

## EMPLOYEES' PROPERTY RIGHTS IN CHINA'S STATE-OWNED ENTERPRISE REORGANIZATION

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### INTRODUCTION

Deteriorating performance by Chinese state-owned enterprises (SOEs) has drained the Government's financial resources and undermined the economy. Therefore, in the early 1990s, the Chinese government decided to reorganize SOEs in order to promote their efficiency. The first step was to lay off redundant employees to improve the allocation of capital and labor in SOEs.<sup>1</sup> The present unemployment law and policies were designed to support massive reallocation of labor and capital in the state-owned economy. At the 15<sup>th</sup> Chinese Communist Party Congress of August 1997, top leaders formally announced their commitment to intensify massive worker lay-offs from SOEs. Most of these SOEs were to be sold, leased or changed to joint ventures while getting rid of redundant employees. Although tremendous numbers of workers were laid off, SOE managers still complain about the heavy burden of lay-off benefits preventing them recovering from their difficult financial conditions. Creditors of SOEs are extremely worried about large SOE bankruptcy liquidation due to the large amount of workers' wage arrears and labor reallocation costs that must be paid first and fully before creditors' conferences. On the other hand, many workers fall into immediate poverty after their discharge. Worker protest actions, claiming property rights from the communist state (that is owned by the working

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1. See Zhou Qiren, *Tizhi Zhuanxing Jiegou Bianhua He Chengshi Juyz* [Institutional Transformation, Structure Changes, and Urban Employment], 3 SHEHUI JINJI ZHIDU BULAO [COMP. RES. ON ECON. & SOC. INSTITUTIONS], 8, 8-15 (1997).

class under the Constitution and Chinese socialist doctrines), are even reported by Chinese domestic media.

This Article argues that current Chinese labor law based on socialist economic doctrines, and the property claims to which it gives rise, improperly compensate laid-off SOE workers, thus frustrating the development of a free labor market in China. The first section of this paper elaborates the Chinese socialist labor theories of the employment relationship in SOEs. Section II introduces the Chinese SOEs' contract employment relationship, which binds together the government, the enterprise, and workers. Section III, explores Chinese SOE workers' property claims arising under Chinese socialist labor theories, while section IV analyzes the law of SOE employees' property claims in SOE reorganization. The last section suggests some possible solutions based on studies of market economy and United States employment law.

#### I. SOCIALIST THEORIES OF THE EMPLOYMENT RELATIONSHIP IN CHINA'S STATE-OWNED ENTERPRISES

China's employment law and policies for SOEs are based on political economic theories consistent with government ideology. Its constitutional and ideological premises are political economic theories of all-people ownership and the Marxian theory of labor.

##### A. *Workers as Owners: the Marxian Theory of Labor and All-People-Ownership*

The largest share of China's economy is the state-owned economy named "the all-people-owned economy." China's constitution provides that the all-people-ownership system is the primary component and the base of China's economy.<sup>2</sup> The state represents all the people in owning and managing the all-people-owned productive materials. The Chinese people own these productive materials as an aggregated community and no individual has a separate share in the all-people-owned properties. Chinese people manage their common properties through their representatives, government officials and delegates of the People's Congress, who are theoretically democratically elected.

In Chinese socialism, it was declared that because the state owned not only productive materials but also labor, the government should allocate labor resources. Therefore, SOE employees were recruited and allocated by the state according to labor and employment plans. College

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2. XIANFA [CONSTITUTION] (1982), art. 7.

graduates and other professional school graduates were assigned their jobs by the government,<sup>3</sup> and they were not allowed to transfer without government permission.<sup>4</sup>

According to Marxist economics, in massive industrial production a worker's wage is only a part of the value created by him because he works longer than the time that he needs to work to create the value equal to his wage.<sup>5</sup> A part of the value of labor created during the means of production is called the cost of labor force reproduction, which should amount to the worker's wage. A worker creates more value than his wage, which is called the surplus labor value. Capitalists in a capitalist economy retain this part of surplus labor value. In order to eliminate the theoretical possibility of the state playing the capitalist role by exploiting workers (including intellectuals), some Chinese political economists view the worker as the owner of his own labor and a co-owner of an undivided interest, the surplus labor value, in the means of production. A worker's ownership interest in the social production does not result from his own personal efforts, but is rather an inviolable right that he enjoys as a member of the working class. The value of his ownership interest is China's continued economic development and the accumulation of productive wealth, which benefits the nation as a whole. These theories explain that a state enterprise worker, although a wage earner, cannot be exploited by his own enterprise because he is also a co-owner.<sup>6</sup> The worker's entitlement to receive a wage is derived ultimately from a constitutional right, so-called "jobs right," and the obligation to work.<sup>7</sup> The state's obligation is to do its best to create employment opportunities so that every person with working ability has a job.

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3. Before 1980, the government also allocated all high school graduates. It no longer does so due to the increasing number of college graduates in recent years. The state attempts to control skilled labor -- a resource that is rare in China.

4. See Gu Kewu, *Guanyu Laodongli Suoyouzhi Wenti De Guandian Jieshao* [An Introduction to the Theories of Labor Ownership], in *JIANGUO YILAI LAODONGLI SUOYOUZHI LUNWENXUAN* [SELECTION OF ARTICLES ON LABOR OWNERSHIP SINCE THE ESTABLISHMENT OF THE PEOPLE'S REPUBLIC OF CHINA] 480, 493 (Xu Jiewen & Gu Kewu eds., 1982).

5. In this section, wages include cash wages and other income in the form of employment benefits.

6. See Rong Zhaozi & Ni Xuexin, *Shilun Shehuizhuyi Shehui De Laodongli Geren Suoyouquan* [Commentary on Individual Ownership of Labor Force in the Socialist Society], in *JIANGUO YILAI LAODONGLI SUOYOUZHI LUNWENXUAN* [SELECTION OF ARTICLES ON LABOR OWNERSHIP SINCE THE ESTABLISHMENT OF THE PEOPLE'S REPUBLIC OF CHINA] 211, 219 (Xu Jiewen & Gu Kewu eds., 1982).

7. XIANFA, *supra* note 2, art. 42.

B. *Workers as Employees: Labor as a Commodity*

Since 1979, the theory of all-people-owned labor has been replaced step by step by the labor commodity theory, along with the establishment of the labor contract system that the growing market economy called for.

At the beginning of the reform, the government's goal was to establish a new income contribution system to improve labor productivity, based on a new interpretation of the principle "distribution based on labor contribution" (*anlaofenpei yuanze*). According to this principle, a SOE employee's income should no longer be decided by the unified wage scales system in which the only wage criteria are a person's skill and seniority. Instead, an employee's income should be based on her labor contribution or labor productivity. Because a worker is able to control her labor directly and immediately, her compensation should be calculated on the basis of her individual labor contribution. Moreover, labor and productive materials are combined in enterprises. Workers' collective productive efficiency affects an enterprise's productivity directly; therefore, an enterprise's productivity is also decisive for a worker's income.<sup>8</sup> The labor contract is the instrument that defines the income distribution rules between workers and their SOEs. The wage fund control system, in which the state controls the sum of a SOE's annual wage fund, decides the distribution between workers and the state as the representative of property owners. Under the 'distribution based on labor contribution' system and the wage fund control system, workers' incomes are supposed to be based on their individual labor contribution and the collective (enterprise) productive efficiency.

In Marxian labor theory, labor is a commodity when workers are separated from productive materials but own their labor. That is, because workers do not own productive materials, they have to sell their labor, which is under the workers' direct control, to capitalists at the price amounting to the cost of labor force reproduction. Only when labor and productive materials are controlled directly by workers is labor not a commodity.<sup>9</sup> In Chinese socialist economics, workers can directly control their own labor. Chinese workers may sell their labor to the state or to others. However, they indirectly control and use productive materials through the state's management. Therefore labor is a commodity in

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8. See Wang Haibo et al., *Shenru Guance Anlaofenpei Yuanze De Ruogan Wenti* [Several Issues on Implementation of the Rule of "Distribution Based on Labor Contribution"], in GUANYU ANLAOFENPEI WENTI [COLLECTION OF ARTICLES ON ISSUES ABOUT DISTRIBUTION BASED ON LABOR CONTRIBUTION] 122, 125 (1979).

9. See Gu, *supra* note 4, at 504.

China's socialist economy.<sup>10</sup> The profits made by the state are put into the common pool of welfare for the people. Workers still own the surplus product they produce through the state-owned system that replaced "the all-people-ownership" system.<sup>11</sup> Workers will benefit through China's long-run prosperity and the victory of socialism achieved by the economic reform.

When the theory of labor commodity became the dominant official ideology in the early 1990s, the government abandoned all ideological, political and moral imperatives for job security in SOEs. SOEs and their employees are now equal parties to an employment contract. One side sells its labor for living materials and another side buys labor for profits. Both sides are free to choose with whom they make an employment contract or terminate an employment contract for their own benefit as long as they do not violate the law.

