



## **RETHINKING THE LABOUR CONTRACT LAW OF CHINA**

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*Preliminary Draft of June, 2013  
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### INTRODUCTION

China has entered its best era for labour legislation from 2007 when the Labour Contract Law (hereof refers to “LCL”) was finally passed by the Standing Committee of National People’s Congress. There is no doubt that the LCL is the most important labour legislation after the Labour Law 1994 was enacted. Compared with the Labour Law 1994 that has provided a set of new rules for the emerging labour market under the reform and opening-up policy, the LCL has adopted a more dedicated and systematic approach. Different with general understanding on contract law, the LCL not only regulates individual employment contract, but, indeed, also restates some of the principle labour standards stipulated by the Labour Law 1994. Moreover, the LCL enjoys a jurisdiction upon collective agreement and informal employment (dispatched employment and part-time workers) as well.

By virtue of this particular nature, the debates around the LCL have emerged nationwide as there are some critics against new floor of labour rights constructed by the LCL.<sup>4</sup> In fact, the LCL was created to response new and pressing problems emerged during the social and economic development of China society, such as underpayment or no-payment of wages, abuse of probation period, short-term trend of labour contract relationship, deficient ruling on informal

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<sup>4</sup> The famous debate on the LCL was described as whether the law should provide timely assistant to employees, or should the law perfect the labour standards even better. See Dong Baohua, *The Position of the Labour Contract Law*, Studies in Law and Business, 2006 Vol. 3.

employment. However, the LCL has encountered many problems while having been implemented. The skepticism believes that the poor enforcement of Labour Law i.e. the wage payment<sup>5</sup> is unlikely cured by the LCL.<sup>6</sup> Apart from its poor enforcement, the rigidity and inflexibility of its mechanic design blocks it from responding to the market reality. The LCL seemly remains its nature under the “command and control” mode.<sup>7</sup>

This paper tries to review the nature of the LCL in neutral manner and to throw some light on the recent amendments of the LCL. This article argues, despite the fact that the LCL is still relatively new in the field of labour relation, the balance of protecting employment rights and flexibility has already been shown. Interestingly, the most recent amendments that are designed to uphold this balance in the fast-changing social context can have uncertain impact up Chinese modern labour market.

## I. THE ADVENT OF THE LCL

The year of 2007 has a special meaning to millions of Chinese laborers. In this year, labour legislation was boomed by the promulgation of three important national laws: Labour Contract Law (the LCL), Employment Improvement Law, and Labour Disputes Mediation and Arbitration Law (amendment). Especially for the LCL, it was valued as the most important legislation on labour issues in China, since the enactment of the Labour Law 1994. The promulgation of the LCL made the central government of China to have confidence to pursue social stability and harmony.

Under the structure founded by the Labour Law 1994, the LCL is regarded as a subordinated part to the Labour Law, and surpassed the scope of civil contract law. Being as one of the principles, to protect laborers who are disadvantaged within the employment relationship signalsthe LCL as an important social law.

### A. *What's new in the LCL*

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<sup>5</sup>Sean Cooney, Chinese Labour Law Work: The Prospects for Regulatory Innovation in the People's Republic of China, Fordham International Law Journal, 2007 .

<sup>6</sup>The wage payment is still an important problem in China labour laws. Non-payment and underpayment of wages with intend became a crime by the Amendment of Criminal Law in 2011, and the Judicial Interpretation by the Supreme People's Court issued in early 2013 made the criminal punishment more feasible and practical.

<sup>7</sup>Anthony Ogus, Regulation: Legal Form and Economic Theory 4, 245-256 (1994).

The LCL in nature is not only a contract law to regulate individual employment relationship, but also, to certain extent, is a labour law with a broad vision which deals with collective agreement and informal employment (dispatched employment and part-time employment). Particularly, as for the collective agreement in China, it was originally regarded as a special contract by the Labour Law 1994. Many Chinese scholars called for a separate legislation to deal with the process of collective bargain and enforcement of collective agreement.

Compared with the Labour Law 1994, the LCL developed the Chapter 3 of Individual Labour Contract and Collective Agreement (see Table I: Structures of Labour Law in 1994 and Labour Contract Law in 2007). The rules on general provisions in relation to labour contract have been further articulated in the LCL. For instance, the lengths of probation period was vaguely stated as no longer 6 months by the former but categorized into three kinds by the latter in accordance with the contract terms; the legitimate conditions for contract termination and dismissal have been further integrated and enriched; protections on employees' dignity and freedom have been clearly interpreted stated by the LCL.

