
Foreign Enterprises and Human Resources

The reasons why foreign firms generally tend to hire and fire on merit is that they must answer to owners who care first and foremost about the bottom line. . . . If they don't pay for performance, they will soon go out of business. By doing so they foster the radical notion—radical at least in China . . .—that individual merit matters and should be rewarded.

This sense of the value of the individual and of fairness is intrinsic to capitalism. It is, at the same time, an essential characteristic of a culture which respects human rights.

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Introduction

Having gotten its “chops,”¹ the FIE in China faces the first task of any business: securing the employees that will make it run. In examining the human resource issues that arise for FIEs in China today, this chapter makes three main points. First, by providing an overview of the day-to-day challenges of personnel management, from negotiating the labor contract onward, it demonstrates how deeply involved foreign firms have become in the development of the Chinese economy. Second, it makes clear that human resource problems account for many of the difficulties suffered by FIEs in the Chinese market: thus exclusionary Chinese

1. When an approved venture is formally registered, it is issued a set of chops, the carved stone seals used to imprint the red mark of the firm on official documents. This method of authentication has been employed in China since ancient times.

commercial policies create only some of the barriers that foreigners face. Third, it portrays foreign interactions with Chinese employees as nonexploitative. This study provides evidence of FIEs as agents for positive change in the employer-employee relationship in China today. To be sure, there are poverty-related abusive labor practices in many quarters, some involving foreign investors. But it is atypical of Western, certainly of US, FIEs, many of which are dramatically improving the social welfare (both material and intellectual) of the Chinese employees within their sphere of operation.²

It is unfortunate that in the rush to judge the inadequacies in China's human resources profile, American observers have largely missed the extraordinary, positive changes that have taken place in the 1990s. Not least, the exertions of foreign firms to reengineer the relationship between employee and employer have been underreported. Why? For one thing, cases of abuse draw more attention than examples of progress, and many of the innovations that FIEs have introduced in China would appear fairly mundane to most Westerners. Furthermore, few FIEs have chosen to showcase their efforts to date.

Many Western observers presume that Chinese labor is remarkable only for its cheapness and pliancy. In fact, the lure of "cheap labor" in China has turned into something of a cruel joke for many foreign investors: the time and effort consumed in managing labor resources are significant, and in many locations costs are ballooning. FIEs are raising staff levels in all major cities, as well as expanding into second-tier cities and beyond (a recent US-China Business Council survey indicates that half of large US firms in China are already serving over 50 markets; see USCBC 1998). Because the market is so large and physically disjointed, and because logistical tasks from advertising to distribution to marketing are in their nascent stages and are all areas that must be developed painstakingly with a hands-on approach, FIEs need the help of local talent. Labor costs have skyrocketed (especially for skilled and semiskilled workers), the relative size of the talent pool has dwindled as demand has grown, and competition among FIEs for competent English-speaking accountants, finance directors, marketing managers, and the like is fierce. These serious challenges are commercial; others come from governmental or quasi-governmental agencies, which press noncommercial labor agendas on both foreign and domestic firms.

One major reason for the urgency is easy to identify. In 1990 just over \$4 billion in foreign direct investment (FDI) was placed in China by FIEs; in

2. In this chapter more than most, it must be stressed that the sample of firms and individuals in this study is not comprehensive. Those interviewed reflect the practices of American firms most of all, with important inputs from European and Japanese firms. Some would argue that a study of Taiwanese, Korean, and Singaporean firms might produce a very different set of findings on the "social footprint" of FIEs. That is so; however, the concerns of readers of this study are likely to revolve around the kinds of firms that are represented here.

Table 3.1 Employment of Chinese by foreigners, 1980-96 (thousands)

	Foreign-funded economic units ^a	Overseas-Chinese funded economic units ^b	Total labor force (rural and urban)
1980	na	na	423,610
1981	na	na	437,250
1982	na	na	452,950
1983	na	na	464,360
1984	na	na	481,970
1985	60	na	498,730
1986	120	10	512,820
1987	200	10	527,830
1988	290	20	543,340
1989	430	40	553,290
1990	620	40	639,090
1991	960	690	647,990
1992	1,380	830	655,540
1993	1,330	1,550	663,730
1994	1,950	2,110	671,990
1995	2,410	2,720	679,470
1996	2,750	2,650	688,500

na = not available.

a. Enterprises established by foreigners in China as joint ventures (cooperative and equity), wholly owned foreign enterprises, and other legal forms.

b. Enterprises established by overseas Chinese from Hong Kong, Macao, and Taiwan in mainland China.

Source: *China Statistical Yearbook*, 1997, China State Statistical Bureau.

1996 the total exceeded \$42 billion; in 1997 it was over \$45 billion. Chinese data (see table 3.1) suggest that the number of Chinese employed by FIEs rose from 660,000 in 1990 to 5.4 million in 1996. The actual number of Chinese under non-Chinese management may be higher.³ This torrent of FDI has led firms to scramble for qualified people, not just for the shop floor but for management, marketing, sales, service, distribution, accounting, and advertising; there is substantial personnel pressure wherever FIEs are found. The task of managing this human resources revolution has been difficult for foreign investors and their Chinese partners.

These challenges are not unique to China, of course. However, they are unusually pervasive, because of the combination of rapid growth in a

3. FIEs are today managing Chinese directly through shell companies that are ostensibly independent. This stratagem allows foreigners to enter distribution and service markets that they would not be permitted to access directly.

large market, competition among foreign and domestic firms for a limited pool of skilled labor in the frontline commercial centers (i.e., Shanghai, Beijing), restrictions on employment practices, and lack of experience in grappling with the cultural nuances of staffing.

Management in general must fight against ancient culture and traditions, which diverge fundamentally from Western workplace habits. Child (1996, 33)—one of the foremost experts on foreign management in China—casts this difference in entrepreneurial terms (drawing on Boisot): “[T]he Chinese are not yet attuned to a ‘Schumpeterian’ kind of learning process based on disequilibrium models of innovation and opportunity; both their culture and governance systems are more attuned to an equilibrium model.” Schumpeter, who championed the “creative destruction” of old patterns of thinking in order to make way for the new, would have found the apogee of conservatism in many Chinese enterprises as they hunker down against the prospect of competition and reengineering. (That this remains a fact is extraordinary given the violence and effort expended by Mao Zedong during the prior period to destroy traditional modes of thinking, and it says something of the tenacity of human belief.) With mixed success, foreign managers have worked to break through the reluctance of indigenous management and labor to accept change. While increasingly they can recognize kindred spirits in their younger Chinese counterparts, many expatriates still perceive themselves in isolated battle against a Chinese sea of statism.

Only a few years ago the purpose of all firms in China was to fulfill goals handed down by planning authorities; all had Communist secretaries and bureaucracies that shared management duties with the commercially oriented staff (most nonprivate firms still do, though to a far lesser extent).⁴ Performance-based incentives were rare for either firms or individuals. How much power did Chinese managers traditionally have to balance their books? How much control did they have over transactions with suppliers and buyers? In each case, the answer is “very little.”

While China’s economy has been gradually introduced to new ideas, the FIEs typically turned old priorities on their heads from the moment of establishment—often in the face of considerable resistance. The level of control foreign managers wanted, the extent of change they intended to bring with that control, and the nature of the changes they sought all directly challenged conventional Chinese thinking. Given how deeply ingrained the old patterns are, the progress has been surprising. Foreign management in China has accomplished much in the years since it was first introduced; nonetheless, many challenges specific to assembling and managing FIE human resources remain.

4. Child (1996, 77) counted from 2 to 42 full-time Party staff at Chinese enterprises that were the subject of his case studies in 1985 and 1988; the average number declined markedly over those years. The average in 1988 for 12 ventures in Beijing and Nantong was 4, down from about 10 in 1985.

This chapter explores these challenges and considers why they are so acute and so important. The issues that FIEs face during establishment include the nontransparent approval process, pressures to overstaff, difficulties in obtaining the desirable mix of staff for the venture, and the fight to secure managerial control. The chapter also discusses the benefits of the FIE presence for the Chinese whom they employ. Operational issues after establishment is complete include availability of key professionals, wage pressures and changing labor patterns, worker mobility, nonwage costs, training and quality assurance, and retention. These concerns were identified through case studies and background interviews with human resource managers and other expatriates in China.

Several additional themes not directly discussed by interviewees could be discerned in their responses. First was the insulation of the foreign venture from corruption problems through loose affiliation with contractors or other indirect employees (including subcontractors). This is especially relevant to US firms, which are bound by the Foreign Corrupt Practices Act (FCPA). A related issue was the management of parts of the organization that must technically be independent to comply with Chinese restrictions on direct foreign participation (say, in distribution and service) while sometimes being in reality closely managed by foreigners. And there was another background theme against which expatriates made their comments on China's labor situation: the preoccupation in the West, particularly in the United States, with human rights and labor rights conditions.

A final introductory note: in general, interviewees reported that their ability to deal with personnel issues had improved considerably in recent years and that labor markets were stabilizing in places (Guangdong Province, for example). But while personnel issues have become less volatile (in terms of salary inflation, contract uncertainty, regulatory requirements, etc.), their scope increases relentlessly as ever broader swaths of the market are opened to FIEs, formally or informally. Therefore, even if 1998's decelerating trend in new FDI persists beyond the short or medium term,⁵ the hothouse atmosphere enveloping human resource management in China will endure.