With the construction of the labor contract system, the Chinese government began to develop the labor market. The government abolished the unified labor employment plan system. SOEs can hire or fire employees without government interference. In the labor market, wage is nothing but a productive factor of income such as return of capital, technology and other productive resources. Thus, workers of SOEs are accorded the same status as other productive resource providers. They invest their labor into SOEs and are paid wages as a factor return of labor.

### *C. Wage Determination — "Two-step Distribution According to Labor Contribution"*

China's wage system has traditionally been based on the Marxist dictum that a worker's wage should be the average social cost of his/her labor force reproduction.

Before the reform of the employment system beginning in the early 1980s, the unified wage scale set by the central government was the only measure for wages. It was deemed a price system based on the average social values of labor force reproduction. As the representative of the whole Chinese people, the state owned labor and allocated labor resources through centralized economic plans. A worker's labor contribution was only decided by its average social value without relevance to an individual enterprise's profitability. Under this theory, no

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10. See DAI YUANCHEN, *ZHONGGUO LAODONGLI SHICHANG PEIYU YU GONGZI GAIGE* [DEVELOPMENT OF CHINESE LABOR MARKET AND WAGE REFORM] 10-13 (1994).

11. See ROBERT C. HSU, *ECONOMIC THEORIES IN CHINA, 1979-1988* 31 (1991).

matter whether an enterprise was profitable or not, its employees' wages would not be affected.

In the beginning of the 1980s, some economists proposed the theory of "two-step distribution according to labor contribution" in order to solve the problem of egalitarianism between enterprises.<sup>12</sup> They pointed out that there were two steps to distribution in China's income distribution system in the state-owned sectors. The first step is the state distributing income to enterprises. The second is the intra-enterprise distribution. "Because an individual's labor can become society's labor only through the enterprise, both levels of distribution should be made according to labor or contribution." Therefore, the total wages of an enterprise should be linked to the enterprise's performance, thereby increasing worker incentives. This theory has become the dominant theoretical basis of the Chinese wage system in SOEs.<sup>13</sup>

#### *D. Conclusion*

Since the end of the 1970s, SOE employees have changed from being elements of a unified state-owned economy to independent laborers in a market economy. The change in their status legitimized contractual employment relationships in China's SOEs. This transformation benefits SOEs' privatization and reorganization. The state has discarded its obligations for full-employment to enable SOEs to lay off redundant workers and hire more qualified employees. The state is not concerned with socialist ideology any more. China's pragmatic policy goals are economic development and a stable society. For such pragmatic purpose, the state has initiated and is constructing a free labor market. On the other hand, Chinese people also receive the right of free employment.

## II. LABOR CONTRACT SYSTEM IN CHINA'S STATE-OWNED SECTOR

### *A. Workforce Structure in Chinese SOEs*

Since the early 1950s, the Chinese SOE employment system has gone through three stages. From 1950 to 1986, all the SOEs recruited under a centralized labor plan made by the government. 1986-1996 was a period when the old labor plan and the free labor market co-existed and SOEs hired workers with employment contracts under the control of the centralized labor plan. Since 1996, SOEs have been able to hire workers

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12. *Id.* at 165.

13. *Id.* at 166.

from the free labor market without reference to the old centralized labor plan. Due to the changes in the SOE employment system, SOEs workers hired at different periods have different relationships with SOEs. They are classified by their relationships with their enterprises.

From Table-1, we can see the structure of the main workforce in SOEs.

Table 1: The Workforce Structure in Chinese State-Owned Enterprises

	Pre-1986	1986-1996	Post-1996
Workers within the state labor wage plan	Permanent workers	Permanent workers or contract workers	Contract workers without duration
	Contract workers	Contract workers with contract duration of 5 to 10 years	Contract workers with or contract workers without duration
	Contract workers	Contract workers with duration	Contract workers with duration
Workers not in the state labor wage plan	Temporary workers, Peasant workers	Temporary workers, Peasant workers	Temporary workers, Peasant workers

The first category of workers is the permanent worker with a lifetime employment contract. Most of these workers were recruited and assigned to their SOEs by the government under pre-1986 labor plans. Some of them were hired under long-term employment contracts during 1986-1996 under the contractual labor system that replaced the lifetime employment system in SOEs. Each of these workers was required to make an employment contract without duration in 1996. Such a contract does not necessarily mean that the employment can be terminated at will. It also does not mean that the employment is permanent. "An employment contract without duration" is a very vague term that can be interpreted either way.

The second category of workers is the contract worker with an at-will employment contract or contract with duration. Although these workers were recruited under the labor plan after 1986 and received semi-public-officer status like permanent workers, their employment can be terminated at will by their SOE after 1996.

The rest are at-will employees. They do not belong to the formal employment system in the state-sector. This means that their employment can be terminated at will and they do not have any privileges

as public employees of the state. They are outside the government labor plans, even under the new contractual labor system.

### *B. Income Distribution*

The wage system in the Chinese state-owned economy was established in 1956. This system successfully reflected the specific political, social and economic characteristics of Chinese socialism. It has been able to survive, in an essentially unchanged form, the many changes in policy since then. One can describe the system as too successful, in the sense that it encouraged adjustments rather than reform. Only the dramatic growth of a market economy can change it step by step.

#### 1. Income Distribution between SOEs and the State

From 1956 until 1978 the wage structure was essentially frozen. The distribution of the wage fund among enterprises was a direct function of the employment allocation plan (the state labor wage plan).<sup>14</sup> Because the wage scale was fixed, the sum of the wage fund of an enterprise was only related to the number and the categories of its workers. No matter whether an enterprise was making money or losing money, its workers' income would not be affected. There was no difference in income between successful enterprises and failing ones. Usually, the government skimmed profits from successful enterprises to pay workers in failing enterprises through subsidies. In order to eliminate the inefficiency of such egalitarian income distribution among SOEs, a new wage fund system was constructed in 1985.<sup>15</sup>

Under this new system, a state-owned enterprise's wage fund ought to float with its profit.<sup>16</sup> Generally, an enterprise's wage fund can be raised 0.3% to 0.7% when its profits rise 1%.<sup>17</sup> The fund base may be the wage sum that was set in 1984,<sup>18</sup> although the actual wage fund base and the floating rate has to be set by the government, which also must approve any change in wage funds. The central government controls the wage fund of each province and the wage funds of the SOEs belonging to it. Correspondingly, local governments of different levels control the

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14. See Caizhengbu [Ministry of Finance], *Guowuyuan Guanyu Guoying Qiye Gongzi Gaige Wenti De Tongzhi* [State Council's Announcement on Issues of Wage System Reform in State-Run Enterprises], in ZHONGGUO GONGZI FAGUI QUANSHU [ENCYCLOPEDIA OF CHINESE WAGE LAW] [hereinafter CHINESE WAGE LAW] 20 (1996) [hereinafter *Wage System Reform*].

15. *Id.*

16. *Id.* at art. 1.

17. *Id.* at art. 5.

18. *Id.* at art. 3.



wage funds of their jurisdiction and the wage funds of the SOEs under their jurisdiction.<sup>19</sup>

There are several methods to calculate the increase of wage funds along with rise in profits.<sup>20</sup> The core factors are the wage fund increase coefficient and the profit base, both of which are controlled by the state plan.<sup>21</sup> In short, the government continues to control SOE employees' income resources through the wage fund hierarchy.

## 2. Income Distribution within SOEs

There are numerous measurements of the components of income from paid employment. Here, I use the measurement of the International Labor Organization to analyze Chinese SOE workers' income from their paid employment in their enterprises. The four major groups of income components are: "total cash remuneration for work done, time worked and time not worked; remuneration in kind and services; profit-sharing bonuses and profit-related pay; and employment-related social security benefits."<sup>22</sup>

## 3. Standard Wages

The core of the wage system of Chinese SOEs is the system of standard wage (*biaozhun gongzi*), or said basic wage (*jiben gongzi*). The standard wage system is accused of complexity and egalitarianism. For a country of China's size and diverse economy, the standard wage system is much simpler than the variety of wages on the free labor market.

The standard wage or basic wage is paid to employees in the state sector when they have worked a certain number of hours and have fulfilled their work task. The standard wage is the basic component of a worker's income. It is also the base of an employee's overtime payment, bonus and pension because it reflects his/her working seniority.<sup>23</sup>

The standard wage system consists of two separate subsystems for management staff (*ganbu*) and workers (*gongren*) in Chinese SOEs. There are eight, sometimes seven, wage levels for workers of different qualities. Position wages (*zhiwu gongzi*) and job wages (*gangwei gongzi*)

19. *Id.* at art. 2.

20. Caizhengbu [Ministry of Finance], *Shixing Gongzi Zong'e Tong Jingjixiaoyi Guagou Qiye Tiqu Xin Zengxiaoyi Gongzi De Jisuan Gongshi* [Announcement on Accounting Rules to Wage Funds Attached to Profits in Industrial and Transport Enterprises], in CHINESE WAGE LAW, *supra* note 14, at 159 [hereinafter *Accounting Rules*].

