

# MNCs in China: Regulation and Reality

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## **Abstract**

In November 2004 Wal-Mart announced that its workers in China could set up unions. This is a change in position for the U.S.-based retail giant, which has resisted the organizing of its employees in every country that it has operations. In this paper we argue that Wal-Mart's change in policy in China is related to both host-country and country-of-origin factors. The reality of industrial relations (IR) in China is that there are two tracks. One track is for stated-owned enterprises, and the other track is for private firms including MNCs. Local governments compete for foreign direct investment (FDI) and relax their enforcement of labor standards to attract or keep MNCs. This allows the Chinese government to appease foreign critics of its workplace practices while giving Wal-Mart a favorable public relations position in the United States.

## **Introduction**

On November 22, 2004, Wal-Mart announced that its workers in China could set up trade unions. This was a change in position for the U.S.-based retail giant, which had resisted the organizing of its employees in China. Wal-Mart's first store in China opened in the southern city of Shenzhen in 1996. The company has 37 stores in 18 cities with 19,000 employees (China Labor Bulletin 2002). Wal-Mart is a U.S.-based multinational corporation (MNC) that has a clearly enunciated policy of discouraging employee organization in

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all of its international markets. This announcement raises the question of why Wal-Mart would change its policy in China.

Edwards and Ferner (2002) propose that there are four key sets of influences that govern the way that labor is managed within MNCs. These four key influences are country-of-origin factor, relative strength of particular countries within the international economy, pressure to achieve a degree of integration across international operations, and the constraints posed by the host country. Translating these four influences to Wal-Mart results in the following assessment. With regard to the country-of-origin effect, the case study by Royle (1999) demonstrates that U.S. MNCs tend to be highly centralized in their decision making regarding industrial relations (IR) matters. This control is through expatriates in key positions and through formalized reporting and written guidelines. With regard to the relative strength of particular countries within the international economy, the United States is the largest foreign direct investor (FDI) in China, and Wal-Mart, along with GM, are the largest U.S. firms. The pressure to achieve integration is important to Wal-Mart. The fourth influence, the constraints posed by the host country, will be discussed later in this paper. In this paper, we conclude that Wal-Mart's changing policy in China is related to both host-country and country-of-origin factors.

The second section briefly reviews China's globalization with a focus on MNCs. Section three summarizes IR regulations, and section four describes the realities of these regulations. The last section presents the conclusions as they relate to Wal-Mart's shift in policy.

## **Globalization**

The United States' current account balance was in deficit by some \$666 billion in 2004 and grew in 2005. One important component of this deficit is the trade in goods with China, which accounted for about \$176 billion. China accounts for the United States' single largest bilateral deficit and has generally remained between 20 and 25 percent of the total (U.S. Congressional Budget Office 2005). Part of the growth in the importing of goods from China to the United States is due to imports being displaced from other countries rather than a decline in U.S. domestic production. Many manufacturers have shifted the final assembly of their products from other Asian countries to China, and the increasing value of Chinese exports consists of parts made elsewhere in Asia and channeled through Chinese manufacturing.

There is a debate about whether U.S. investment in China is primarily targeted at the domestic Chinese market or exports. An American Chamber of Commerce–China survey (2005) found that only one in ten U.S. companies in China invested in order to shift U.S. manufacturing to a lower-cost

location. This contrasts with the findings of Bronfenbrenner and Luce (2004), who reported that for just three months, January to March 2004, China was the largest destination for production shifts.

FDI has been largely concentrated in coastal provinces, mainly because of the special economic zones granting preferences to foreign investment that have been established in these regions. The two leading manufacturing regions producing for the global market are the Pearl River Delta near Hong Kong and Macao of Guangdong province, and the Yangtze River Delta and the Shanghai Municipality of Zhejiang Province and the southern half of Jiangsu Province.