Table I: Structures of Labour Law in 1994 and Labour Contract Law in 2007

<b><i>Labour Law of 1994</i></b>	<b><i>Labour Contract Law of 2007</i></b>
<i>Chapter 1. General Principles</i>	<i>Chapter 1. General Principles</i>
<i>Chapter 2. Employment Improvement</i>	<i>Chapter 2. Conclusion of Labour Contracts</i>
<i>Chapter 3. <u>Labour Contract and Collective Agreement</u></i>	<i>Chapter 3. Performance and Alteration of Labor contract</i>
<i>Chapter 4. Working Time, Rest and Leaves</i>	<i>Chapter 4. Discharge and Termination of Labor Contract</i>
<i>Chapter 5. Wages</i>	<i>Chapter 5. Special Rules</i>
<i>Chapter 6. Occupational Health and Safety</i>	<i>Section 1. Collective Agreement</i>
<i>Chapter 7. Special Protections on Female Workers and Minor Workers</i>	<i>Section 2. Dispatched Employment</i>
<i>Chapter 8. Occupational Training</i>	<i>Section 3. Part-time Employment</i>
<i>Chapter 9. Social Insurance and Benefits</i>	<i>Chapter 6. Surveillance and Inspection</i>
<i>Chapter 10. Labour Disputes</i>	<i>Chapter 7. Legal Liabilities</i>
<i>Chapter 11. Surveillance and</i>	<i>Chapter 8. Supplementary Rules</i>

<p style="text-align: center;"><i>Inspection</i>  <i>Chapter 12. Legal Liabilities</i>  <i>Chapter 13. Supplements</i></p>	
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There are a number of issues that the LCL is designed to address by the legislature in China:

- (1) Wage arrears or non-pay of other benefits (i.e. overtime wages, social insurance contributions, work-related injuries liabilities by employers) due to the fact the employers refuse to recognize the existence labour contract relationship where the labour contract has not been formed;
- (2) Abuse of probation period;
- (3) Short-term trend of labour contract;
- (4) Rapid growth of informal employment and insufficiency of legal instrument to regulate this particular areas;
- (5) Employment instability derived from (3) and (4).

With regard to the issues stated in Note (1), the heavily effected group is Chinese rural migrant workers. The difficulty to confirm the existence of labour relationship was the major barrier for their wage claims. Although the Labour Law 1994 allows the existence of *de facto* labour relationship,<sup>8</sup> and has created several rules to ease the burden of proof by the employee, the original scheme to recognize labour relationship remains burdensome for the workers. In order to avoid disputes on wage payment or other right infringements that are led by the determination of labour relationship, the requirement of the written labour contract has strictly required by the LCL.

To resolve the problems stated in Note (3) and (4), the LCL reinforced its mechanism on the open-ended contract, which secured employees of the right to conclude an open-ended contract. The open-ended contract applies to four circumstances, (i) the employee has been working for the same employer continuously over ten years; (ii) when the employer initially adopts the labour contract system, or State-owned enterprises renew their labour contract for transformation to break away from residual impact of the planned economy, the employees could ask for the conclusion of the open-ended contract, when they have been working for the employer continuously over ten years and are no more

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<sup>8</sup>Detailed rules refer to Several Opinions on the Implementation of Labour Law (enacted by Ministry of Labour in 1995) and the Notice of Relative Issues on Establishment of Labour Relationship (enacted by Ministry of Labour and Social Security in 2005).

than ten years for legal retirement; (iii) the employee signed twice fixed-term contracts with the employer consecutively, when the contract for a renewal and the employee require to change into the open-ended contract; and (iv) the employer did not sign the written contract with the employee and one year passed, the labour contract relationship should be treated as a open-ended contract. The open-ended labour contract was initially addressed in Labour Law 1994<sup>9</sup> where one may find a similar statement in relation to the situation of (i). Meanwhile, the (ii) and (iii) are pretty new and can be regarded as the outcome of employment stability policy, and certain concerns about age discrimination<sup>10</sup>. Indeed, the rule of (iv) is to stimulate the signing of labour contract.

On the other side, being as another innovation within the LCL, the instrument of economic compensation is extended further. It is no longer merely the compensation to the employee who has been wrongfully dismissed; actually, the economic compensation steps into for the summary dismissal as well so as to promote employment stability. That is, even if the labour contract is terminated as to expiration of its term, the employer should pay the economic compensation to the former employee.

Actually, the LCL has made other attempts to protect the rights of employees. The law introduced the right to know for both sides before the conclusion of a labour contract. In addition, the LCL provides legal regulations on the enterprise work rule, which were usually formulated by the employer unilaterally. The Labour Law 1994 kept silence to the regulation on the code of conduct at work; however, the LCL clarifies its legal procedure that requires employees' participation. Thirdly, the LCL is the first time to specify some of legal instrument for informal employment relationship.