21. *Wage System Reform*, *supra* note 14, at art. 5.

22. INT'L LAB. ORG. BUREAU OF STATISTICS, MEASUREMENT OF INCOME FROM PAID EMPLOYMENT, REPORT II 14 (1998).

23. See MICHAEL KORZEC, LABOR AND THE FAILURE OF REFORM IN CHINA 56 (1992).

are the complements of the eight-level wage system. Workers with hard work conditions are compensated by extra job wages. Supervisory workers can earn more in position wages. The amount of a worker's position wage or job wage is also based on a worker's standard wage.<sup>24</sup>

Wage levels vary between different types of industries, with relatively high wage levels in heavy industry and mining and relatively low wages in light industry and services. The wage differences between areas reflect price differences and hardship compensations.<sup>25</sup>

Although the wage system has been reformed since the promulgation of the State Council's Announcement on Wage System Reform in 1985, the standard wage system has been the basic wage scale in Chinese SOEs until now. Most of the SOEs still pay workers basic wages according to the standard wage scale.

#### 4. Efficiency Wage or Floating Wage

Besides standard wages, workers can earn efficiency wages according to their work achievement.<sup>26</sup> Standard wages paid by the state-controlled wage funds restricted the financial and managerial power of an enterprise to link wages with efficiency and encouraged employees to continue eating from the big pot of the state budget. In the 1980s, the efficiency wage (*xiaoyi gongzi*) or floating wage (*fudong gongzi*) was designed to create worker incentives. Generally, workers can earn double standard wages if they obey work disciplines and fulfil their work task. If they fail to do so, their floating wage or efficiency wage will be reduced partially or wholly.<sup>27</sup> Thus, the efficiency wage or floating wage depends on the standard wage scale system. From this perspective, an employee's quality and seniority, which are decisive factors in the basic wage, also decide the efficiency or floating wage.

#### 5. Bonuses

Unlike efficiency wages or floating wages, bonuses (*jiangjin*) are decided directly by work achievement. They are not only decided by an employee's own work achievement, but also by the work achievement of his/her productive team.<sup>28</sup> In this sense, the bonus system is tied to

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24. See ZHUANG QIDONG, LAODONG GONGZI SHOUCE [LABOR AND WAGE HANDBOOK] 51 (1984).

25. *Id.* at 47.

26. Telephone interview with Dong, Chief Accountant and Engineer, State-Owned Enterprise in Chengdu (Dec. 13, 1998) [hereinafter Dong].

27. See *Id.* See also telephone interview with Wu, Union Chairman, State-Owned Enterprise in Chengdu (Dec. 13, 1998) [hereinafter Wu].

28. *Id.*

fulfillment of production plans that are made by the agreement of the teams and the enterprise management, according to the enterprise's plan and the state's plan under the wage fund control system.

## 6. Benefits

The simple and transparent structure of Chinese standard wages does not necessarily mean that it is easy to describe components of SOE employees' incomes. Cash income, wages (basic wages and efficiency wages), and bonuses are only one part of SOE employees' incomes. For a long time, SOE employees have gained much from China's high employment benefits with low wages policy.<sup>29</sup>

SOE employees usually enjoy health services, housing, pensions, education, and entertainment provided by their enterprises. In many cases the cost of these benefits exceeds the total wage bill, no matter how poor the actual quality of these social services.<sup>30</sup> A survey found that 70 percent of state enterprise workers felt that social benefits were as important as their cash incomes. In the same survey, workers reported that the most important social benefits were, in order of priority, health services, housing, and pensions.<sup>31</sup> Another survey of the social programs in 156 SOEs showed that non-wage labor costs for Chinese SOEs amount to more than 75 percent of labor costs of the average firm.<sup>32</sup> The largest component of these costs is housing, with recurrent subsidies equaling more than one-third of total labor payments. Pensions and health care are the next largest items, together equaling 35 percent of labor costs. Education is consistently the smallest component, amounting to 2 percent of the total wage bill.<sup>33</sup>

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29. See Gu, *supra* note 4, at 493.

30. See Wu, *supra* note 27. In a huge state-owned enterprise of about 20,000 employees, many of the teachers in the schools (*zidi xiao*) and the doctors in the enterprise hospitals are senior management's relatives who are not willing to be workers. They have little if any formal professional training. For example, my primary school teachers always gave me some difficult questions to ask my parents who have advanced education so that I could bring the answers back to my classmates.

31. ASIAN DEVELOPMENT BANK/MINISTRY OF LABOR PRC, STUDY OF SOCIAL WELFARE AND LABOR ADJUSTMENT FOR ENTERPRISE REFORM (Hewitt Associates, 1995). Cited in CHINA & MONGOLIA DEP'T, WORLD BANK, REP. NO. 14924-CHA, CHINA REFORM OF STATE-OWNED ENTERPRISES 27 (June 21, 1996) <<http://www.worldbank.org/pics/eco/14924>> [hard copy on file with author] [hereinafter WORLD BANK REPORT].

32. Hu Zuli, *Social Protection, Labor Market Rigidity, and Enterprise Restructuring in China* (IMF Paper on Policy Analysis and Assessment, Oct. 1994), cited in WORLD BANK REPORT, *supra* note 31, at 27.

33. The estimate of total social costs is conservative because the author used a conservative estimate for the housing subsidy and did not include costs for services such as kindergarten and dining halls. See HSU, *supra* note 11, at 32.

The enterprise reforms of the 1980s, which were intended to control cash wage increases, gave firms incentives to provide more social services using enterprise funds (*qiye ziyou jijin*). In particular, housing seems to have been used as a substitute for bonuses when bonuses reached levels that were officially discouraged or taxed. As a result, about two-thirds of China's housing supply was built by state enterprises during the construction boom of the 1980s. Between 1981 and 1992 the ratio of housing investment to GDP oscillated between 1.6 and 3.3 percent of GDP and the supply of housing grew quickly. The share of worker compensation from implicit housing subsidies grew from 7 to 16 percent between 1978 and 1988.<sup>34</sup> Between 1978 and 1992, aggregate state enterprise spending on labor insurance and welfare (including medical benefits, pensions, unemployment, disability, maternity, and other benefits) increased from 71 to 80 percent of total national spending in these areas.<sup>35</sup>

Chinese SOE workers receive a large portion of their compensation in the form of such in-kind benefits with relatively low wages. Until such benefits as implicit income are converted into a cash wage, workers will be extremely unwilling to leave their jobs if unemployment compensation replaces only cash wages. For a Chinese worker, the loss of a position in a state-owned firm means loss of medical benefits, shelter, pensions, and entertainment.

SOEs have been laying off redundant employees since 1985. They are paid 60% of their basic wages as a living stipend during the period they are waiting for a new job. Laid-off employees' living stipends are usually a little higher than unemployment benefits because they have kept their job position in the state-owned sector. Their health care benefits, housing, and other aggregate welfare do not cease as long as other employees enjoy benefits. On the other hand, former SOE workers who were permanently discharged from their jobs in the SOEs only receive an unemployment benefit amounting to the lowest wage. They are not eligible for any welfare benefits provided to the SOE employees.<sup>36</sup>

### C. Conclusion

Chinese SOE workers' income structure has changed along with economic reform. Before 1978, SOE employees' income consisted of standard wages and social services benefits from their enterprises. From

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34. WORLD BANK REPORT, *supra* note 31, at 27.

35. *Id.*

36. See *Accounting Rules*, *supra* note 20, at 41.

1978 to 1985, the components of SOE employees' income included standard wages, bonuses, and benefits. After 1985, floating wages or efficient wages were added.

All sources of SOE employees' incomes are controlled by the state although sometimes the state fails to do so. Before 1985, workers' wages were paid directly from the government budget through the state labor wage plan. After 1985, wages are paid directly by the enterprises through the wage funds that are still managed by the government through the system of the wage fund base. Bonuses and benefits come from the enterprise fund (*qiye ziyou zijin*) which is a part of the profits retained by the enterprise. The amount of the enterprise fund is decided by the state's share of the enterprise's profit. The state encourages SOEs to spend more in social service benefits than bonuses.<sup>37</sup> Now, we can see the whole picture of a state controlled distribution system within the SOE system in China. The state collects the profits made by SOEs and then redistributes them among the SOEs, then the SOEs distribute income to their workers in the form of wages, bonuses, and welfare benefits within the enterprise.

### III. WORKERS' PROPERTY RIGHTS

Redundant SOE workers who were laid off or facing unemployment brought property rights claims against the state and SOEs. Individual cases and massive protests were reported. They claimed wage and pension arrears, medical payment reimbursement, employment security, and enterprise property.<sup>38</sup> Among the reported 247 street protest cases in Henan Province in 1998, 199 cases were for property claims.<sup>39</sup> Most of these claims arise under the Chinese socialist labor theories discussed in Section I.