## Regulation

China's IR system was characterized in the 1950s through the 1970s by what was called "three old irons": lifetime employment, centrally administered wages, and state-controlled appointments and promotion of managerial staff. State-owned enterprises (SOEs) carried out the system in the industrialized sector, usually located in urban areas. Workers and managers held jobs for life. Workers were assigned to SOEs, which guaranteed lifetime employment and a wide range of benefits, including housing and education (Ding and Warner 2001). Wage levels were set centrally, and the Communist Party played a supervisory role in the factory. Productivity was often low, and there was considerable redundancy in the workforce. Lifetime employment was secure in the SOEs and was reinforced by workers being required to have resident permits (*hukou*). Migration was difficult since the resident permit was not portable. The trade unions acted as a transmission belt, enforcing the regulations and requirements of the government. The unions' principal tasks were to handle social welfare programs, housing for employees and their families, and employment for family members.

Transformation of the system began at the end of the 1970s. Centralized state guarantees of lifetime employment were relaxed, and firms were no longer required to provide social welfare benefits. These benefits were gradually shifted to regional authorities. In 1986 a change in the law required that new workers be hired on fixed-term contracts for the maximum duration of four years, although these were not approved by local authorities and implemented systematically until the 1990s. In addition, workers could now be dismissed under certain circumstances. The authority of the factory director was enlarged and the power of the party in the enterprise downgraded. Firms were encouraged to link rewards to performance through the use of bonus systems.

The Trade Union Law of 1992 spells out the organizational structure of trade unions and defines their rights and obligations (Chang and Bain 2006).

Unions are structured by both geographical location and industrial classification. The National All China Federation of Trade Unions (ACFTU) sits at the top. This legislation extends the scope of collective agreements from industrial enterprises to all firms and organizations. Unions may negotiate collective agreements on behalf of workers with management. These draft contracts have to be submitted to a meeting of the workers for approval. The Trade Union Law recognized union activities; however, there is no enforcement mechanism nor is there immunity for union officials. Strikes are also forbidden. Trade unions have nonvoting representation at board of directors meetings and are funded by 2 percent of total wages. The collective agreement remains a formal document, largely spelling out the rights and benefits already regulated, with supplementary terms added by management.

Unions appear to be hampered by a lack of rights and unenforceable power. However, one source of local power is their close connection with the labor department of the local governments, whose cooperation is essential to the MNCs success. Labor is structured into four tiers (ORC Sightlines 2005). Each province has one union that coordinates with the ACFTU and may discuss general issues with FDIs. Each city has a union that may negotiate with FDIs about job creation and help firm-level unions. Each district in a city has a union that also helps firm-level unions and may negotiate directly with the company. Firm-level unions represent workers in disciplinary hearings, collective bargaining, and the signing of individual employee labor contracts. Workers can organize a firm-level union if they get at least twenty-five employees to sign on.

The 1994 labor law spelled out in greater detail the character of collective agreements, which could cover such matters as wages, hours of work, breaks, vacations, occupational safety and health, and insurance. The Chinese prefer to use the term *collective consultation* rather than *collective bargaining*. Clarke, Lee, and Li (2004) conclude that the process of collective consultation has not introduced a new system for negotiating the terms and conditions of employment, that there is no real negotiation of the collective contract, that the union defers to management with no participation by the union members, and that employers do not add very much to the contract beyond what has been regulated. SOEs and FDIs are now included in the same legislation.

## Reality

The globalization of the industrialized urban sector brought large changes to China's IR system. China developed a two-track system instead of a single system. There is an SOE track with remnants of the "three old irons" and an MNC track subject to market forces. The SOEs were put under some

competitive pressures and local management was given considerable freedom to increase the SOEs' productivity and competitiveness. These SOEs have become responsible for their own profits and losses. Many of the SOEs have restructured and reduced their employment levels, adding to China's unemployment.

The private sector, subject to market forces, is very diverse. It ranges from small Chinese-owned businesses to large, entirely foreign-owned MNCs. In this sector connections are still important, as is the competition among localities to attract and keep FDIs. This competition has encouraged local governments to relax their enforcement of labor standards. Among MNCs there is a distinction in the enforcement of labor standards between ethnic Chinese investors from Taiwan and Hong Kong, the Sino-MNCs, and other, often Western, firms. Sino-MNCs are given greater freedom to minimize labor law enforcement at their facilities, while Western MNCs must comply more strictly with national and international standards. This results in the inconsistent application of labor and employment regulations between the national and local levels, the type of organization, and the firms' location. Different forms of FDIs require different forms of approval from district governments. For example, recruiting techniques could differ among MNCs based on local approval. The government has also been more responsive to the demands of management than to workers with a lot of local interpretation. In Guangdong Province, firms were able to extend working hours beyond the sixty-hour maximum, including overtime, by getting permission from the local government labor authority.