#### ***B. Debates on the Law Making Process of the LCL***

Indeed, there were a number of hot debates<sup>11</sup> during the draft process of the LCL, some of which remain active as five years after. From 2005 to 2007, there were altogether five different versions of the law drafts publicized by the State

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<sup>9</sup> Labour Law of 1994, Article 20.

<sup>10</sup> Another illustration is about contract discharge. The employee could not be discharged in case he/she has been working for the same employer consecutively for over 15 years, and is no more than 5 years away from his/her legal retirement. Labour Contract Law of 2007, Article 42 (5).

<sup>11</sup> See serial comments from Steven Cheung, <http://www.doc88.com/p-996190579400.html>. Debates between labour law scholars, see Wang Quanxing, *Debates on the Formation of Labour Contract Law*, China Legal Daily 2006 April 12; Dong Baohua, *Contend and Thought of Chinese Labour Contract Law*, Shanghai Renmin Press, 2011

Council, without mentioning various versions provided by P.R.C. National Federal of Trade Union. After the Labour Law 1994 was passed, the Chinese legislators had designed the blueprint of future legislations including Labour Contract Law, Employment Improvement Law, Labour Disputes Resolution Law, and Social Insurance Law.<sup>12</sup> The original plan was initiated from Social Insurance Law, which was aimed to define the state duties to provide public service of social insurance and clear the institutional obstacles. Thereafter, the LCL takes the role of ensuring the employer's duties and liabilities to be clarified.

The debates or arguments about the LCL concentrated on the following questions: (a) shall employment stability prevail employment freedom or market liberty? (b) shall the law declare to protect laborers unilaterally or protect both parties within the labour relationship? (c) shall the law encourage more administrative interference on the contract relationship? (d) how to balance the regulations dealing with formal and informal employment relationships?<sup>13</sup>

Just as raised by many the critic, questions of (a), (b), and (c) are actually the same one. It is about the goal of the law, whether to pursue the harmony of labour relation through enforcing employment stability, or approach flexibility realized by the market principles.<sup>14</sup>

Another criticism is about whether the LCL could care for employees in lower level, since laborers in modern society have developed its own hierarchy. Criticism considered the LCL could not benefit to employees at lower level i.e. migrant workers. Economic compensation provisions could hardly be implemented upon this group. They argued that when the contract is ended by the employer, employees in this level usually would select to leave rather than claim for economic compensation. Only those powerful workers could win in the new law, because they could have strong protection due to high wages and keep employment stability easily.

## II. THE BALANCE OF EMPLOYMENT RIGHTS AND FLEXIBILITY

Indeed, unlike the observations raised by many, the author has found the LCL set up new balances in the Chinese labour market. In the macro level, it

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<sup>12</sup>Liu Tao and Wang Qi, 2008.

<sup>13</sup> Dong Baohua, *Contend and Thought of Chinese Labour Contract Law*, Shanghai Renmin Press, 2011 p159.

<sup>14</sup>*Ibid.*



provides choices for the employer to be a “good” labour user since they can enjoy some sort of labour flexibility by forming fix-termed employment or other employment relationship. In micro levels, there are several new instruments for both employees and employers to approach a balanced labour relation by their own means.

#### **A. Contract Signing and Economic Penalty**

In order to set up a contract system, forming a written labour relationship is emphasized as a compulsory duty to both the employee and the employer. Since in most cases, it was the employer who refused to sign the contract, the LCL added the instrument of economic punishment to impel a self-enforcement of contract signing. If the employer illegally refuse to sign the contract, even when the employee ask for doing so, the employer should pay the employee one-month wage for each month since the labour relationship was founded.

This fine is not an administrative punishment but a compensation for employee similar to tort liability , which means the employee can benefit from it directly. It is aimed to avoid difficulties and costs to provethe de facto employment relationship. Moreover, it can be helpful to solve labour disputes as to reducing the effects to verify an employment relationship by the authority. With regard to the employer side, restrictive covenant and confidential liabilities could reduce the risks of illegal competition by core workers.

#### **B. Workplace Rules**

Workplace rules within an enterprise were early regulated by the law. Prior to the establishment of Labour Law 1994, workplace rules had to be made in a democratic process where the workers representatives and trade union could participate to the co-determination. Labour Law 1994 changed this rule. It only articulates thatworkplace rules should be formulated in accordance with law, and the opinion from the trade union should be heard during this process. This loosely worded provision was proposed to release enterprises from original restrictions, and served for the policy of business freedom.