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37. See *Guowuyuan Guanyu Zhengque Shixing Jiangli Zhidu Jianjue Zhizhi Lanfa Jiangjin De Jixiang Guiding* [State Council's Prescriptions on Award System and Prohibitions on Excessive Bonus], in *CHINESE WAGE LAW*, *supra* note 14, at 273.

38. See News Brief (Oct. 1999) <<http://www.china-labor.org.hk/eindex.htm>> [hard copy on file with author].

39. General Office of the Henan Federal of Trade Union, *Analysis of Workers' Street Demonstrations in Henan Province during 1998* (1998) <<http://www.china-labor.org.hk/eindex.htm>> [hard copy on file with author] [hereinafter *Henan*].

A. *Wage arrears*

Many SOEs have not paid their workers for a certain period because of their poor financial conditions. These workers are creditors of their enterprises. When they leave the SOEs and terminate their contractual relationship, they require the SOEs to pay them their wage arrears. According to China's civil law, when a contract is terminated, the parties should liquidate their obligations and their rights.<sup>40</sup> The termination of a contract shall not injure any party's rights.<sup>41</sup> SOE workers' claims for wage arrears are under the protection of China's civil law and labor law.

B. *Workers' Share in State-Owned Property*

The redistribution of SOE income between SOE workers and the state begins with a massive extraction of accounting surpluses from industry by the state. Due to this, relieving the excessive tax burden of SOEs (*jianqing jiye fudan*) has been a hot topic during the whole reform era. Before 1978, all the after-tax profits generated by SOEs were turned over to the state (*tongshou tongzhi*).<sup>42</sup> However, the enterprises could retain a small amount of profit, amounting to about 0.7 percent of the profits in a year, to put into the enterprise fund.<sup>43</sup> From 1978 to 1983, SOEs could retain 10 to 30 percent of their profits (*lirui liuchen*) after tax. During 1978 to 1982, SOEs, on average, retained 22.7 percent of their profits after taxation per year.<sup>44</sup> Since 1983, the state has been enlarging the profit retention of SOEs. Until 1985, SOEs could retain about 41.6 percent of profits after taxation. From 1990 to 1992, the average level of profit retained by enterprises was 41.5 percent yearly.<sup>45</sup> During the same period (1978 to 1995), the SOE income tax rate was 55 percent while

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40. See ZHENG LI & WANG ZUOTANG, MINFA XUE [CIVIL LAW], 303-08 (1994).

41. Zhonghua Renmin Minfa Tongze [Civil Law Principles of People's Republic of China] (1987), 1994 ZHONGHUA RENMIN GONGHEGUO FALU FENLEI ZONGLAN, MIN FA [CLASSIFIED ASSEMBLAGE OF THE LAWS OF THE PEOPLE'S REPUBLIC OF CHINA, CIVIL LAW] 1, art. 115.

42. See Liu Zhicheng, *Woguo Gongshangshuizhi De Fazhan* [The Development of Industry and Commerce Tax in China], in ZHONGGUO DE CAIZHENG GAIGE [CHINA FINANCE REFORM] [hereinafter CHINA FINANCE REFORM] 53, 54 (Caizhengbu Jiaoyusi [Ministry of Finance Education Bureau], ed., 1986).

43. Tao Shengyu, *Guoying Qiye Cunshouru Fenpei Tizhi Gaige De Huigu Yu Zhanwang* [The History and Future of the Pure Income Distribution System Reform in State-Run Enterprises], in CHINA FINANCE REFORM, *supra* note 42, at 93, 96.

44. See ZHUANG, *supra* note 24, at 99.

45. See Xiang Huaicheng, *Caizheng Fenshuizhi* [Double-Tax System], DANGQIAN JIXIANG ZHONGDA JINJI TIZHI GAIGE [SEVERAL IMPORTANT ECONOMIC INSTITUTION REFORMS] [hereinafter INSTITUTION REFORMS] 86, 98 (Zhongyang Caijin Lingdao Xiaozu Bangongshi [Chinese Communist Party Central Committee Finance and Economy Leading Commission], ed., 1994).

collective enterprises and joint-ventures enjoyed an income tax rate of 33 percent.<sup>46</sup> According to these official reports, a Chinese state-owned enterprise had to submit about 80 percent of its income to the state in 1994. Compared to the income tax rate of other types of enterprises, SOEs had to submit 47 percent more of their income to the state.

Besides their higher taxation and heavy profit submission duty, SOEs usually have to share some public expenditure by donating money or goods to their local governments.<sup>47</sup> They have to pay for public activities such as city concerts, city sports meetings, birth-control policy propaganda (*jihua shengyu xiuanchuan*), public legal education, and funfests on all kinds of socialist or traditional holidays. SOEs also have to allocate persons to help organize these public activities. It is not rare for SOEs to establish a temporary department for some public purpose according to their local government's requirement.<sup>48</sup> This is called *tanpai* in Chinese. There is no statistical report on the amount of such public extraction from SOEs. However, it is estimated that a SOE has to spend 5 to 10 percent of its profits on such public expenditures. *Tanpai* is a heavy burden for the SOEs, especially for unprofitable SOEs.<sup>49</sup>

A conservative estimate is that a SOE had to contribute in total 78 percent of its gross profits to the state in the mid-1980s.<sup>50</sup> This contribution was an essential state financial resource, and through government investment, was put into state-owned enterprises and created tremendous state-owned property. Most of the surplus labor value was gathered as state property and designated as state fiscal income. State property has increased much faster than the productivity rate.<sup>51</sup> This means that the state capital accumulation has grown faster than wages.<sup>52</sup> The secret lies in the state capital producing process. The state reinvests surplus labor value into SOEs, and consequently, the reinvestment creates profits for the state. The state can also extract surplus labor value from

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46. Zhonghua Renmin Gongheguo Waishang Touzi Qiye He Waigo Quiye Suodeshui Fa [Income Tax Law of Enterprises with Foreign Investments of the People's Republic of China] (Jan. 1, 1982) 1991 ZHONGHUA RENMIN GONGHEGUO SHEWAI FAGUI HUIBIAN [LAWS AND REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA GOVERNING FOREIGN RELATED MATTERS] 81, art. 5. See also Jin Xin, *Gongshang Shuizhi* [Industry and Commerce Tax System], in INSTITUTION REFORMS, *supra* note 45, at 58, 59.

47. See Liu Biao, *Guanyu Gaige Guojia Yu Guoying Qiye Fenpei Tizhi De Jige Wenti* [Several Issues about the Distribution between the State and the State-Run Enterprises], in CHINA FINANCE REFORM, *supra* note 42, at 116, 137.

48. See Dong, *supra* note 26; Wu, *supra* note 27.

49. *Id.*

50. See Andrew Walder, *Property Rights and Stratification in Socialist Redistributive Economics*, 57 AM. SOC. REV. 524, 527 (Aug. 1992).

51. See ZHUANG, *supra* note 24, at 23.

52. Extraction of resources from rural areas also contributes to the fast accumulation of state property. However, agricultural productivity has hardly changed since 1952. Even under the contract responsibility system, agriculture productivity stopped increasing after the mid 1980s.

this cycle of production. This cycle of investment and production is exactly the same as the capital producing process described by Karl Marx. The only difference is that in a capitalist economy workers are paid their wages fully, while in China workers do not receive full compensation for their labor. Accordingly, the capital accumulation consists of only surplus labor value, while in China the state capital accumulation consists of surplus labor value, and labor value that is part of the cost of labor force reproduction.

Under Chinese socialist ideology, all profits of an enterprise are created by the workers. Chinese law entitles ownership to persons who create the property by their labor. Thus, workers and some scholars declare that the SOE workers' contribution entitles them to property rights to the state-owned industry, which is a huge enterprise consisting of thousands of productive entities.<sup>53</sup> In other words, SOE workers own a share of state-owned property, which is the surplus labor value created by the workers according to socialist ideology.<sup>54</sup> Workers claim their shares when they leave their jobs in the SOEs, or when their enterprises are liquidated for bankruptcy or sale.<sup>55</sup> The government tries to legitimize its policy of laying off or discharging workers without compensating them with a substantive share of state-owned property by explaining that workers' long-term benefits from the growth of the Chinese economy and development of society will reflect their ownership interests.<sup>56</sup>

### C. Social Welfare

SOEs transfer their property rights in the surplus labor value to the state for expected social security benefits in the future.<sup>57</sup> When they are about to terminate their relationships with SOEs, they expect to receive their wage residuals that they invested into their enterprises for their social welfare or social security.<sup>58</sup>

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53. See Chen Qingtai, *Xiandai Qiye Zhidu* [Modern Enterprise System], in INSTITUTION REFORMS, *supra* note 45, at 159, 164.

54. See He Chunlei, *Tizhixing Shiye Yu Zaijiuye: Jiben de Zhengce Xuanze* [Institutional Unemployment and Re-employment: the Basic Policy Choices], 2 JINGJI GUANLI [ECON. MGMT.] 52, 52-53 (1998).