Human Resources and Establishment: Pressures Shaping the Labor Contract

Human resource issues start with the negotiations to set up a venture, as noted in the previous chapter. In law, FIEs enjoy broad freedom to hire

5. Financial upheaval in Asian markets in 1997 will likely curb the rate of overall Chinese growth, though this may be offset by announced fiscal stimuli of \$750 billion or more over the period 1998–2000. The crisis' effects on the foreign-invested sector in particular are not clear as of this writing. It is foreseeable that a heavy impact would only encourage FIEs to focus that much more intensely on the Chinese *domestic* market instead of on glutted export markets, making demand for local personnel to serve the domestic business even more intense.

Table 3.2 Unemployment estimates

Source	Unemployment rate	Increase in unemployment	Timing
Chen Jinhua (State Planning Commission)	Target 3.5 percent		1998
Li Boyong (labor minister)	4.2-4.3 percent ("China could sustain 5-6 percent")	3.5 million (state sector)	1998
<i>China Economic Times/Reuters</i>		4 million (civil service)	1998
The Institute of Macroeconomics	5 percent		1998-2003
Wang Dongjin (senior state planner)		20 million (state sector)	1998-2000
Chinese Academy of Social Sciences		40 million (state sector)	na
All-China Federation of Trade Unions		8-10 million (state sector)	1998-2000

na = not available.

Sources: Reuters (8 March 1998; 27 February 1998); *China Daily* (16 March 1998; 16 February 1998); *China News Digest* (1 March 1998; 7 May 1997).

and staff a venture as they see fit (USCBC 1996a, 23), choosing from the open market or among the staff available from a Chinese partner (in the case of a joint venture, or JV). The exception is the more timid foray into the market—the representative office—which must hire through an employment service company managed by the government; and even rep offices are finding ways to avoid these restrictions.

But despite these statutory rights and the evidence of pockets of flexibility in practice, considerable labor pressures are brought to bear on a potential FIE petitioning for approval. The authorities can withhold approval until the labor contract is suitably adjusted, or else until management control is structured in a way that will permit the Chinese representatives in the venture to control decision making on labor questions (e.g., salaries, hours, bonuses, responsibilities). Chinese motives for manipulating foreign investors' decisions on human resources are discussed later.

Official rhetoric fulminates against foreigners being permitted to hold imperialistic sway in China, but the immediate motives for shaping FIE labor profiles are more practical. First, central authorities have an interest in encouraging the use of Chinese personnel instead of expatriates, where possible, to promote managerial learning and to reduce high expatriate salary costs (which have the potential to add to remittances out of the country).

Moreover, the greatest political threat confronting Chinese reformers today is increased unemployment among unskilled labor. Table 3.2 cites

some estimates of unemployment for the coming years: taken together, they suggest an astounding social dilemma. The figures included are both official and quasi-official; experience suggests that the reality will be worse, though some of these estimates (e.g., 40 million unemployed due to state-sector reforms) are fairly bold. Line ministries overseeing sectors of already high unemployment⁶ (and their provincial and local subsidiary units) have an interest in FIEs' retaining as much surplus labor as possible, and they can try to force concessions on ventures. At local levels, officials may seek sinecures for specific individuals. Moreover, the bureaucratic inertia and difficulties caused by the *dang an* and *hukou* systems (described later) complicate the negotiation process for FIEs.

The Chinese partner firm (in the case of JVs) often has a similarly strong interest in maintaining employment levels and management control, even at the expense of performance. Chinese managers traditionally defined prestige in terms such as high head counts, even if that meant lower output per worker. One set of interviewees (##12, 14) related their difficulty in negotiating a partnership with a coastal petrochemicals refinery south of Shanghai. They laid out a plan to spin off the noncore elements of the business to subcontractors, and thus raise profitability. Their suggestions—for example, to divest the enterprise of its factory-owned crematorium—met with confusion and reluctance: why would anyone wish to reduce staff and scope of operations?

Nontransparent Approval

Despite the freedom provided by statute, FIE human resource latitude is constrained in practice. The appropriate labor bureaus (local, municipal, provincial, or central) must approve the labor contract of a joint venture (and of a wholly owned foreign enterprise, or WOFE, though that structure brings less potential for conflict on employment issues because downsizing is usually not involved), and they can therefore pressure FIEs to accept employment commitments. It is not unusual for a potential partner and the overseeing authority to collude to elicit employment concessions. It was reported that labor authorities may take the hard-line role on behalf of the Chinese partner (#7) or may work to compel the Chinese partners to accept some amount of downsizing (#53).

This process is largely nontransparent and prone to abuse. Dealing with such a system, which can clearly deny most favored nation or national

6. It was announced at the 15th People's Congress in March 1998 that many of these would be shut down or merged, including the Ministries of Chemical Industries, Coal, Electric Power, Electronics Industry, Forestry, Geology and Mineral Resources, Machine Building, Metallurgy, and Post and Telecommunications. Premier Zhu Rongji has staked his credibility on realizing this pledge; still, it might be too early to begin drafting obituaries for the ministries.

treatment to any given FIE,⁷ is the first human resources challenge with which FIEs must grapple. China has not obligated itself to respect such principles, nor does the WTO yet reach into the area of rights of establishment deeply enough to address labor issues in particular. Still, capricious practices that do not offer predictability or recourse to investors will justifiably draw the attention of foreign trade negotiators until they are remedied. At a minimum, one could argue that the present nontransparent regime impairs or even nullifies the legitimate expectations of China's trading partners that their firms will enjoy the same commercial rights as other firms in China. FIEs unable to manage human resources with latitude equivalent to that enjoyed by private Chinese firms will lack the local presence needed to compete on an equal footing in, or sell goods into, the Chinese market.

As with other aspects of enterprise freedom, firms willing to establish ventures off the beaten path, especially in the interior, report greater leverage to stave off entreaties on the human resources front (#26). But regulatory disparities between the coast and the interior can be disadvantageous as well. Smaller foreign ventures without big-money leverage still face greater struggles with labor contract negotiations than do larger ones, especially when their operations cross jurisdictions. "Problems can arise from differences in labor regulations and practice from region to region, and ensuing uncertainty with interpretation," as one consultant noted (#53).

Pressure to Overstaff

Successful negotiation of a number of issues is key to running a profitable venture. Among the first to arise, for JVs, is the number of staff that will be absorbed from the Chinese partner. Earlier case studies of FIEs in China (e.g., Mann 1997) identified forced overstaffing as a major concern, and it continued to receive much attention in the literature of the 1990s. The problem is manifest in the state sector, as State Economic and Trade Commission Vice Minister Chen Qingtai recently conceded (remarks to the National People's Congress, 8 March 1998): "Within these [state-

7. The most favored nation principle requires that commercial rights offered to the interests of any one nation are no more advantageous than those extended to others, assuming all are parties to such an agreement. The national treatment principle stipulates that once goods have entered a market, discriminatory distinctions are not drawn between foreign goods and domestic goods. These concepts form the bedrock of the General Agreement on Tariffs and Trade, which anchors the WTO, and traditionally apply to trade in goods. Under the Uruguay Round, which established the WTO, progress was made extending the principles to services. Some, but far less, progress was made toward extending them to investment rights; this is a major task to which negotiators are now turning. China, which is not now a member of the WTO, is not bound by these principles. However, they are clearly the benchmarks against which its deeper integration with the international commercial regime will be judged in the immediate future.

owned] enterprises, if a third of the workforce was cut, these enterprises [could] still operate normally. If half of the workers were reduced, some could operate even better.” As reforms progress, Chinese authorities have not been shy about pressuring FIEs to shoulder some of the burden of carrying excess staff. Over this period, firms unable to point to demonstrable technological contributions (or, just as usefully, powerful patrons) have experienced firsthand the difficulty of carrying on their payrolls a large share of redundant workers.

However, many respondents for this study suggested that the problem’s severity is diminishing as they gain experience in negotiating labor arrangements. Foreign investors in some cases can now pay severance fees to shed staff,⁸ insist on screening out unskilled workers or “lifers,” and create retraining or placement centers to redirect unneeded staff. As the market for such services grows, capable human resource consultancies have emerged to help FIEs deal with overstaffing. Whether these adjustment mechanisms will successfully reallocate excess workers to new jobs, or just shuffle them out of the FIE’s in box to an unspecified future, is not clear. It is a question that must be answered to gauge the potential for labor instability in China.

Increasingly, FIEs are pursuing a wholly owned format (WOFE) and build facilities from scratch. The desire to avoid the burden of excess staff plays an important part in this shift (as do other management control benefits, such as the chance to build a fresh corporate culture). Thus, while the problem of overstaffing remains widespread, FIEs are finding a variety of ways to cope. Perhaps in the future FIEs will continue to act surprised about the intractability of overstaffing problems, but they will have little excuse for not knowing what they were getting themselves into.

The Right Staff

Beyond the quantity of staff lies the question of quality. Foreign firms want to absorb the most capable personnel from Chinese partner organizations and avoid the burden of the less capable. Senior Chinese managers with critical connections are important; middle managers with demonstrated business skills are desirable; and younger staff with good language skills or exposure to foreign business culture are also sought after. Often firms prefer those workers with lower skills who have not grown accustomed to a state-owned enterprise (SOE) work environment. An additional complication is the massive “education gap” perceived among Chinese who were of school age during the Cultural Revolution

8. Other firms gain a credit or debt forgiveness in exchange for not letting people go. One investment banker helping to merge and reengineer industrial firms reported a credit against debt liabilities of 25,000 RMB per worker retained (#49).