The LCL restates the principle in relation toworkplace rules. In accordance with the LCL, the legitimate validity of workplace rules is determined by its rule-making process, in which the voices from the employees’ side or their representatives the trade union. This change is made to balance powers of employees and employers, and improve industrial democracy.

### **C. Penalty for Contract Violation**

Similar with the economic measures applied to labour contract formulation, penalties including compensations and fines imposed on any violation to the labour contract are also strengthened the economic punishment. A penalty equals to one or two months' wage calculated months is directly endowed to the employee once the employer violates the duties on the labour contract. But the amount of the penalties made the balance again.

In order to protect the employee, the compensation or fine amount could not lower than the local minimum wage for per month. To avoid unfairness to the employer, different compensations could not applied together, which means if the employee selected one favorite compensation (for example double wages fine for illegal discharge), he could not ask for other compensations at the same time.

In addition, if the employee's wage is too high (three times higher than average local wage level), the compensation he could claim for is limited up to three times wage for per month and no more than 36 months wages for the total amount.

With regard to restrictive convent, the agreement shall not exceed two years, which is shorter than previous term of 3 years, which was provisioned in labour rules by Ministry of Labour.

### **D. Restrictive Convent**

In order to secure the trade secrets and intellectual property, the LCL articulates confidential obligation on the employee. However, the obligation is not unlimited. The applied scope is only limited to employees of senior management, senior technicians and other personnel important.

As the consideration of employees' confidential liability, the employer has to pay economic compensation to the employee on a monthly basis, during the term of the competition restriction after the termination of the employment contract.

The LCL states nothing about the compensation in details, although it requires the compensation should be reasonable compared with the employee's wage level. It leaves the problem to the local government, so as to balance different economic development level of locals. In most locals, the compensation is as from 20% to 60% of wage payment, i.e. Zhejiang and Guangdong are 50% of the wage payment, other than agreement with higher amount between both parties.

## **E. Dispatched Employment**

The balance between the employer and the employee also shows in the provisions of dispatched employment. In order to protect employment stability of dispatched workers, the fixed-term labour contract no less than 2 years is required by the LCL. By the law, dispatched works shall have a wage payment no less than local minimum wages even for the time period when they are not dispatched.

Another balance appears in the liability relocation. The real user of dispatched workers has to provide onsite protection and working conditions to the dispatched workers. Different to other countries, the liabilities imposed on the real user of dispatched workers are regarded the same with the employer, who concludes labour contract with the employee directly. Especially when the employee gets loss from the violation of the labour contract from the employer or the real user, both the employer and the real user are imposed the conjoint liability to the employee, so as to balance interests of each party within the unique relation.

### **III. REBALANCE, REGULATION ON DISPATCHED EMPLOYMENT**

After five years implementation of the LCL, a number of new phenomena emerged from Chinese labour market. Speaking positively, the ratio of signing labour contract has increased dramatically, due to the server penalty upon the employer who failed to form labour contract with employee. In accordance with a latest research,<sup>15</sup> within enterprises of more than 1000 employees, the labour contract signing rate has reached 89%. By official statics, the rate of large-scale enterprises was 94% in 2010.<sup>16</sup> It was found that the high signing rate is helpful to the employment stability, and the trade union played a very important role in such changes. Now the fix-termed contract is three-year contract usually, and social insurance benefits especially for the medical insurance are better protected as a side consequence.

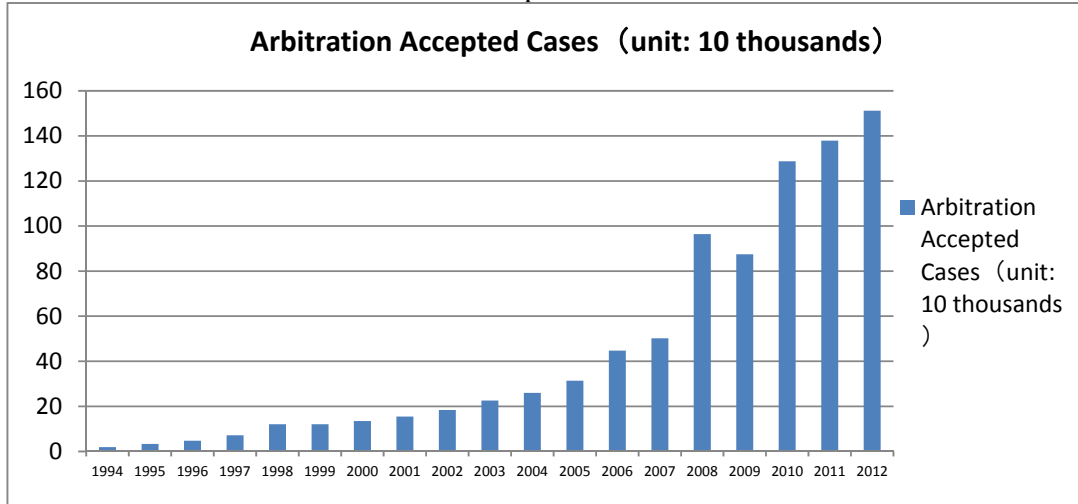
However, the dark side of story, which has been frequently referred by many commentators, is twofold. First, the increase of labour dispute cases in last few years is alarming (see table 2). Second, the use of labour dispatching workers became out of control. The latter seems particularly worrisome for the top legislature in China.