55. See Henan, *supra* note 39.

56. Hu Baojun, *Xiagang Daiye Yu Zhurenweng Diwei* [Laid-off and Ownership Status], RENMIN RIBAO [PEOPLE'S DAILY], June 2, 1998, at 10. See also Zhao Zhenhua, *Zhenyang Renshi Jianyuan Zengxiao* [How to Understand Decreasing Employment and Improving Efficiency], RENMIN RIBAO [PEOPLE'S DAILY], Sept. 8, 1998, at 10.

57. See the discussion in note 52 *supra*.

58. See Yan Wenguang, *Guoyou Qiye Neibu Laodong Yu Ziben Goucheng* [On the Relationship between Labor and Capital in State-Owned Enterprises], 2 XIANDAI QIYE [J. MOD. ENTERPRISES] 38, 38-39 (1997).



The state does leave a part of surplus labor value to the enterprises in the form of collective welfare funds. The enterprises' social services and insurance are paid by the collective welfare fund. Through this decentralized social welfare system, a part of workers' surplus labor value is paid back through benefits.

From another perspective, the SOE workers voluntarily transfer their surplus labor value to the state for future benefits. They have lent their surplus labor value to the state. They presumably believe that the state will pay them back through pensions, free medical services, housing and education for their children, as the state did in the past for their parents. The fact is that they do not have welfare at present and will not enjoy the benefits after their retirement. The benefits paid back to them are much less than their contribution. Therefore, the state owes another debt to SOE workers. The relationship between laid-off SOE workers and the state is the relationship between a borrower and her lenders.<sup>59</sup>

#### D. Membership

Properties are able to produce benefits that can be either material or nonmaterial, and property rights are rights to benefits on certain properties. Membership is a kind of nonmaterial property. People obtain membership when they conform to certain qualifications, such as payment of dues, education or profession. Membership makes people eligible for either monetary or spiritual benefits. Because of the great benefits from membership in SOEs, SOE workers are reluctant to give up their status as SOE employees.<sup>60</sup>

A SOE is a closed community where workers presumptively had lifelong tenures. For many years they even had the right to transfer their jobs to their children when they retired. Each employee in the enterprise is eligible for enterprise welfare. The distribution is totally egalitarian. SOE workers also have the right to participate in the enterprise's

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59. See He, *supra* note 54, at 52-53.

60. See *Id.*; Hu, *supra* note 56, at 10; Zhao, *supra* note 56, at 10. See also Jian Gongzhan & Xiang Wupeng, *Qiye Pochan Zhengdun Youquan Caijian Renyuan* [An Enterprise Has Rights to Discharge Employees for Reorganization], RENMIN RIBAO [PEOPLE'S DAILY], Sept. 9, 1998, at 12 (In the reported case, two SOE workers were laid off before their employment contracts expired when the enterprise was liquidated for bankruptcy. After the creditors and the enterprise entered into a reorganization compromise, the bankruptcy procedure stopped and the two workers requested their jobs back. The court rejected the workers' suit on the ground that a state-owned enterprise can discharge its employees because of economic difficulties even if the employment contracts had not expired, and further, that neither the SOE nor the government has a duty to find the workers other SOE jobs). See also Feng Kui, *Xiagang Zhigong Weihe Bu Yuanyi Lingqu "Xiagang Zheng"?* [Why Laid-off Employees Do Not Want to Get a "Laid-off Employee Certificate"?], RENMIN RIBAO [PEOPLE'S DAILY], June 7, 1998, at 4.

democratic management.<sup>61</sup> They participate in and supervise the management through the Employee Representative Conference (*zhigong daibiao dahui*).<sup>62</sup>

The contract employment system contemplates that workers will be subject to layoffs after the specified term of their employment contract. In addition, it contemplates that the enterprise will shed responsibility for most housing and welfare functions, many of which will be left increasingly to the market, and for retirement and disability benefits, which are to be taken up by general social insurance systems.<sup>63</sup>

In fact, the membership scheme has survived the state-owned enterprise reform because the implementation of the new system has been slow and erratic.<sup>64</sup> The establishment of government programs compatible to the social insurance functions of the SOEs has been very slow. Thus, the enterprises retain many of their welfare functions. The idea of presumptive tenure for workers is unlikely to be abolished. The 1995 Labor Law makes tenure mandatory for workers who have been with the enterprise for ten years.<sup>65</sup> Some of the reformed enterprises have even continued the SOE tradition of enterprise-focused collective consumption. Although the new consumer goods markets have reduced dependence on enterprises for such goods, enterprises continue to provide consumer goods to their workers.<sup>66</sup>

Due to the failure of reform proposals, the membership system is also explicitly prescribed in the 1994 Company Law, principally in the requirement that a company set aside five to ten percent of its profits for a "common welfare fund" to be used for "collective welfare programs of the company's workers."<sup>67</sup> In fact, SOEs continue to be closed communities with a reduced but substantial range of collective cultural

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61. See David Ellerman, *Workers' Cooperatives: the Question of Legal Structure*, in *WORKER COOPERATIVES IN AMERICA* 257 (Robert Jackall & Henry M. Levin eds., 1984). Ellerman points out that membership rights = voting rights + economic profit rights (present and future). *Id.* at 272.

62. *Zhonghua Renmin Quanmin Suoyou Zhigongye Qiye Fa* [State-Owned Industrial Enterprise Law of the People's Republic of China] (Apr. 13, 1988) 1994 *ZHONGHUA RENMIN GONGHEGUO FALU FENLEI ZONGLAN, JINJI FA*, VOL. 2 [CLASSIFIED ASSEMBLAGE OF THE LAW OF THE PEOPLE'S REPUBLIC OF CHINA, ECONOMIC LAW] 1209, art. 5. See also *Zhonghua Renmin Gongsi Fa* [Company Law of the People's Republic of China] (Jul. 1, 1994) 1994 *ZHONGHUA RENMIN GONGHEGUO FALU FENLEI ZONGLAN, JINJI FA*, VOL. 2 [CLASSIFIED ASSEMBLAGE OF THE LAW OF THE PEOPLE'S REPUBLIC OF CHINA, ECONOMIC LAW] 1034, art. 45, 55 [hereinafter *Company Law*].

63. See William H. Simon, *The Legal Structure of the Chinese "Socialist Market" Enterprise*, 21 *IOWA J. CORP. L.*, 267, 268 (Winter 1996).

64. *Id.* at 270.

65. See *Zhonghua Renmin Laodong Fa* [Labor Law of the People's Republic of China] (Jan. 1, 1995) *ZHONGHUA RENMIN GONGHEGUO XIANXING FALU XINGZHENG FAGUI HUIBIAN* (1949-1994), VOL. 2 [COLLECTION OF LAWS & REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA (1949-1994)] 2214, art. 16, 20 [hereinafter *Labor Law*].

66. See Dong, *supra* note 26; Wu, *supra* note 27.

67. *Company Law*, *supra* note 62, art. 177.

and consumption responsibilities. Nevertheless, there is a trend, particularly in SOEs converting to stock companies, to try to spin off housing and other consumption activities into separate organizations. These separate organizations operate on a fee-for-service basis.

One aspect of corporatization that bears on the membership theme is worker shareholding. Together with managers, employees hold substantial stocks in most corporatized enterprises. Although employee shares typically cannot be sold outside the enterprise and have to be relinquished on departure, when employees get shares, their membership and other property interests become transferable within the enterprise. The purpose is to counter employees' pressures for short-term income distribution by giving them a capital stake designed to reflect long-term enterprise performance.<sup>68</sup>

Membership as a SOE worker is of great value to workers not only because of the monetary benefits, but also because they regard their job as their whole life position and their social identity within society. Most of them have worked on the same job for many years and have invested much time and energy to develop the particular skills required because they assumed that they would be there for life. Their promotions and wage increases, even their reputation and their families' reputation, are all decided by their job performance in their enterprise community. SOE workers regard themselves as the owners of the nation and the leaders of the Chinese people. When their relationship with the SOEs cease, they lose their high self-esteem as members of a leading class.<sup>69</sup>

#### IV. PRESENT UNEMPLOYMENT LAW AND POLICIES

Chinese SOE law, regulations and policies reflect SOE workers' property rights claims. Generally, the Chinese legal system provides SOE workers with legal security for their property rights in their jobs. Although this does successfully maintain a stable society, from a free market perspective, such legal security for SOE workers' priorities impedes Chinese SOEs' privatization or reorganization.

##### A. *Present Legal Scheme for Unemployment*

China does not have a code or a statute for unemployment. The rules dealing with employment termination, unemployment benefits, unemployment insurance, and other legal issues related to unemployment

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68. See Simon, *supra* note 63, at 274.