(roughly 1966–76), when schools and universities were largely shut down so people could focus on their ideological convictions.

FIEs often deal with problematic realities in hiring. They are sometimes pressured to put friends or relatives of partners or approval authorities on staff whom they wish to refuse, either because of the expense or because such favors are a symbol of past practices that are at odds with the environment foreign managers are trying to create. Some labor agreements give hiring preference to spouses and siblings of current employees (#26). Interviewees almost uniformly desired young, untrained workers rather than older ones already inculcated with the local work ethic, but they recognized that nurturing good relations with local partners and authorities is critical to success.

In some sectors, foreign investors are required to meet quotas for Chinese employees. These restrictions can be found in the Guidelines on foreign investment and in the offers China is making to foreign trade negotiators in its WTO accession talks. For example, at joint venture medical clinics serving the foreign community, no fewer than 50 percent of the staff must be selected on the basis of Chinese nationality, a rather arbitrary criterion for declaring nurses and anesthesiologists qualified.

The number of expatriate managers staffing the venture and the payment of their costs are important negotiating issues. At least until Chinese markets and universities supply sufficient pools of managerial talent, FIEs will call on expatriate staff to oversee the rapid reengineering or development of their China operations. These individuals are the wellsprings of skill that nurture China's fragile markets. And yet, both Chinese policy and market forces argue for localizing management as quickly as possible (see box 3.1), and authorities may try to speed the process by discouraging ventures from budgeting for expatriate expenses. Therefore, according to confidential remarks by several interviewees, high expatriate costs (a possible cause for rejection by approval authorities) are sometimes borne offshore, offset (and disguised) with fees and payments to the parent company (a transfer-pricing phenomenon).

Securing Managerial Control

The foreign investor must also secure management control over the workforce in the negotiation process. In 1985 the top two concerns of SOE managers interviewed by a Western scholar (Child 1996, 94) were freedom to recruit and dismiss workers and freedom to set their salary and bonus levels; not surprisingly, these same issues were at the top of the list for foreign managers in 1997. Thus control over appointing the FIE's director of human resources is critical.

There are examples both of smooth Chinese acquiescence to foreign management leadership and of contentious wrangling that sinks ventures.

Box 3.1 The importance of localizing management

The World Bank claims to be satisfied with its loan performance in China, but its private-sector finance arm, the International Finance Corporation (IFC), has had less than stellar results in its 25 China projects (worth slightly under half a billion dollars in total). The IFC points to “extremely tough operating situations” in explaining a tendency to make investment decisions from headquarters in Washington, DC, using risk models not designed for the Chinese market (*Business China*, 15 September 1997, 12). Its share of equity in its China ventures is high, they are more costly than investments in other emerging markets. Scrappy local competitors outcompete them with cheaper production technologies in the tire, cement, and glass businesses. The IFC faces the same challenges as do other organizations: if management is not local, or if the firm insists on out-of-country decision making, it will likely be disappointed in China.

Expatriates stress that locating management in China is essential to success. This is why FIEs are scrambling to groom local Chinese, with marginally lower salary and overhead costs than imported managers and better local knowledge, to fill decision-making positions. While expatriates do report pressure from overseeing authorities to localize management as much as possible, in practice internal commercial logic argues even more strongly for localization. Those on the ground know, for example, that many Chinese enterprises will simply write off suppliers if they get far enough ahead on credit terms. Because local savvy is so crucial, relations between field managers and home-country officers are frequently tense. Local managers often point to underdelegation as an important reason for poor venture performance.

The widely read account of the Beijing Jeep venture was strewn with battles over management that nearly destroyed the business (Mann 1989). The official regulations themselves are only marginally useful in determining the extent to which foreign management control is possible in a given industry. The Guidelines broadly signal the level of foreign control Chinese authorities are prepared to countenance, by way of ownership and share structure. But minority or majority ownership only partly correlates with foreign control. Other factors reported by firms include the closeness of the Chinese partner firm to the core business lines, the presence of higher-level partners intent on forcing reform in the sector, the decision of the foreign negotiator to make control a priority, and the leverage provided by the technology the foreign firm brings or other strategic tradeoffs it can make (recall the discussion of strategic positioning in chapter 2).

An example of a management control pitfall is the inability of foreign managers to set salary incentives. Howson (1997, 30) notes that until recently, JVs were required to pay workers at least 120 percent of the average wage at comparable state enterprises, *but not more than 150 percent*. Statutes required that the FIE receive permission from examination and approval authorities to go outside these parameters. Several interviewees (##20, 26) were prevented from raising salaries to a competitive level, because they failed to negotiate control over this point during establishment

and their Chinese partner was uncomfortable paying higher salaries to productive employees than to average ones. Though the statutory ceiling on wages has apparently been removed (for purposes of contracts henceforth), in practice FIEs must still secure management control over incentives, including salaries.

The authorities' veto power over incentive decisions is a major limitation on foreign management control. Others important limits involve appointing and appraising venture managers, supervising the recruitment process, assigning production targets and overtime limits, setting training allotments and priorities, determining gift-giving and travel policies, and other matters of daily operation. The Chinese regulations provide grounds (i.e., that the venture would otherwise face "serious losses") that permit foreigners to negotiate far-reaching control over all these issues of human resource management. Many foreign firms are learning to take advantage of these regulatory loopholes; others are opting for the do-it-yourself WOFE solution. Both of those stratagems depend on the blessing of local authorities, however.

Interviewees were aware that JV partners had preexisting patterns of management that could not be changed overnight. Child (1996, 90) notes the extent to which planning officials withheld management control from state-owned enterprises even recently. Solely in the personnel area, the SOEs studied by Child commonly lacked decision-making authority to recruit managers, determine enterprise size, set workers' basic salaries, and set compensation for the mandated Party employees; for several, dismissing workers was off-limits, too. The abrogation of management control inherent in the SOE system underscores the importance for FIEs of selecting partners wisely and then negotiating authority to reengineer these issues where need be.

After the Contract: Just the Beginning

While poorly negotiated labor arrangements are trouble, much is worked out despite or sometimes in violation of the contract—provided things are otherwise going well for the venture. For example, in many JVs, especially in southern China, hours worked commonly exceed the limits set out in the labor contract. Local authorities and partners are often complicit in this violation (see table 3.3). Reportedly, local authorities take a pragmatic position: "as long as you have worked this out in a manner acceptable to your employees, and we don't hear complaints, then we don't care how many hours overtime they work" (#19).

This illustrates an important point: as much as FIEs sometimes complain about legal ambiguities and unenforced contract terms, they routinely benefit from these conditions as well. For larger Western firms with a stated commitment to the letter of the law, the attitude of both Chinese

Table 3.3 Overtime at a southern China FIE, 1997 (hours)

	Position				
	Driver	Guard	Cook	Cleaner	Contractor
January	<i>40</i>	<i>40</i>	9	26	33
February	18	<i>42</i>	2	14	20
March	<i>43</i>	30	5	32	26
April	27	7	4	<i>52</i>	<i>69</i>
May	<i>67</i>	29	0	35	<i>48</i>
June	<i>43</i>	<i>56</i>	0	28	32

Note: Chinese law limits overtime to 36 hours per month. Numbers in italics indicate employees working over the regulatory limit.

Source: Author's interviews.

and other foreign investors, and even authorities, presents a dilemma. Absent credible enforcement, domestic rivals scoff at the notion of complying fully with labor regulations. Chinese partners discourage (and occasionally almost forbid) foreign managers from naively following the rules. This creates tension within firms over labor practices. For Western firms trying to showcase their ability to implement a corporate code of conduct worldwide, these tensions are not only ethically but commercially worrisome (consider the massive bad press directed at Nike over Chinese labor conditions in recent years). China is increasingly porous to foreign journalists and “social auditors,” and the power of publicity about China operations to affect global sales is now clear.

The contract negotiation only foreshadows the human resource challenges to come. A well-negotiated labor structure can reduce sources of contention, but it cannot eliminate them. Conversely, while problems built in during the process of establishment will create headaches for the foreign manager trying to reengineer his or her corner of the vast Chinese marketplace, they do not present an insurmountable problem if the parties are open to learn—and if the potential for profitability is fundamentally sound.⁹ And, of course, one must consider the leverage the foreign investor possesses (a function of sector, technologies involved, etc.). Like other factors, trades can be made affecting control over labor, depending on what other chips are on the table for China (exports, technology transfer, jobs) and what the gains are for the investor (market access, profits, market share).

9. Numerous expatriates commented that the performance of the venture was the best indicator of whether such issues could be resolved. It appears that as long as there is a good cash flow, anything can be worked out—a very practical perspective.

Human Resources after Establishment

FIEs face various operational human resource challenges once they are up and running in China. Many are common to other high-growth emerging economies where multinational firms operate. What is unusual (and thus may make these problems themselves appear unusual) is the intense criticism in the West of China's labor profile in recent years. The key topics interviewees discussed are wage pressures and patterns, mobility, non-wage costs, training, and retention. Two supplemental themes distilled from the interviews are insulation from dubious business practices through comprador relationships with local Chinese partners and the background concerns about human rights and labor rights that echo through debate about China in the United States. Each of these issues remains important over the life of the venture. The interviewees described deep interaction between foreign firms and Chinese employees, in stark contrast to the depiction offered by many human rights groups of penniless laborers, alienated and exploited.