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<sup>15</sup>XuDaowen, Labour Contract and Its Effect of Protecting Rights- Based on Survey Data of Nine Cities, Hebei Law Science, 2011 July, Vol. 29 No. 7.

<sup>16</sup>Survey Report of Migrant Workers in Zhujiang Delta Zones, Zhujiang Economics 2007.

Table-2: Labour Arbitration Accepted Cases from 1994-2012



Notes:

- (1) The statistics is based on annual data release by Ministry of Human Resource and Social Security of China.
- (2) Data from 2008 includes labour disputes accepted by the mediation process.

Therefore, the Standing Committee of the National People’s Congress launched its revising project in 2011 and finally enacted an amendment for the the LCL curbing the widespread of labour dispatching service in 2012. It is a record-breaking speed in Chinese labour legislation history as a new labour subject to any amendment. It not only shows the urgency of dealing with issue of labour dispatching service but also illustrates the determination of central authority to drive the labour market back on “track”.

The amendments of the LCL focus on five aspects. First, the threshold of entering labour dispatching business has been clearly lifted. The requirement of the deposit for registering a labour dispatching business is 2 million RMB instead of 500,000 RMB in the original the LCL. Second, the registration of a labour dispatching company is subject to the pre-approval of labour authorities prior to entering into formal procedure of registering a company. Third, some clarifications have been made upon the terms of “temporary, auxiliary, or substitute positions”. Fourth, the amendment of the the LCL has reemphasized and polished the equal pay principle for the dispatching workers. Fifth, the legislator authorizes the Ministry of Human Resource and Social Security to decide a cap for maximum portion of headcounts for dispatched workers in any company.

It is not unreasonable for the government to put labour dispatching service under strict scrutiny in order to protect the rights of dispatched workers. Lifting up the threshold to entering labour dispatching business is definitely a way to ensure those well-established entities providing employment service. Moreover, the pre-approval requirement is an instrument for the labour authorities to step in as to screen out those unfitting employment providers.

Meanwhile, it seems a healthy movement to address some of the terms that appears vague in the previous legal text. During and after the process of drafting the LCL, many commentators have pointed out the unclearness in the clauses of labour dispatching section might lead to abuse of labour dispatching service. As the amendment of the LCL has made some sort clarification on the “equal pay” principle, the dispatched workers can have better chance to receive sufficient protection. The specification for the terms of “temporary, auxiliary, or substitute positions” is another tool to reduce the possibility for the employer to abuse the labour dispatched workers.

However, the quota for the amount of dispatched worker imposed upon a company has an uncertain impact on labour dispatching business. So far the authority has not yet hamper out any indication on the quota in question. There are widespread speculations amongst commentators on Chinese market. On the one hand, if the quota is too loose, there is a worry that the abuse of labour dispatched activities may not be curbed. On the other hand, if the quota is too tight, the entire labour dispatching service might be frozen. Therefore, it is a subtle approach for the government to make a final decision.

## CONCLUSION

The advent of the LCL leads Chinese labour regulations into a new era. Since the LCL is a new instrument for over 400 million workers, it is unsurprising that there is a great deal of debates amongst various commentators. The legislature of the the LCL has made great efforts to enhance the protection of workers. However, the critics pointed out the level of protections may be too heavy for the employers to share.

This article argues any reviews of the LCL shall put this instrument into Chinese context. It is necessary to take the social context five years ago when looking at the establishment of the t LCL. As being illustrated, the then the LCL has create a rather balanced protection for both workers and employers. Five years later, whilst new phenomena have emerged interfering such balance, the

legislature has made prompt response to readdress. Most movements made by the LCL amendment are rather positive, such as clarification of vague terms. It may be too early to judge the real impact of the amendments as the administrative quota upon amount of dispatched workers in a company has not been finalized.

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