69. See Henan, *supra* note 39.

are found in the Bankruptcy Law (1988);<sup>70</sup> the Regulation of State-Owned Enterprises' Employee Waiting-Employment Insurance (1993);<sup>71</sup> the Regulation of State-Owned Enterprise Redundant Employee Deployment (1993);<sup>72</sup> the State Council's Supplement Announcement on the Issues in State-Owned Enterprise Acquisition, Bankruptcy and Employee Re-employment in Several Cities (1997);<sup>73</sup> and the Chinese Communist Party Central Committee and the State Council's Announcement on State-Owned Enterprises Laid-off Employees' Basic Living Security and Re-employment (1998).<sup>74</sup> China's SOE unemployment law is concerned with three major issues: (1) employees' property rights in SOE liquidation when SOEs are reorganized due to bankruptcy or acquisition; (2) the reemployment of SOE workers with continuing employment relationships; (3) social security for unemployed SOE workers whose SOE employment relationships have been terminated. Because the rules for these issues are based on both Chinese socialist labor theory and market oriented reform policy considerations, contradictions between the two cause some inconsistencies in the law.

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70. Zhonghua Renmin Qiye Pochan Fa [Enterprise Bankruptcy Law of the People's Republic of China] (Nov. 1, 1988) 1994 ZHONGHUA RENMIN GONGHEGUO FALU FENLEI ZONGLAN, JINJI FA, VOL. 2 [CLASSIFIED ASSEMBLAGE OF THE LAW OF THE PEOPLE'S REPUBLIC OF CHINA, ECONOMIC LAW] 1205 [hereinafter Bankruptcy Law].

71. Guoying Qiye Zhigong Daiye Baoxian Tiaoli [Regulation of State-Owned Enterprises' Employee Waiting-Employment Insurance], in CHINESE WAGE LAW, *supra* note 14, at 5 [hereinafter *Employment Insurance*].

72. Guoyou Qiye Fuyu Renyuan Jianyuan [Regulation of State-Owned Enterprise Redundant Employee Deployment] (1993), in YOUGUAN SHEHUIZHUYI SHICHANG JINJI FAGUI HE ZHENGCE HUIBIAN [LAWS AND POLICIES ON SOCIALIST MARKET ECONOMY] 1511 (1996).

73. Guowuyuan Fachu Zai Ruogan Chengshi Shixing Guoyou Qiye Jianbing Pochan He Zhigong Zaijiuye Youguan Wenti De Buchong Tongzhi [State Council's Supplement Announcement on the Issues in State-Owned Enterprise Acquisition, Bankruptcy and Employee Re-employment in Several Cities], RENMIN RIBAO [PEOPLE'S DAILY], Apr. 21, 1997, at 1 [hereinafter *Enterprise Acquisition*].

74. Zhonggong Zhongyang Guowuyuan Guanyu Qieshi Zuohao Guoyou Qiye Xiagang Zhigong Jiben Shenghuo Baozhang He Zaijiuye Gongzuo De Tongzhi [The Chinese Communist Party Central Committee and the State Council's Announcement on State-Owned Enterprises Laid-off Employees' Basic Living Security and Re-employment], Section 3, RENMIN RIBAO [PEOPLE'S DAILY], June 23, 1998, at 1 [hereinafter *Laid-off Employees*].

## 1. Employees' Priority in Liquidation

Employees enjoy the first priority as creditors in a liquidation procedure. Employees' wage arrears and labor insurance must be paid before the other creditors can distribute bankrupt property.<sup>75</sup> The bankrupt enterprise must also allocate funds for employees' re-employment services. The wage level should not be lower than three times the average annual wage in the city where the enterprise is located. The funds for re-employment services can be raised by selling the enterprise's land rights. If the land price is insufficient for the re-employment funds, the enterprise should pay the rest through other unmortgaged properties. If the value of unmortgaged properties is less than the re-employment funds, the enterprise should pay for the fund with its mortgaged property. The government will pay for the rest of the re-employment funds if the enterprise still lacks financial resources for the re-employment funds after selling all of its properties.<sup>76</sup> In short, no other creditors can be paid before employees' property claims are satisfied.

During the bankruptcy process, the enterprise must pay its employees' living expenses. These are deducted as part of the administrative costs of bankruptcy.<sup>77</sup>

## 2. Laid-off Workers

According to the interpretation of the Ministry of Labor and Social Security, laid-off workers are SOE employees who have not ended their employment relationship with the SOEs, have not been assigned to any job position for three months due to the SOEs' economic difficulties, and do not have a new job.<sup>78</sup> Hence, there are two types of laid-off workers within the definition. The first type is "laid-off workers hired before the contractual employment system."<sup>79</sup> Usually these workers were employed before 1986 when the contractual employment system was put in place. They made employment contracts with SOEs between 1986-1996. Most of them have tenure or have employment contracts of ten years or longer. The second type of laid-off workers are those that were hired after 1986 and whose employment contracts have not expired at the time when they have to leave their job positions in their SOEs.

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75. See Bankruptcy Law, *supra* note 70, art. 37(1).

76. See *Enterprise Acquisition*, *supra* note 73.

77. See Bankruptcy Law, *supra* note 70, art. 37(1).

78. Zhengce Jieda [Ministry of Labor and Social Security - Policy Interpretation], RENMIN RIBAO [PEOPLE'S DAILY], Aug. 24, 1998, at 12.

79. See *Laid-off Employees*, *supra* note 74.

### (a) Severance Payment

Laid-off employees leaving their SOEs can choose severance pay instead of re-employment services. The severance payment should amount to three times of last year's average annual wage in the city where the employee lives or worked.<sup>80</sup> The regulation does not mention factors like seniority and job position, which are wage determiners in SOEs. One resulting problem is that the severance payment is the same amount, no matter how much the workers' wages were and how long they worked in the SOEs.

### (b) Re-employment Services

Local governments and SOEs that lay off employees are required to establish re-employment services. SOEs, local governments and unemployment insurance funds<sup>81</sup> are each responsible for one-third of the cost of re-employment services in SOEs with deteriorating profitability. Profitable SOEs should pay all the expenses of their re-employment services. The government allocates funds to SOE re-employment services. Re-employment services supply laid-off employees with a living stipend, which can be a little higher than unemployment relief. Re-employment services should help laid-off employees to find new jobs. When laid-off employees find jobs, they should no longer enjoy any benefits provided by their re-employment services. If a laid-off employee does not find a new job within three years, he can not stay in the re-employment service and he will be treated as unemployed rather than laid-off.<sup>82</sup>

### (c) Welfare Benefits

Medical services, housing, and social insurance will not stop as employees are laid off. Laid-off employees have the same benefits as their colleagues who remain in their SOE job positions. Their welfare benefits will be provided by their former enterprises until they have a new job. Each enterprise's re-employment service manages the funds for a laid-off worker's welfare benefits.<sup>83</sup>

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80. *Id.*

81. Since 1993, all SOEs have been required to submit 0.6% of their wages to the government to set up unemployment insurance funds. See *Employment Insurance*, *supra* note 71, at 5.

82. See *Laid-off Employees*, *supra* note 74.

83. *Id.*

### 3. Unemployed Workers

Employees discharged from SOEs lose their job positions in the state-owned economy. They are unemployed and ineligible for benefits from re-employment services. They can only get unemployment benefits from local unemployment insurance funds. These unemployment benefits are available for at most 12 months for a worker who has worked for 1 to 5 years, and for at most 24 months for a worker who has worked longer than 5 years.<sup>84</sup>

#### *B. Effects of the Present Law and Policies*

SOE employees have great property interests in their jobs and their enterprises. In order to keep a society with massive unemployment stable, the government chooses to secure SOE employees' property interests. Although the legal security for SOE laid-off employees may effectively help to maintain a stable society in the short-term, in the long run it will impede the growth of a free labor market and free capital market. As an official union's report points out, "the laws and policies that have already been formulated suffer from considerable limitations and often result in the authorities resorting to emergency and stopgap measures. We are still a long way off from having laws and policies that can cope with the new realities."<sup>85</sup> The dilemma of China's unemployment policy is rooted in its political economic premises.

China's unemployment regulations and policies struggle to be consistent with socialist labor theories and socialist ideological dogmas while aiming for a free labor market. The lawmakers' goal is the growth of a free labor market; however, the unemployment regulations, which are embryos of future employment law, raise labor costs through expensive re-employment services and enterprise welfare. The law intends to satisfy employee property rights as fully as possible. It even sacrifices investors' property rights in bankruptcy law for SOE employees' benefits, which may harm the infant capital market seriously, especially in localities.

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84. *Id.*

85. See He, *supra* note 54, at 52-53.

### 1. Impacts on SOEs' Creditors and the Capital Market

In the State Council's Supplement Announcement on the Issues in State-Owned Enterprise Acquisition, Bankruptcy and Employee Re-employment in Several Cities (the embryo of China's new bankruptcy law), SOE employees receive unique privileges to maintain their economic interests in SOEs. Without paying for the re-employment fund fully, no creditor is able to get back a penny no matter whether the property is mortgaged or not, while the living stipend paid to employees during the bankruptcy process is deducted as an administrative cost.