Availability, Wage Pressures, and Changing Labor Patterns

Surveys of FIEs consistently identify "local management and skills shortages" as among the greatest impediments to productivity growth in China operations (EIU 1997, xv).¹⁰ Shortages in the pool of labor clearly lead to difficulties in filling critical roles in finance, accounting, marketing, human resource management, and other important business fields, which frustrate FIE operations. And, naturally, because these resources are scarce their cost has risen.

Expatriate managers are increasingly aware of rising wage pressures, along with the changing expectations among staff that accompany increasing salaries. Table 3.4 and figure 3.1 offer illustrative recent wage increases for local managers at a Sino-American firm in China, with projections (1998–2000). Four sites are included: Beijing, Shanghai, Guangzhou, and Tianjin. Table 3.5 shows the variation in average annual compensation at joint ventures in locations in coastal China for positions ranging from deputy general manager to unskilled production worker.

The data in these tables suggest several important points. First, while wages are climbing across the board, there is a widening gap between salaries of high- and low-skilled workers. This is a promising sign of a

10. As with many issues addressed in this study, China is not unique in this regard, although the problem may be most pronounced there. Manager polls indicate that fewer than half the firms in East Asia feel they have enough skilled managers to meet company growth over the next 10 years in Taiwan, Hong Kong, Singapore, South Korea, Malaysia, Thailand, and Indonesia ("Asia Executive Poll," *Far Eastern Economic Review*, 28 August 1997, 28).

Table 3.4 Local managers' salary increases, 1996-2000
(percentages)

	Location			
	Beijing	Shanghai	Guangzhou	Tianjin
1996	24.0	24.1	21.8	16.5
1997	18.6	17.6	17.3	12.5
1998	17.1	16.7	15.3	12.5
1999	16.6	16.2	14.7	12.3
2000	16.1	15.7	14.1	12.1

Note: The numbers after 1998 are forecasts.

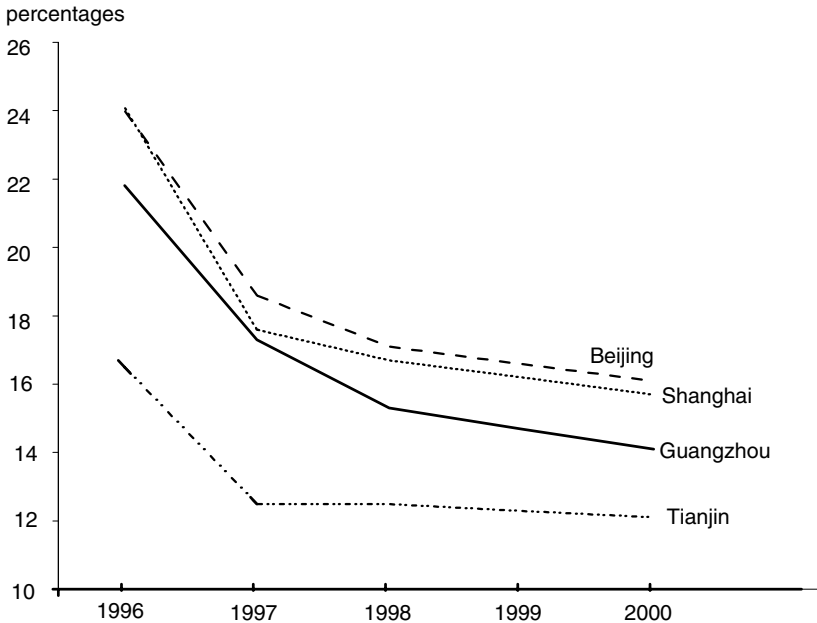
Source: Author's interviews.

change in the culture of the Chinese firm, moving away from a focus on nominal equality and toward efficient use of incentives and increased productivity. Increasing productivity is the real source of wage growth, as the second point demonstrates: the average wage earnings of even the lowest-paid workers in these joint ventures are higher than the national average manufacturing wage of 5,642 RMB reported for 1996 (China State Statistical Bureau, *China State Statistical Yearbook 1997*, 124). In Shanghai, where interaction between Chinese workers and FIEs is quite advanced, the wages of unskilled workers are almost *double* the national average and rising precipitously.

Perks to retain good employees are also more common. The most remarkable example may be the home mortgage financing programs initiated by many of the firms involved in this study. In these programs, the employer uses its financial power to finance low-cost, typically 10-year mortgages for employees (in some cases for only the best employees, in others for all employees). This creates a disincentive to leave the firm, because doing so would lead to foreclosure. The firms that introduced this practice find also that the work ethic and psychology of employees who own their own homes is superior. These FIE home acquisition projects have attracted copious positive attention in China, yet are barely known in the United States.

Ironically, this acceleration both in wage growth for capable individuals within firms and in wage differential between FIEs and domestic firms is creating hostility and resistance in some quarters. Bureaucrats are anxious about the social implications of these increasing disparities. While the solution employed until recently—chaining the compensation of the most productive workers to that of the lowest (or to the industry average)—is being abandoned, several foreign managers interviewed for this study described how their Chinese board partners were still preventing raises that would result in more venerable employees making less than their aggressive, productive juniors. The Chinese partner was able to

Figure 3.1 Managers' salary increase, 1996-2000



Note: The numbers after 1998 are forecasts.

Source: Author's interviews.

block the salary increases because the investor tolerated a weak position on labor control when the venture was first established, quite possibly in order to accelerate approval. The debate over income distribution and globalization is now heating up in the United States as well (see Cline 1997, Rodrik 1997b); but there is no question that for the time being, in China greater variations in income are necessary.

Third, tables 3.4 and 3.5 indicate that there still exist major locational differences in salary. An accountant's salary in Shanghai is double that in Hangzhou. Given that the two cities are only a few hours apart, why don't people simply move to meet demand? The answer is threefold. First, living costs vary significantly between cities, accounting for some of the differences in compensation. Second, labor mobility in China remains limited, as noted already, because of bureaucratic impediments to changing residence and because of the difficulty of carrying over benefits for dependents.¹¹ Third, there are simply not large pools of professionals in any

11. Most young Chinese do not want to move from Shanghai to the hinterlands any more than a New Yorker would relish an assignment in Arkansas. Andrew Jackson, human resources manager for Ford China, recently put it this way in an interview: "No one is ever going to give up living in Shanghai or Beijing and yell, 'Yes! I want to go and live in Nanchang!' You would need your head examined to do that" (Weir 1997).

Table 3.5 Average annual pay at FIEs, October-December 1996
(renminbi)

Position/title	Salary (cash)		Total earnings ^a	
	HWN ^a	Shanghai	HWN ^b	Shanghai
Deputy general manager	83,593	104,394	103,653	115,538
Accounting supervisor	22,912	58,450	31,620	72,441
Receptionist	12,350	16,722	16,232	24,406
Line supervisor	18,100	48,360	27,832	59,968
Unskilled production worker	6,000	14,241	13,580	23,833

a. The source for this table does not define the composition of total earnings, but presumably it includes bonus and other in-kind payments.

b. HWN = Hangzhou, Wuxi, Nanjing.

Source: China STAFF (1997).

location, and reaching them through advertising and recruitment is not always easy; securing their release from current employers (i.e., release of their *dang an*, discussed later) may be complicated as well.

Somewhat shell-shocked by the sudden onset and pace of new labor pressures, authorities have been slow to fashion a comprehensive response to the human resource regulatory needs of dynamic firms. The *dang an* and *hukou* systems have not been overhauled, only tinkered with (eroded mostly *despite* government, not because of it). Unfunded pension and welfare systems and state-allocated housing diminish labor mobility. Greater flexibility is required to permit firms to fashion modern organizational structures in China to serve the growing market, streamline production, and operate productively. But firms, including FIEs, will not wait forever for reform; they are contributing to making the government's role over human resources marginal—albeit by moving forward in the dark, interpretation by interpretation.

Mobility and the *Dang An* and *Hukou* Systems

Markets that are segmented—that is, disconnected from national distribution patterns—are emerging across China, particularly but not solely along the Pacific coast. To serve these burgeoning centers in spite of internal barriers to trade, shortages of local expertise, and other complications, firms foreign and domestic in many sectors must rely on increasingly mobile management teams. Now is the time to hit the ground running in the 11 “first-tier” cities (population more than 2 million people), the 23 “second-tier” cities (1–2 million), and 239 more cities with between 200,000 and 1 million residents (the numbers would swell if the “unregistered population” were included). A primary constraint for many

firms as of summer 1997 was availability of upper-level personnel. If a general manager for a regional office in Xinjiang cannot be found locally, then the question is whether someone with the needed skills can be dispatched from Shanghai, or Beijing, or Tianjin.

Two inevitabilities of postwar life in China, nowadays waning in importance yet still essential, are the *dang an* and the *hukou*.¹² The *dang an* is a personnel file, a dossier on each employee, established as early as primary school and maintained by employers thereafter. It tracks an individual's political and professional record, from academic grades to performance reports, problems with authorities to marriage and childbearing. This dossier is an essential record needed before an employer can hire or provide pension or insurance benefits for the individual. One employer might demand a payment before releasing the *dang an* to a new employer. The *hukou* is a residence permit, entitling the bearer to social services and rights (including not being removed to the countryside) available to local residents only. Without this permit, an individual has no access to the subsidized housing, medical care, schooling for dependents, and social security that urban China was organized around over the past 40 years.

