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New labour contract laws to come into force in China

With effect from 1 January 2008, China will introduce new labour contract laws, which will make it harder for companies to dismiss people. From 1 January, employees who have been with a company for 10 years – or signed two fixed-term contracts – will be entitled to severance pay. This will close a loophole that allowed companies to dismiss workers on temporary or fixed-term contracts without compensation, or even to employ them without a formal contract. The law also requires employers to contribute to employee social security accounts and sets wage standards for workers on probation and overtime. Employers will also have to consult an "employee representative congress" on any changes to areas such as hours, benefits and compensation.

Perhaps not surprisingly, even in China it took over two years to implement the law and, when an early draft was posted on the internet for comment in March 2006, it generated nearly 200,000 responses in a month. Whilst a lot of companies, particularly smaller ones, have complained that the law will lead to higher labour costs, experts have commented that China's low labour costs have led to an unhealthy model for growth. The Government believes that the new law will help to develop a genuine market economy and, whilst conceding that companies may move production to cheaper offshore locations, comments that that is how a market economy should operate (Italy? France? are you listening?).

It will be interesting to see how strictly – and consistently - the new law is enforced. It has been suggested that around 40% of private sector employees do not have contracts and this will be a very major change for them and their employers. However, China has long been criticised for poor labour rights, amid accusations that its economic boom has been accompanied by unpaid wages, forced/slave labour and other abuses, and it is very keen to shed its sweatshop image.

However, whatever effect the new law has on China's image, if it is enforced it will inevitably lead to higher costs. Wages in China have been increasing in recent years – monthly wages rose 18.8% in the first nine months of 2007 according to the National Bureau of Statistics – and this rise will continue. Coupled with increased fuel, energy and raw materials costs, not to mention the possibility that the rate of the export rebate will fall again, China is going to become more expensive anyway. And, whilst labour costs in China are low by developed country standards, they are still a great deal higher than those in least developed countries such as Bangladesh, Cambodia and Vietnam.

It is, perhaps, a measure of its self-confidence that China genuinely seems to believe that it can survive its move from being regarded as a low-cost supplier and is not apparently too concerned at the possibility that companies will outsource the production of labour intensive goods, such as clothing and textiles. Of course, it will also be hoping that all this will make it less of a target for trade defence measures by the EU and US – but that is probably a trifle over-optimistic at this stage!!

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