Two effects of this law are foreseeable. First, enterprises are able to transfer their assets to their re-employment services. They can use bankruptcy as a strategy to evade their debts. This will cause creditors, most of whom are also state-owned banks, great damage. The poor credit system in the state-owned economy may get worse through these bankrupt enterprises' illegal practices of "fake bankruptcy." In fact, the State Council requires local governments to pass local legislation to regulate bankruptcy procedure and to protect creditors, mainly state-owned commercial banks, from the widely prevailing "fake bankruptcy."<sup>86</sup>

Local governments may have an incentive to encourage their SOEs to apply for bankruptcy because re-employment funds go to local governments. In this way, the local government can help SOEs to shed their debts to creditors outside the locality. Such localism will impede a nation-wide free capital market.

SOE employees' priority status will also stop investment flows to SOEs. Investors are unable to receive guarantees for their investment because the employees and the local government will hold most of the property of a bankrupt enterprise. Moreover, the offeror in a merger or acquisition has to pay the re-employment cost for all laid-off employees. With such an additional cost, SOEs are far more expensive than private enterprises and therefore much less attractive. The re-employment requirement adds a large amount of cost to SOE reorganization.

Secondly, it will be difficult for creditors to prevent the liquidated enterprises and their employees from transferring assets during the bankruptcy procedure. The worst is that managers and local government officials can easily seize properties under the cover of laid-off living stipends or re-employment fund allocations. Additionally, creditors may compete for privileges from the money designated as the re-employment

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86. Guifan Pochan, Guli Jianbing, Dali Shishi Zaijuye Gongcheng [Regulating Bankruptcy, Encouraging Acquisition, Constructing Re-employment Project], RENMIN RIBAO [PEOPLE'S DAILY], Apr. 21, 1997, at 1 [hereinafter *Regulating Bankruptcy*].



fund. Corruption will be inevitable. It means that it will be more costly and more risky to invest in Chinese SOEs.

The purpose of laying off employees was to improve SOEs' labor and capital structure. SOEs need to attract more capital and reduce redundant labor. However, SOE employees' dominant privileges in SOE reorganization thwarts capital flow to SOEs and therefore conflicts with policy intention.

## 2. Huge Expenses for SOEs

The Chinese Communist Party Central Committee and the State Council's Announcement on State-Owned Enterprises Laid-off Employees' Basic Living Security and Re-employment (1998) requires SOEs with laid-off employees to establish re-employment services. Although the government shares part of the cost of re-employment services, re-employment services are still expensive for SOEs in financial difficulties.<sup>87</sup>

SOEs have to pay laid-off employees' living expenses. Laid-off employees' housing, medical care and some other benefits will continue until they find a new job, and their enterprises also have to pay pension insurance for them.<sup>88</sup> Thus, SOEs only marginally reduce their wage costs because the laid-off living stipend is lower than wages. Laying off redundant employees does not reduce the enterprises' burden effectively.

On the other hand, laid-off employees remaining in re-employment services still stay within SOEs. They not only receive living stipends from their SOEs, but they also expect re-employment in the state-owned sectors, even if they may not be able to stay with their original employers. With such an expectation, they try to keep their laid-off status as long as they can. Thus, many laid-off workers keep their new jobs secret so that they can retain SOE employees' social security benefits, such as livelihood allowance, medical insurance and other social welfare.<sup>89</sup>

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87. See JIANG JIAJUN & WANG KEZHONG, *SHEHUI ZHUYI CHUJI JIEDUAN DE LAODONG GONGZI HE SHEHUI BAOZHANG* [LABOR WAGES AND SOCIAL SECURITY IN THE PRIMARY PERIOD OF SOCIALISM], 77 (1994).

88. Sun Bin et al., *Shanghai Zaijiuye Zhidu Diaocha Baogao* [Report on the Survey of Re-employment System in Shanghai], 3 FUDA DAXUE XUE BAO (SHEKE BAN) [J. FUDAN U. (SOC. SCI.)] 102, 102-108 (1997).

89. See Yan, *supra* note 58, at 38-39.

### 3. Impacts on Social Security System and SOE Reform

A well-recognized problem that was a cause of the fall of China's SOEs is that an individual enterprise has to bear the costly responsibility for its workers' social welfare. Such a social welfare system is called "enterprise administrating a society" (*qiye ban shehui*).<sup>90</sup> It is a source of problems for both social security and state-owned enterprise reform: problems for social security, "because it makes the cover dependent on the financial position of the enterprise, eroding its uniformity and reliability; problems for enterprise reform, because it forces the government to subsidize loss-making enterprises for reasons of social welfare."<sup>91</sup> The goal of SOE reform and the social security system is to end the "dependence of the unemployment insurance and pension system on individual enterprises."<sup>92</sup>

However, present regulations require SOEs to establish re-employment services and take responsibility for laid-off workers' re-employment and social welfare (with governmental subsidies if the enterprise is a loss-maker). This policy brings the Chinese social security system back to its pre-reform model, under which the government allocated welfare funds to the enterprises and the enterprises bore the cost of administration of the social welfare system. This tremendous retrogression in social security reform has caused serious problems.

First of all, the enterprise has to bear at least one-third of the expense of the re-employment service program, including administrative costs and laid-off workers' livelihood allowance and other welfare. SOEs are not willing to shoulder the responsibility of establishing the re-employment service centers. They attempt to shift the burden to the government. The central government prevents any SOE without a re-employment service center from laying off any workers.<sup>93</sup> Some SOEs have to keep their redundant workers because it will be more expensive for them to lay off these workers. These SOEs are trapped into high labor expenses that were supposed to be shed through SOE reform and social security system reform. Some SOEs were sold to non-state-owned companies without liquidation and their workers were discharged immediately after the acquisition. They are not eligible for any laid-off

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90. See Chen, *supra* note 53, at 160.

91. See Athar Hussain, *Social Security in Present-Day China and Its Reform*, 84 AM. ECON. REV. 276, 278-79 (May 1994).

92. See Dwight Perkins, *Completing China's Move to the Market*, 8 J. ECON. PERSP. 23, 39 (Spring 1994).

93. See He Jingsong, *Yanglao Baoxian He Zaijiuye Fuwu Zhongxin Jianshe De Ruogan Wenti* [The Problems of Aging Insurance and Re-employment Service Center], RENMIN RIBAO [PEOPLE'S DAILY], July 27, 1998, at 2.

workers' benefits or social security as former employees of the private sector.<sup>94</sup> The local governments encourage such kinds of acquisition as they can save funds spent on laid-off workers' re-employment services and are also rid of the burden of those loss-making enterprises.<sup>95</sup>

On the other hand, the established expensive re-employment service centers have not satisfied the demands of laid-off workers. Many re-employment service centers do not even have sufficient funds to pay laid-off workers' livelihood allowances.<sup>96</sup> They can barely find job positions inside or outside the state-owned sector for the huge number of laid-off workers.<sup>97</sup> Their re-employment training programs do not satisfy the expectations of either laid-off workers or potential employers.<sup>98</sup>

The re-employment service center system pushes the Chinese social security system backwards to the pre-reform decentralized social security model. A worker's social security depends on the economic conditions of his/her enterprise and the fiscal conditions of the local government. Ultimately, it depends on how much money the enterprise can obtain for him/her from the government.<sup>99</sup> This will expand the inequality of distribution in the society. Moreover, laid-off workers may lose their social security because the enterprises and local governments circumvent the law through selling the enterprises to non-state-owned investors.

## V. FURTHER LEGAL RESOLUTIONS

China has chosen a route of evolutionary transformation from a central-planned economy to a free-market economy. The wide gap between intentions and unexpected outcomes has imposed pressures on the existing institutional structures and demanded further institutional adjustment. The employment system reform, which accompanies and serves the SOE reform, also has to adjust its policies to achieve the goal of a free market, one component of which is the free labor market. China's unemployment law and regulations for reorganized SOEs are aimed at the reform of the whole employment system. A free labor market cannot grow up and function efficiently under the present

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94. See *Regulating Bankruptcy*, *supra* note 86.

95. Shasha "Mai Qiye" Zhe Gufeng, [New China News Commentator for People's Daily, Stop "Selling Enterprises"], RENMIN RIBAO [PEOPLE'S DAILY], Aug. 5, 1998, at 11.

96. See He, *supra* note 54, at 52-3.

97. See Peng Jialing, *Zaijiuye Gongchen San Nian Huigui* [Retrospect of Three Years of the Re-employment Project], RENMIN RIBAO [PEOPLE'S DAILY], May 13, 1998, at 1.

98. Xiagang Zhigong PeiXunban Bugai Ruci Lengqing [Laid-off Worker Training Programs Should not be So Poorly Attended], RENMIN RIBAO [PEOPLE'S DAILY], May 27, 1998, at 10.