These bureaucratic devices were the keys to controlling Chinese society under communism. They have less force today, as increasing numbers of Chinese join private enterprises and become less beholden to government, yet many potential employees still resist changing localities or employers if it means compromising their *dang an* and *hukou* status. Fearful of being burdened with new residents without an accompanying transfer of their pension benefits from the old jurisdiction, many localities are fiercely reluctant to hand out new *hukous*, at least until the social welfare system is revamped.¹³ The US-China Business Council (1996a, 24) estimated that Beijing Municipality handed out only 2 new *hukous* per 10,000 residents in 1996 (thus merely 2,100 or so in a city with an official population of 10 million).

Freelance service companies have emerged as valid depositories for the *dang an*, giving greater employment flexibility to foreign firms that are not permitted to hold personnel files directly for Chinese workers. Temporary residence permits are supplementing the *hukou* for some staff on assignment away from their home municipality. However, these remnants of totalitarianism and the intractable problems of the existing social system remain challenges to foreign investors concerned above all with building

12. In the state-owned sector the bureaucratic apparatus is far more complex; the *dang an* and *hukou* elements discussed here are only part of the story, but are the parts most relevant to FIEs. See Child (1996) for more background on labor markets and rigidities in China.

13. Such transfers are unlikely on a large scale, because obligations are largely met out of current revenues: that is, there is no funded lump sum to be transferred (see World Bank 1997h, 18–25).

Table 3.6 Per capita income by area, projected

Area	1996 (RMB)	2000 (RMB)	2010 (RMB)	Annual growth rate (percentage)
Urban residents	4,839	8,508	29,162	13.7
Rural residents	1,926	3,278	10,707	13.0

Source: State Information Center, Reuters,
http://biz.yahoo.com/finance/971214/china_gap_1.html,
 14 December 1997.

Table 3.7 Per capita GDP by province, 1996 (dollars)

Province		Province	
Shanghai	2,679.2	Inner Mongolia	512.3
Beijing	1,809.4	Hunan	496.7
Tianjin	1,475.8	Guangxi	490.8
Guangdong	1,144.2	Henan	485.0
Zhejiang	1,137.2	Anhui	466.8
Jiangsu	1,016.0	Sichuan	452.6
Fujian	978.6	Qinghai	450.8
Liaoning	929.7	Ningxia	448.8
Shandong	822.0	Yunnan	446.8
Heilongjiang	777.9	Jiangxi	446.8
Hainan	661.5	Shanxi	398.5
Hebei	642.9	Shaanxi	398.5
Xinjiang	621.5	Gansu	348.9
Jilin	621.0	Tibet	328.6
Hubei	616.1	Guizhou	251.7

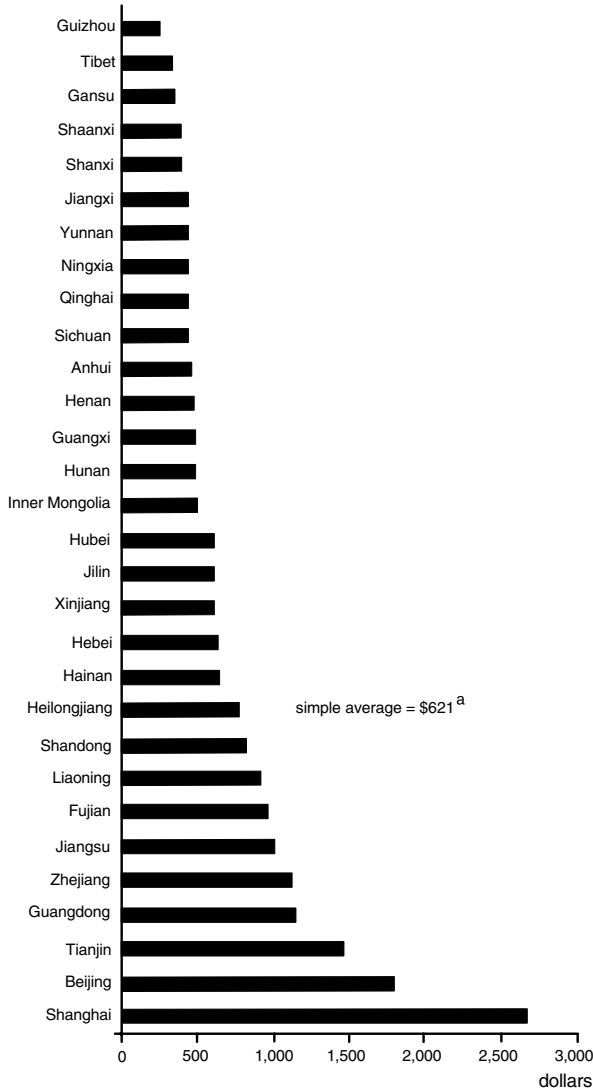
Note: \$1 = 8.3RMB, the average market exchange rate in 1996.

Source: *State Statistical Yearbook*, 1997, China State Statistical Bureau.

flexible organizations. It will take some time for these bureaucratic hold-overs to disappear.

To better understand the source of government anxiety and hence its sluggishness to engage in reform, see tables 3.6 and 3.7 and figure 3.2. It is predicted that the sizable income gaps between dynamic commercial centers and poor hinterlands will widen, continuing to separate Chinese into the well situated and the unfortunately placed. These disparities are spawning intense migratory pressures that, without the presence of the

Figure 3.2 Per capita GDP by province, 1996



a. Average of all 30 provinces, not adjusted for population.

Source: *State Statistical Yearbook, 1997*, China State Statistical Bureau.

old checks on movement, could quickly lead to serious and violent social deterioration. Of course, masking these pressures will not make them go away; but Chinese leaders are buying themselves time, hoping that in the future they will be able to bring to bear greater resources and more policy acumen on these problems.

Nonwage Costs

Foreigners have seen many changes in the social obligations that stand alongside wages as major worker-related costs.¹⁴ When they arrived in the early 1980s, FIEs faced nonwage obligations modeled on those prevailing in the state sector. In 1978 SOEs were reported to pay out nonwage benefits valued at 14 percent of wages; in 1994 the amount was 30 percent on average for all enterprises, according to the US-China Business Council (1996b, 3). The World Bank calculated pension contribution expenses of about 25 percent on average for all firms in the 13 provinces and 12 municipalities it has studied, a figure it judges “well above the international norm” (1997g, 2).

The total nonwage overhead costs (including pensions) for foreign enterprises reported by managers interviewed for this study were as high as 65 percent of salary. Recall the discussion of incentives in chapter 2: less attractive locales can waive many (if not all) nonwage costs, while more popular destinations have the leverage to make more demands. The range of nonwage costs identified here is consistent with the US-China Business Council surveys.

In the mid-1990s, authorities attempted to provide a new basis for social security, moving toward a government-managed system (to be based at the local level) instead of an enterprise-based regime. The new framework was an improvement over past practice; however, there remained ambiguity about local implementation of fee schedules and obligations, requirements to keep longtime employees on staff, and many other labor factors. Today, municipally managed pension funds coexist with old, enterprise-based funds in many jurisdictions, and ultimate obligations are unclear. In some cases pensions are being pooled provincewide; in others enterprises are still pooling by industry or by a particular set of firms (World Bank 1997g, 2). As in the past, compliance of FIEs with local obligations varies and is commonly settled by negotiation, a situation the World Bank describes as a “hornet’s nest.” It appears that southern FIEs tend to contribute to fewer funds, while WOFEs, especially in the north, are compelled to comply more closely than JVs with the overlapping obligations set out in law (USCBC 1996b, 2).

An illustrative list of common nonwage costs an FIE might face (by statute) includes

- pensions (local and/or provincial),
- unemployment insurance,

14. A review of the evolving social welfare regulatory environment and its implications for FIEs can be found in USCBC (1996b). For an assessment of China’s policy choices, see World Bank, *Old Age Security* (1997g).

**Table 3.8 Personnel overhead expenses:
contribution of an FIE in Shanghai
(percentages of total wages)**

Overhead expense	Employer contribution
Pension	30
Housing fund	15
Medical insurance	7
Matching fund	5
Union fee	2
Housing allowance	2
Unemployment insurance	1
Birth insurance	1
Total	63

Note: In the pension category, 17 percent goes to the government while 13 percent goes to insurance.

Source: Author's interviews.

- accident and disability insurance,
- maternity fees,
- health insurance,
- housing (subsidies or direct obligations),
- enterprise-based welfare funds,
- bureaucratic administration funds,
- union fees, and
- vacation allowances, funeral subsidies, education allowances, etc.

Table 3.8 presents the cost over wages that some of these fees represent to an American joint venture in Shanghai. Some readers might find these obligations excessive; others will find them comparable to those in many OECD economies. But that is the point: FIEs do not avoid all labor costs in China.

