interested in economic growth, relying on huge numbers of unskilled laborers, mainly from inland rural areas, who lived on barely subsistence wages. Since 2003, however, the government has begun to shift some of its focus from growth to political issues such as social harmony, stability, and a better distribution of the fruits of prosperity. This new approach is reflected in the enactment of a new minimum wage law in 2004 and the much-touted new Labor Contract Law that was enacted in 2007, enhancing statutory rights for employees and imposing greater obligations on employers. The government’s tolerance of sustained, extensive media coverage of the suicides and strikes at several FIEs may also be a reflection of this new thinking.

**Government’s Interest in Promoting the ACFTU.** It has been a long-standing desire of the Chinese government to install its official union system, the All-China Federation of Trade Unions (the “ACFTU”), in the FIE sector. Based on the communist model of trade unionism, the ACFTU functions largely as

an arm of the state, supporting government policies and promoting stability. In many places, the ACFTU representatives are selected by the local government; nearly all union officials and personnel are members of the Communist Party.

The ACFTU has been relatively inactive in the FIE sector. As of the end of 2005, only 18 percent of FIEs in China had collective wage contracts with the ACFTU. According to a more recent survey, more than 10 million out of the 13 million enterprises in China still have not set up a collective wage bargaining system.

In 2008, the Ministry of Human Resources and Social Security issued a “Rainbow Plan,” which set a goal of establishing a collective bargaining system in all companies in eastern and central China by the end of 2010 and expanding the system to all of China by 2012. On May 5, 2010, the ACFTU and two other agencies issued a notice regarding the implementation of the Rainbow Plan, envisioning that all companies would be covered by collective wage bargaining agreements by the end of 2012, with a goal of 60 percent coverage by the end of 2010 and 80 percent coverage by the end of 2011. The ACFTU and the local government in Shenzhen jointly announced early this year that they would pick 120 companies from the Global Fortune 500 and China Fortune 500 that have operations in Shenzhen, and push for collective bargaining with those companies. Around the same time, the government in Shanghai issued a new regulation on collective labor contracts, setting out procedural and substantive requirements for collective employment contracts.

It remains unclear, however, whether the ACFTU initiative and the recent labor unrest will lead to greater ACFTU penetration of FIEs. This is because of widespread worker distrust of the official union. Many of the FIEs in which large-scale strikes took place in 2010 either did not have unions or did not look to the unions as the means of redressing their grievances. For instance, although the contract manufacturer where the suicides occurred had unions at group company levels, they did not function at the plant level. Moreover, even where there are factory locals, they were distrusted and bypassed by the striking workers who sought a new election of union representatives as one of their strike demands.

In an attempt to shore up the integrity of the ACFTU, the government is presently considering paying union staff at the factory level and experimenting with worker selection of union officials at that level. The ACFTU intends to preserve its central role. As the head of the legal department of the ACFTU recently observed: “Even with the direct elections, no mode is allowed other than the current unified trade union system, where grass-roots unions are led by their higher authorities.”

## IMPLICATIONS FOR FIEs

FIEs operating in China will undoubtedly face a more challenging labor environment. Additional investment in employee compensation and benefits and in improving the management of the employer–employee relationship may be warranted. The State Council is considering the issuance of a new national wage regulation, which will likely raise minimum wages. The higher labor costs, coupled with the expected appreciation of RMB after the Chinese central bank announced early this year that it would allow a more flexible exchange rate, will eventually lead to higher prices for China-made products.

**Ongoing, Periodic Review of Compliance with Labor Regulations.** In the wake of the recent events, 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. FIEs would be well advised to extend their compliance review to their supply chain because increased cost pressure and regulatory oversight of, say, a parts supplier cannot be readily confined to the parts supplier and will have effects on the costs and operations of the purchaser of the contract services.

**Consider a Proactive Posture on Wages and Unions.** FIEs should also consider whether they wish to take a proactive posture on wages and relations with the ACFTU. Either of these steps, if not undertaken carefully, has potential drawbacks. Increasing wages to keep track of inflation is one way of eliminating an oft-mentioned cause of worker discontent,

but it may also stoke demands for even higher pay. Similarly, embracing a relationship with the ACFTU, perhaps with the help of the local government boss, may help stem labor protests but also has the effect of inviting an arm of the state onto the shop floor.

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

**Consider Moving West.** When pressed by increasing labor costs at coastal cities and provinces, including the traditional manufacturing base—the Pearl River Delta region (as represented by Shenzhen) and the Yangzi River Delta region (as represented by Shanghai)—FIEs in labor-intensive industries may also wish to consider relocating their operations to inland provinces, especially to traditionally less-developed central and western regions. Minimum wages vary widely by region. Under the recent “grand development strategy for western regions” issued by the Chinese central government, companies including FIEs in central and western regions of China may enjoy the benefits of low land price, reduced income tax, and low labor costs, which are no longer available in the coastal regions.

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This is a time of ferment for Chinese manufacturing and for FIEs owning or operating facilities in China. Close review of existing practices and a strategic plan to avoid future problems would be indicated to navigate these difficult waters.

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