Chinese workers appear to have little faith in their unions, based on interview and survey evidence, and many go directly to management to resolve a dispute. Worker discontent has not been channeled through unions but through disagreements over contracts, work stoppages, and strikes. Sit-ins, mass protests, and strikes are not unusual. In April 2005, 10,000 workers in a Uniden electronics factory staged a strike in an attempt to form a trade union in the factory. In response to local pressure, the Guangdong Provincial People's Congress passed a local law allowing ten or more workers employed in a factory in the province that does not have a union to establish a union of their own. In September and October 2004, about 7,000 workers staged a seven-week strike in the Xianyang Hearn Textile Factory in protest of management attempts to impose a new labor contract (see [www.union-network.org](http://www.union-network.org)).

The consensus from the literature is that with regard to the employment policies of MNCs, the MNCs pay higher wages and engage in more training than the SOEs and the state-influenced enterprises (Clarke, Lee, and Li 2004). IR practices appear to be a blend of foreign practices and traditional, "iron-rice bowl," practices. Pay for performance is used and there is less

unionization in the FDI's. Where unions are present they perform a social welfare function.

### **Wal-Mart**

Wal-Mart has been under attack in the United States and overseas by unions, governments, and nongovernmental agencies. The company has recently launched its own public relations campaign. Any evaluation of Wal-Mart's IR practices in China has to also include the company's suppliers in that country as well as its retail stores. One union estimate is that 80 percent of Wal-Mart's suppliers are in China and that \$18 billion worth of goods were imported by Wal-Mart into the United States in 2004 (see [www.union-network.org](http://www.union-network.org)). The Institute for Policy Studies (2005) reports that workers in Guangdong Province who made toys for Wal-Mart sometimes worked 130 hours per week and averaged 16.5 cents per hour.

Wal-Mart was reported in October 2004 as resisting union representation in China before its turn around in November 2004. The same report said that municipal unions in three cities had approached store management in several cities but that managers had refused to cooperate in the establishment of unions. Our explanation of this turn around in corporate policy, a month later, is based upon our assessment of the IR system among MNCs in China. It would appear that Wal-Mart is attempting to satisfy both host-country and country-of-origin objectives. The Chinese government has been under pressure from both inside the country and from international agencies and nongovernmental groups to improve its labor standards and show support for worker organizations. Inside China it has been the ACFTU. The ACFTU has threatened to blacklist Wal-Mart and take legal action against it. The union threatened to send representatives into MNCs to organize their factories and use the courts if necessary. Outside China, the International Labor Organization (ILO), World Trade Organization (WTO), Woman's Christian Temperance Union (WCTU), and AFL-CIO have been pressuring China. The Chinese government's efforts to appease foreign criticism about industrial conditions at the workplace has led the government to make its efforts at the workplace coincide with international norms on matters of collective bargaining and labor protection. This resulted in a May 2004 Cooperation and Partnership Memorandum of Understanding between the Ministry of Labor and Social Security and the ILO based on the ILO's goal of decent work. The announcement of possible unionization by one of the world's largest corporations assists the Chinese government both domestically and internationally. Workers in China and international bodies are both given assurance that the Communist Party is doing something to assist worker demands and enforce labor legislation.

The same pressure on the Chinese government is also felt by Wal-Mart in the United States. The company has been under attack for its anti-union policies and employment practices, particularly in the area of benefits. The company's consumer opinion efforts are helped by its 2004 announcement. Wal-Mart's choice of union recognition, as opposed to union avoidance, in China can be expected to have little impact on operational performance and the company's bottom line. Labor regulations in China are not likely to place heavy constraints on Wal-Mart's managers. While some regulations restrict employer freedom to set the terms of employment, there is considerable freedom for the company to liberally translate the enforcement of these regulations with the assistance of district and local government officials. There may be some costs for the company associated with union recognition and collectively bargained contracts in its stores; however, the public relations benefits to China and Wal-Mart can be expected to outweigh the costs.

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