In addition to these payments, workers must be granted paid leave for a host of eventualities including funerals, sickness, paternity, maternity, miscarriage, “home leave” of up to 45 days every two years to visit family, and public holidays. State enterprises often provided services including schools, doctors, movie theaters, festival halls, funeral homes, restaurants, and many other aspects of civil life—most particularly housing. These all added to the value of the enterprise’s contribution to the individual’s compensation. It has been common, though the matter is negotiable, for FIEs to be asked to make funds available to offset their savings from not having to meet such expenses. It is important not to ignore these

expenditures when debating Chinese labor issues in the West. Too often, low daily pay figures are bandied about with cries of “How is anybody supposed to live on that?” with no mention of the value of room and board, as well as medical, holiday, and other in-kind payments.

The imprecise obligations of the FIE and the ad hoc nature of setup negotiations have led to widely differing nonwage costs in different municipalities. The US-China Business Council (1996b, appendix C) found overall nonwage costs per worker to range from as little as 22 percent of the value of wages in Shenzhen to as much as 98 percent in Wuxi. Not only is this variability confusing but it can also serve as a barrier to mobility, as noted already. While today’s crazy quilt of regimes is problematic, FIE human resource managers also fear that nonwage obligations could increase unpredictably in the future as China struggles to cover the rising tide of social obligations.

Setting aside the question of whether the social insurance revenues garnered from FIEs are managed responsibly on behalf of workers (generally they are not), these requirements impose discriminatory fee burdens on foreign investors that domestic companies do not face. Firms in different cities face different assessments, but similar firms in the same city might also pay different amounts, depending on their negotiating skills and the influence of their partners. Foreign enterprises pay larger tuition “reimbursements” to Chinese colleges when employing graduates than domestic employers do, for example. This violates the spirit of the national treatment principle: the full catalogue of differential payments could be questioned within the WTO accord.

On the other side of the equation, many domestic firms in the state sector receive subsidies so many and so varied that the Chinese government itself has said it has no idea what the total value is, or even what all the subsidies are. Communist rule in China has been marked by the transfer of resources from productive to less productive elements, a practice that thoroughly eroded Chinese productivity. The next 20 years, like the past 20, will witness the unraveling of this knot of transfers. A closer accounting of where the nonwage costs paid by FIEs actually go is long overdue. Increasingly, FIEs are treating these cash flows as owed directly to their workers instead of as a cover charge to operate in China, and they are more aggressively trying to control the use of these moneys.

As traditional barriers to competition between FIEs and domestic firms come down, preferential or discriminatory nuances such as those characterizing nonwage labor obligations will draw careful scrutiny because they may violate national treatment provisions of international economic regimes. At a minimum, statutory clarity will be required, including legal means of recourse to challenge unfair practice under the current regime. More important, central authorities must take the initiative in making labor practices around China uniform in order to nurture a more efficient, modern labor market.

The World Bank (1997g) argues that the present social welfare system fails to serve its purpose (provident savings to meet the needs of the unemployable) and is unsustainable (if current trends prevail, it will soon go bankrupt). It also fails to intermediate effectively between long-term savers and users of investment, thereby missing the opportunity to contribute to strengthening the financial sector.¹⁵ Furthermore, the Bank recognizes that the present arrangement hampers structural adjustment:

If a nonviable mill closes down in one city, laid-off workers need to be able to move to areas where similar industries might be expanding. For that to happen, the pension benefits of workers must be portable. The division of the national system into many separate unfunded municipal pools makes portability difficult and will become an increasingly serious impediment to labor mobility. (1997g, 3)

Should unmet pension needs lead to fiscal deterioration, FIEs will likely be forced to assume an even larger share of these obligations. Already, many are going beyond the letter of the law in providing for the well-being of their employees (e.g., by financing housing, education), recognizing that current arrangements fall short.

Training and Quality

Most FIEs must to some degree systematize production, operational style and management, and quality across their operations. The trick is doing it while retaining the flexibility needed to succeed in the diverse markets around China. The CEO of United Technologies, George David, has called this the imperative of “disciplined decentralization” in his speeches.

Training is crucial, as well as attention to objective metrics—first and foremost, *quality*. The *People’s Daily* reports that *half* of all Chinese output is “substandard” (21 January 1998). Not surprisingly, therefore, in a mid-1996 survey only 7 percent of Chinese considered Chinese products to be of very good or excellent quality.¹⁶ Such figures indicate where the battle for dominance of the Chinese market is likely to be fought and won in coming years, underscoring how important it will be to inculcate in workers a consciousness of quality.

Expatriate managers emphasize training within the firm, preferring to teach young staff to do things right the first time instead of retraining staff accustomed to outmoded practices. By schooling raw staff in-house, they can also help to moderate labor market constraints. However, managers worry that their good employees will take their new training to other jobs

15. Eighty percent of pension funds must, by regulation, be invested in government bonds, the remainder in bank balances, despite piteously low returns—below the rate of inflation, in recent years (World Bank 1997g, 3).

16. Gallup/Bozell, cited in EIU’s *Business China* (7 July 1997, 3).

(a problem in developed markets too, of course). The US-China Business Council describes higher turnover and increased poaching of employees as undesirable side effects of training (1996d).

Fears of poaching notwithstanding, the larger firms examined in this study have developed extensive in-house training programs to build their China organizations. Making a considerable investment of time, they send employees, regulators, potential suppliers, and other partners back to the home country (or to hubs in China or Asia) for training and exposure. Some even sell their training expertise to outside companies too small to have training functions themselves (#34). Smaller firms can use the services of private human resources training consultancies, a number of which have emerged in China (##44, 61). An article in *Business China* (4 August 1997, 8) describes the expansion of Hewitt East Gate, a successful wholly foreign-owned training consultancy (able, as a local company, to invoice other FIEs directly in RMB) and profiles other new entrants to this rapidly growing market.

New opportunities for training are appearing regularly. In recent years numerous Sino-foreign MBA programs have opened their doors. With growing backing from FIE corporate members (and local Chinese companies), China-Europe International Business School (CEIBS) at Jiaotang University in Shanghai is graduating MBA students with concentrations in marketing, human resources, finance, and corporate restructuring. The main constraint on growth for CEIBS is the availability of foreign business professors willing to spend extended periods of time in China. In March 1998, New York's Fordham University announced that it is leading a consortium of 24 American colleges that will join Beijing University in running an MBA program. Official Chinese estimates suggest that 300,000 MBAs are needed to help privatize SOEs and revitalize the economy,¹⁷ so many more such cooperative programs seem likely.

Quality is an important foreign enterprises comparative advantage. Foreign firms seek to use the reputation of being more reliable than their Chinese competitors to bolster their market position.¹⁸ But the potential for loss of that reputation is a serious threat. For example, streetside "fountain" (not prebottled) Coca-Cola is frequently made with unpurified water direct from the water system, water that often fails to meet drinking standards.¹⁹ If children were to die drinking contaminated Coca-Cola,

17. United Press International, "MBA in China," 10 April 1998.

18. The consumers' strong beliefs can have amusing consequences. A manager for a major American manufacturer whose products involve prerecorded announcements demanded that his factory manager explain why the recordings were made in English. The response was that Chinese purchasers of the product prefer the English announcements—even though they cannot understand them—because they are a sign of Western quality.

19. This is true in major hotels in some cities as well, where the water lines feeding the hotel bars and kitchens are the same ones marked "NON-POTABLE" in guests' rooms.

hypothetically speaking, the brand's good name could be threatened not just in China but worldwide. Adequate training—for the bottlers, the installers of lines to soda fountains, and retailers—is critical to make sure that does not happen. Foreign firms are devoting enormous energy to building quality management around their branded products in China, ensuring first of all that workers can judge what is safe and what unsafe.

FIEs must also use training and quality to respond to anticompetitive practices directed against foreign products. Such practices include deliberate acts of sabotage (such as induced spoilage) and besmirchment (starting libelous rumors about competitors). They are not unique to China by any means. Unfortunately, in the Chinese case they often coincide with official or quasi-official endorsements of the superiority of “glorious Chinese brands,” a display of partiality worrisome when shown by industry regulators.²⁰

By focusing on modern management, training, and quality, FIEs are engaged in a form of technology transfer that is reshaping business enterprises in China. Young Chinese are eager to work for foreign ventures, and this soft technology is spilling over to domestic firms that increasingly emulate their foreign rivals. Indeed, the culture of the foreign firms in their midst is affecting Chinese society more generally; as Lieberthal notes,

Technology doesn't develop in splendid isolation. Its use also transmits values, and it has wide-ranging, complex effects on those who seek to absorb and utilize it. . . . How far to open this window [to foreign technology and the culture attending it] has been an issue of contention in China since the 1860s. (1995, 23)

Retention

That retention of staff is a problem for FIEs in China today reflects a quite radical change: staff are now free to choose their career paths. Until recently, careers were largely assigned by state authorities, and urban jobs were for life.²¹ Job mobility also indicates that there are opportunities available: people with business skills or knowledge of foreign languages

20. Chen Zili, deputy secretary of the Shanghai Communist Party, endorsed the revival of the Peony ink brand in the *Shanghai Wenhui News* (14 May 1997). The entrepreneurs in question had established themselves by unilaterally breaching their contract with a foreign firm, which the newspaper insinuated was unscrupulously trying to cheat the patriotic Chinese businessmen.