99. See Walder, *supra* note 50, at 536-537.

unemployment law which struggles to be consistent with the dogmas of socialist labor theories and to satisfy SOE workers' property rights claims legitimized under these theories.

It is unfair to deny SOE workers' property claims in SOEs or in China's state-owned property. These workers have contributed to their SOEs under the low wage policies, and they also receive economic benefits from their membership as SOE employees. However, the issue is whether they should keep their property rights granted by an old system that is losing its legitimacy and is to be abolished. The current law, which protects these property rights in almost their entirety, has become an obstacle to the development of a free labor market and has unjustly injured the property rights of other citizens such as creditors of SOEs. For the purposes of justice and efficiency, Chinese law should not make sacrosanct laid-off SOE workers' property rights but instead should give modest compensation.

#### A. *The Experience of American Employment Law*

The traditional American adherence to the assumption that employment should be at-will has been broken down. In situations where dismissal is precipitated by factors beyond the control of the employee as an innocent victim, the employer is required to provide some cost of dislocation from the workplace.<sup>100</sup>

That a job is property has become widely accepted. Since the 1970s, American employees have been increasingly tied to their jobs:

The new ties that bind an employee to his job — seniority, pension rights, and related benefits — together with traditional constraining factors — fear of the unknown and economic pressure — simultaneously provided an employee with security and limit his freedom to change jobs as service with a particular employer accumulates. . . . Thus, at some point in the early years of employment, an employee begins to sense that he has made an investment which will be lost if he leaves before vesting occurs.<sup>101</sup>

The courts and legislatures have recognized the perception of 'new property' for economic security.<sup>102</sup>

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100. See Frances Raday, *Individual and Collective Dismissal -- A Job Security Dichotomy*, 10 COMP. LAB. L. J., 121,123 (Winter 1989).

101. See Mary Ann Glendon & Edward Lev, *Changes in the Bonding of the Employment Relationship: An Essay on the New Property*, 20 B. C. L. REV. 457, 476-477 (1979).

102. *Id.* at 479-483.

From a later perspective of corporate law, shareholders' property rights are based on the shareholders' willingness and ability to "pay" more than other stakeholders for supremacy and to bear all the risk in corporation's gaining explicit contractual protection, and efficiency. Thus, shareholders obtain a legal claim on corporate residuals. These justifications for shareholder preeminence, however, do not adequately distinguish the interests of shareholders from those of employees. Employees also have property claims for the residual interest in corporations as Greenfield has argued:

Employees, too, bear agency costs of monitoring management to ensure that management fulfills its part of the implicit and explicit understandings that define the relationship. Employees, too, retain an unfixed, residual interest in their firm; their fortunes rise when the company does well, and they are worse off when the company founders. Employees, too, enter into long-term, relational contracts with management in which it is very difficult to reduce all important aspects of the agreement to writing.<sup>103</sup>

With the recognition of employees' property interests in their jobs that directly affect their social security benefits, especially pensions, Congress has passed several statutes to protect such property interests in long-term employment.

First, during the bankruptcy process, unions may bring out proposals for necessary and feasible modifications to employee benefits. Under this rule, employees get an opportunity to maintain their benefits during company reorganization as long as "all creditors, the debtor and all of the affected parties are treated fairly and equitably." 11 U.S.C. § 1113.<sup>104</sup>

Second, "§507(a)(3) of the federal bankruptcy law gives employees preference over general creditors as to wages earned but uncollected before bankruptcy. This preference is limited to \$2,000 per employee."<sup>105</sup> However, employees are not eligible for this preference when they voluntarily did not collect their wages to help their companies surmount the financial hardship.<sup>106</sup> In such a situation, the employees can foresee the risk of their uncollected wages. They lend their money to the

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103. See Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B. C. L. REV. 283, 321 (Mar. 1998).

104. See MARK A. ROTHSTEIN & LANCE LIEBMAN, *EMPLOYMENT LAW: CASES AND MATERIALS*, 1058 (5<sup>th</sup> ed., 1998).

105. ROTHSTEIN & LIEBMAN, *supra* note 104, at 1059.

106. See *Law v. Law Trucking Co.*, 488 A. 2d 1225, 1228 (R.I. 1985).

company so that they may be able to keep their jobs. They should bear the loss of their loan to the company as other creditors must.

Third, "[w]hen a pension plan covered by Title IV of ERISA [Employee Retirement Income Security Act] terminates without sufficient funds, the PBGC [Pension Benefit Guarantee Corporation] takes over the assets and liabilities of the plan and makes up any deficiency in plan assets from its own funds. PBGC funds are drawn from the annual insurance premiums paid by administrators of covered plans as well as employer liability payments collected when a plan terminates for insufficient funds. 29 U.S.C. §§ 1306, 1307, and 1362."<sup>107</sup>

Fourth, in 1988, the United States Congress enacted the first federal statute restricting employer authority to shut factories: the Worker Adjustment and Retraining Notification Act (WARN), 29 U.S.C. §§ 2101-2109, applying to businesses that employ at least 100 workers. A "plant closing" is a shutdown at "a single site" resulting in loss of work for at least 50 employees. Employers must give 60 days notice to a union, to each worker, and to state and local government officials before closing a plant.<sup>108</sup> However, a report found that "70% of covered employers failed to give advance notice to employees before a mass layoff or plant closing and 54% failed to file advance notice with state officials" as required by the WARN Act. The reason is that the implementation cost is too high for employees and the government. Employees' private actions against employers' failure to give notice are too expensive and the remedies are limited. Additionally, employees are always facing the problem of collective action. "Moreover, local governments are reluctant to bring cases for fear of appearing anti-business."<sup>109</sup>

The federal government regulates the labor market to reduce employees' risks. Although American employment law protects employees' property interests in their job security, such protection is available only when other creditors are treated fairly and when the law does not interfere with employers' rights to make their own business decisions.<sup>110</sup> In other words, employees' property interests in their job security will be protected only if the employees' priority will not break the competitive order of labor and the capital market. Otherwise, employees will have to bear the risk of their investments in their jobs.

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107. *In re Chateaugay Corp.*, 130 B.R. 690, 695 (S.D.N.Y. 1991).

108. ROTHSTEIN & LIEBMAN, *supra* note 104, at 1083.

109. *Id.* at 1090.

110. *See* Local 1330, *United Steel Workers of America v. United States Steel Corp.*, 631 F.2d 1264, 1282 (6<sup>th</sup> Cir. 1980).

### *B. Possible Solutions for China*

With reference to America's experiences, China may have possible solutions:

#### 1. Employees' Priority in Bankruptcy Law

In Chinese bankruptcy law, SOE employees have foremost priority. This priority includes not only their wage arrears but also their unemployment benefits (re-employment funds). As the foregoing analysis found, this hurts creditors' rights in a fair capital market. A possible solution may be (1) to make wage arrears a priority only in liquidation; and (2) to give SOE unions and a creditors' conference joint responsibility for the re-employment plan. Under such a legal scheme, the conflicting interests of laid-off employees and creditors can be balanced through bargaining.

#### 2. Social Insurance

The state should establish a unified social insurance system like the PBGC to replace the dispersed re-employment services in SOEs. Only when the state takes on the tasks for supplying unemployment benefits, medical care and pensions when SOEs are not able to continue their obligations, can SOEs be rid of their heavy burden of redundant employees. A unified social insurance system is also necessary for a free labor market. In a free labor market, laborers transfer between areas and industries frequently. The unified, multi-employer benefit system is a back-up system for labor transferability.

#### 3. Re-employment Projects

Employees have property interests that are created by employees' long-term human capital investment in their jobs or in their companies. Both China and the United States tend to protect employees from property losses due to corporate reorganization. The difference between the two countries' policies is that the United States terminates the employment relationship immediately, while China keeps it for at most three years. The employers' re-employment services are responsible for employees' living expenses and job allocation for three years. Thus, while American employees bear the risk of their human capital investment, Chinese SOE employees bear almost no risks. If an investor can gain benefits with no risk, she may make excessive investments causing a waste of resources. This may be one reason why SOE

employees would rather stay at their jobs doing nothing. The expensive re-employment project might effectively assist the state in keeping a stable society, but on the other hand, it impedes SOE employees' transferring to new jobs. Thus, the re-employment project should not be a long-term policy in bankruptcy and corporate law.

## CONCLUSION

Supported by the labor commodity theory, China established the labor contract system. When labor becomes a commodity that can be bought and sold on the factor resources market in socialist ideology, the Chinese government has no difficulties in discharging SOE employees. Although SOE employees have property rights in their enterprises, they should have to bear the risk and loss of their human capital investment as other capital investors do. The high priority of SOE employees in SOE reorganization will impede the transfer of redundant employees to new jobs. It will also thwart the growth of a free labor market and a free capital market. A unified social welfare system managed by the state will be an efficient back-up system for SOE reorganization and will enable SOEs to get rid of their heavy burden of redundant laid-off employees. SOE employees' property claims should not be an obstacle to SOEs' labor and capital reorganization.