21. Such rigidity was institutionalized during efforts to force peasants who had moved to the cities back to the countryside after the failed harvests of the Great Leap Forward (1958–61). By giving factory staff lifetime employment in exchange for no labor mobility, the Party hoped to check migratory pressures on the cities and to spur agricultural output. As a result the work unit, or *danwei*, became the focal point of the individual's labor existence (Lieberthal 1995, 109).

have choices. From the perspective of the liberal West, where freedom is gauged by the ability of individuals to act on their choices, this is extraordinarily good news.

Though the majority of Chinese do not yet fully enjoy such skill-based mobility, an emergent middle class offers powerful evidence of social and cultural change in China, with important implications for the economic—and ultimately political—behavior of younger generations of Chinese. What's more, interviews did suggest that even in low-skill industries such as garment manufacturing in southern China, staff turnover is very high. Rural peasants reportedly leave urban factories within a year of arrival, more often to work elsewhere locally than to return home (annual turnover at a textile firm with headquarters in Hong Kong and factories in Guangdong approached 100 percent; #8).

Human resource managers for FIEs do not always see the turnover trend in such a rosy light: for them, it threatens company growth and leaves some firms unready for market while ventures that were established earlier build an unassailable advantage. The temporary surge of demand for young Chinese professionals has put tremendous leverage in the hands of people in urban areas whom Margaret Pearson (1997) calls "China's new business elite." That leverage is largely a function of the arrival of foreign investors.

Insulation

By the standards of the Organization for Economic Cooperation and Development, the Chinese marketplace is not particularly "clean" in its commercial practices. Virtually anyone who has done business in China says that playing entirely by the rules is not an option: kickbacks, bribes, favors, rough collection tactics, and other irregularities are ubiquitous.²² Informal affiliation with local Chinese staff is sometimes used to insulate FIEs from disreputable practices, ensuring distance (and deniability) while at the same time providing a modicum of foreign control. Foreign managers can point to the "complexities" of local markets and claim to prefer dealing with buyers and sellers through an intermediary (thereby also acknowledging the importance of personal connections in Chinese business culture). Such "subcontractors" ostensibly form a barrier between foreign investors and operations that dispose of toxic or hazardous wastes, "convert" imports across the Hong Kong border at low tariff rates (see chapter 5), manage factories with substandard labor conditions, and so on. These arrangements conveniently shield foreign managers (who, if American, are liable to the FCPA) from blame for dubious practices.

22. There will always be a few who insist that they have found a magic way to insulate themselves from these pressures.

FIEs are also using loose organizational affiliations to expand their scope of business beyond the restrictions set by Chinese law. Central authorities have withheld distribution and service rights from non-Chinese firms, partly under pressure from local industries. But in alliance with Chinese firms legally permitted to exploit such areas, FIEs circumvent the rules, often controlling the Chinese “front” company. In many cases this is done with tacit approval from local authorities. Central authorities no doubt are generally aware of these practices as well, but still the ruse of insulation is important. The FIE needs a defense should it attract too much bureaucratic attention, and authorities need an appearance of propriety to retain “face”: that is, to avoid appearing impotent to enforce the law.

All this is reminiscent of the comprador phenomenon. Foreign businesses operating in China prior to the Communist era used Chinese merchant-middlemen, known as compradors (a term borrowed in the mid-19th century from the Portuguese word for “buyer”), as intermediaries to the markets for many of the same reasons: they provided knowledge of the language and culture, some political protection, and insulation from corrupt practices. Some expatriates describe the present business environment as “the return of the compradors.”

Some Western firms (e.g., Nike and Reebok in the footwear and garment industries), criticized for such arm’s-length stratagems, have responded by trying to manage the work environments of their subcontractors more closely (Chan and Senser 1997).²³ Clothing conglomerate Liz Claiborne now requires all subcontractors to meet the “Liz List,” a checklist that takes account of a broad set of labor conditions. The CEO of one textile firm subject to the checklist (#8) suggested that such voluntary standards (in large part devised for good public relations) are having real, beneficial effects in factories in southern China.

However, these voluntary regimes are not likely to satisfy labor advocates. Although it has had a “standards for vendors” program in place since 1992, Wal-Mart Stores of the United States continues to skirmish with activists over its “Kathie Lee” clothing line, partly manufactured in China.²⁴ The National Labor Committee, a watchdog group, claims that Wal-Mart is incapable of monitoring Chinese subcontractor practices and calls their certification program ineffectual. Judging compliance with labor standards is highly inexact, and debates about the efficacy of certifications and checklists will be determined by public relations concerns as much as by anything else. Irrespective of their other merits, however, such scuffles do raise awareness of labor issues. Labor advocates believe that any pub-

23. See also Anita Chan, “Boot Camp at the Shoe Factory,” *Washington Post*, 3 November 1996, C1; Dana Canedy, “Peering into the Shadows of Corporate Dealings,” *New York Times*, 25 March 1997, B1; and “Group Faults Reebok, Nike on Child Labor,” *Journal of Commerce*, 22 September 1997, 3A.

24. Reuters, <http://biz.yahoo.com/finance/980318/walmart>, June 1998.

licity is good publicity, and businesses' voluntary programs—even if undertaken solely to forestall bad press—may have virtuous results.

In the Background: Human Rights

FIE managers in China have a strikingly low opinion of the fixation on human rights back home (especially in the United States), which is seen as hopelessly misdirected in light of the epochal social changes taking place across China today. Expatriates see misunderstanding of common Chinese attitudes about government, failure to grasp the connection between these attitudes and per capita income growth, and ignorance of the scale and scope of the reforms with which authorities are wrestling. They focus instead on the rapid growth of social and economic freedom in China over the reform period and the government's relative success to date in managing these changes since 1978.²⁵ Indeed, China has achieved far more than anyone could have reasonably predicted before reform began. Thus when talk turns to human rights, many expatriates tend to lecture their Western compatriots.

However, the interviewees realize that this perception could destroy the hard-won beachheads established by FIEs, regardless of their capacity to function as catalysts for social change, and therefore it must be taken seriously. The more thoughtful managers were also aware that, as Bette Bao Lord of New York's Freedom House has remarked, China does not have a suitable safety valve to harmlessly vent the steam building up from civil dissatisfaction (personal communication, 23 April 1998). Though FIEs are doing much to facilitate a change in culture by demonstrating a new sort of employer-employee social contract, based on individual rights and responsibilities, they must do more, this argument goes, to ensure the safety of their golden goose. But what is the "more" that the virtuous company can do?

A significant number of the firms involved in this study have instituted voluntary standards programs designed to assess their performance concerning human and labor rights, and many hosted visits and factory tours for US members of Congress in 1997. These programs and exchanges have been useful steps toward giving Western opinion makers a better understanding of Chinese conditions. However, most FIEs still have not sufficiently communicated to home audiences their labor experiences in China.

There is evidence of reasoned thinking in this debate on China. Models of fair allocation of responsibilities to press human rights concerns in China (Santoro 1998 is a good example) distinguish between, on the one

25. Commentators usually remark on the opposite: the imbalances in development taking place in China. But social imbalances plagued Chinese society long before the market was introduced; the difference now is that more of the problems are related to prosperity, not simply poverty.

hand, the FIEs' responsibility for the conditions found under their roofs, in the course of their business, and among their subcontractors and, on the other hand, general levels of human rights in China outside their scope of business. Such differentiation is practically as well as ethically sound. If firms were expected to pressure the Chinese on questions of human rights outside their operations, they would be so distracted from the tasks of doing business that most would be bankrupted and the opportunity to sow change even locally would be lost.

The Chinese authorities also bear blame for the unfavorable perceptions of their country, not only because they still resist political liberalization but also because they have failed to take seriously the importance of public diplomacy abroad. Beijing's disastrous neglect of its image suggests a lack of concern for the sensibilities and democratic political processes with which other world leaders must contend. Bad Chinese media management, in other words, has made the job of other foreign policymakers trying to build bridges to China more difficult.²⁶ This has begun to change in 1997–98, with the early release of prominent dissidents, a less bellicose dialogue with Taiwan, and a more tempered reaction to the cacophonous anti-China rancor in the US Congress.

Nonetheless, ultimate responsibility for a sound policy toward China rests with the foreign nation itself. Richard Latham, president of United Technologies Beijing office, remarked to members of Congress visiting Beijing in January 1997:

We play a fool's game if we overplay our hand or misunderstand the stakes in the relationship. Fifty years from now, we'll find that our good intentions didn't secure much in the long term for a democratic China, but it will have cost us mightily in terms of our trading tradition. And here is the true irony: China will be a much more democratic society, albeit with Chinese characteristics. And people will be hard put to show any linkage with the US-China dialogues of the early 1990s. (Latham 1997)

Latham encapsulates the wisdom of foreign firms regarding the relationship between human rights and human resources. First, Westerners do have a hand to play—as major customers, they have the ability (and the right) to tell our merchant a thing or two; but they should not overestimate its value. Second, the aggressive unilateral tactics embraced to date have accomplished little for anyone other than the interest groups clustered around Capitol Hill. Third, and ironically, China is changing for the better on its own, by virtue of rising standards of living, increased daily caloric intake, movement of industrial facilities out of populated urban areas, and loosened controls over employment, residence, schooling, and ideology. Should threats to impose damaging sanctions on the Chinese

26. A conference on US-China media perceptions was cosponsored 6–8 May 1998 by the National Committee on US-China Relations, Harvard University, and American University; the proceedings can be accessed at <http://chinamedia.soc.american.edu>.

economy be carried out, the results would undoubtedly be regressive. Once China does achieve the degree of liberality countenanced by the West, will the record show that it happened because of economic sanctions, or despite them? The evidence of narrow limits on the utility of sanctions is nearly conclusive (see Hufbauer, Schott, and Elliott 1990).

Analysis

The view of FIEs and the Chinese labor market that emerges from this chapter has a number of implications. First, foreign economic officials should recognize that human resource constraints not related to policy explain many difficulties encountered by foreign firms in China. This deflates somewhat the thesis that trade policy pressure can compel the Chinese government to remedy all foreign investor woes. Thus, a better understanding of Chinese personnel challenges can both temper the appetite for aggressive trade policy that many Westerners have worked up and redirect attention to those areas where policy pressure is more likely to have beneficial effects.

Second, there are indeed policy dimensions to the labor situation in China today: roughly half the concerns raised by interviewees do have a policy aspect. Some of these are amenable to pressure from China's trading partners, and chapter 7 offers a prescriptive agenda for addressing them.

Third, in light of this analysis, groups fighting for human and labor rights might reconsider their dark depictions of FIEs' impact on labor and civil society in China—that is, if their interests are genuine and not merely protectionist. If the goal of developed-country labor advocates is really solidarity with workers in China, not just protection from foreign competition, then they must distinguish between the many foreign firms contributing positively to Chinese development and the notorious cases in which investors are involved in abuse. If standards are ratcheted up so high that FIEs are made to pull out of China, Chinese workers will be deprived of the beneficial impacts of the foreign presence while receiving little real help in its place. Human rights activists, too, must respect the extent to which economic changes, including—if not especially—those brought about through foreign investment, drive progress; and foreign withdrawal would unquestionably slow that progress.

The four drivers behind the human resource issues described in this chapter are examined next. Table 3.9 summarizes the 14 human resource themes treated in this chapter, the categories of problem at issue, and the level and importance of the policy dimensions.²⁷

27. The question of labor unions in China has not been discussed in this chapter; somewhat surprisingly, the topic rarely arose in the interviews.

Table 3.9 Roundup of issues: labor

Issue	Category	If policy . . .	
		Level	Priority
Nontransparent approval	Policy	Central, provincial, local	Medium
Availability of skilled, semiskilled labor	Transitional		
Pressure to overstaff	Policy	Central, provincial, local	Medium
Selecting the “right” staff	Self-imposed, policy	Local	Low
Securing managerial control	Self-imposed, policy	Central	High
Ability to employ expatriates	Self-imposed, policy	Central	Low
Wage pressures and patterns	Transitional, self- imposed		
Mobility	Transitional, policy	Central	Medium
High nonwage costs	Transitional, policy	Central	Low
Training capacity issues	Transitional		
Quality management	Transitional		
Retention problems	Transitional		
Comprador employment	Transitional, policy, self-imposed	Local	High, medium
Human rights, labor rights	Transitional, policy	Central	Low

Transitional and Self-Imposed Factors

Many problems in the human resources area have transitional or self-imposed aspects. Availability of skilled staff, a first-order concern for FIEs, is transitional in nature. Wage pressures are obviously related to this undersupply and share a transitional dimension, although a reckless tendency to poach others’ employees by offering bloated salaries rather than training one’s own staff represents a self-imposed problem. Reaching an equilibrium of demand and supply for skilled and semiskilled workers will require time and the reallocation of resources by the market; meanwhile, volatility in salaries and high staff turnover will continue. These are natural challenges on the road to a market economy, though the further a nation had departed from an efficiency-oriented model prior to reform, the greater they are (in China’s case, this departure was epic).

Foreign investors and indigenous firms alike struggle to find the right people and impose predictability on their payrolls while the infrastructure necessary for adequate human resources (everything from schools to want ads) reevolves. Everyone has an interest in seeing these problems fixed, not least FIEs—which are making a disproportionately large contri-

bution to building a functional labor market by adding training capacity and creating the benchmarks for effective human resource practices.

Many self-imposed problems stem from FIEs' recklessness as they rushed to enter the Chinese market. Many foreign investors have carefully built their Chinese teams, but others have set up without understanding local sensibilities, regulations, prerogatives, or economics. Following those poor starts, many firms try wrongheaded approaches to training and incentives, using managerial techniques ill suited to China or reacting to underdeveloped local conditions with disdain. A major problem is the failure to bridge the cultural divide between different languages and traditions that creates misunderstandings between partners from different backgrounds. Remedying those misunderstandings requires time, exposure to one another, and a willingness to learn. It is the need to bridge these divides that has led to the widespread employment of overseas Chinese to help in managing Western ventures, a trend that is mutually beneficial as long as it doesn't decay into mere dependency on new age compradors instead of real marketplace learning.

Policy Issues

Policy issues remain a significant problem in the human resources area as well. They begin before the firm exists: the nontransparency of establishment, a policy-related problem in part, affects human resources as it does every negotiated area. Approval of a foreign venture is conditioned on the labor authority accepting the human resources contract. These authorities operate with wide discretion to require changes and concessions, and they leave the FIE little avenue for formal recourse (and little chance that investors would be wise to seek such recourse when it is available). Resolving these matters rests primarily with central authorities, who have the power to streamline labor-related approvals, especially by restricting the scope for arbitrary action by local officials captured by special interests. Some progressive local areas and certain economic zones have blazed the trail by basing approval of labor agreements entirely on well-defined criteria.

Lack of transparency affects foreign investors in China generally; but pressure to overstaff is a very specific policy-related labor problem. As already noted, the overstaffing problem is today better managed by foreign enterprises, thanks to experience and new mechanisms for shifting surplus workers elsewhere (including buyouts and the use of retraining agencies). Nevertheless, there remains policy pressure to overstaff foreign enterprises (just as for domestic enterprises), especially in sectors undergoing deep adjustments. It arises because of high-level anxieties about employment, and it affects FIEs at all levels of approval. While overstaffing pressure has a transitional aspect, the problem will not go away

until central authorities, changing their policy, decide to stop trying to deal with unemployment through imposed labor rigidity.

Rhetoric at the National People's Congress meetings of March 1998 suggests that leaders are aware that this is the way forward. At the 15 September 1997 Congress opening, President Jiang Zemin had focused on reform of the social safety net to facilitate labor adjustment. However, some expatriates are concerned that the increase in unemployment stemming from quickened SOE reform in 1998–2000 and the Asian financial crisis will lead to renewed pressures to overstaff.

Restrictions on the foreign enterprise's ability to select what it considers the right staff are self-evidently related to policy. However, this problem is typically expressed at the local level, as overseeing authorities try to secure positions for friends or Chinese partners attempt to pad the payroll with cronies: central authorities do not generally support or defend such practices. But central officials have interfered with FIEs' ability to hire expatriates, reflecting an enduring suspicion that each foreign employee represents a high cost and the loss of one more local management job. Local authorities seem to rely on more highly placed officials to tell foreign negotiators seeking approval to cut back on the number of expatriate employees. Increasingly, this is more a financial question of whether a JV should be expected to pay all the costs of expatriate staff than an ideological worry about foreigners running the show (although that has not entirely disappeared).²⁸

Foreign enterprises' managerial control over their ventures is hampered by central policy. The Guidelines on foreign investment forbid using the WOFE structure or require Chinese majority control in many industries. If foreign investors cannot control the company board, they cannot freely manage human resources. Even foreign majority JVs and WOFEs can be pressured to share control. They may have to return to examination and approval authorities if they wish to change labor practices. FIEs can also be subject to greater labor union activity than domestic firms are. Although in practice the authorities responsible for limiting foreign control often remain silent *unless* a Chinese interest beseeches them to do something, the potential to restrict the rights of foreign management remains and raises issues of national treatment.

While the wage costs that many FIEs face are increasingly market-driven, the nonwage bill—a policy-related factor—remains significant. The central government must lead in reforming the Chinese social security system. At present a mosaic of experimental policies stretches across the country. These costs appear to be marginally higher for FIEs than for domestic enterprises. Far more serious, however, is the difficulty caused

28. A number of Chinese sources argued that covering the costs of foreign staff was sometimes a surreptitious means of extracting gross cash flow from the venture without attracting attention from authorities. Expatriates also described the use of various fees to compensate the parent for costs that the JV did not want to pay directly.

by conflicting or incompatible obligations across jurisdictions; these thwart a firm's efforts to operate regionally or nationally and aggravate the labor rigidities that hamper staff adjustment.

The inchoate state of social security reform is just one source of difficulties faced by FIE staff (and by dynamic domestic firms as well); the bureaucratic *hukou* and *dang an* systems also impede reform. Like many problems connected to the immobility of the labor force, these are partly transitional matters that will lessen with time and market reallocation; but if this reform is to take root, they must also be addressed on a policy level.

A final policy matter is the phenomenon of comprador employment used to skirt either Chinese regulatory blockades or US laws governing corrupt practices. Central authorities promulgate vague statutes in order to mask their uncertainty about regulatory direction, and then they tolerate the extraordinary interpretations that proliferate. Ambiguities in their policies buy leaders time to adjust course while maintaining a consensus favoring reform; they also foster a commercial environment in which compradors are everywhere and respect for law is hard to find.

Nine of 14 labor issues in this chapter included a policy aspect, but in only two cases—securing managerial control and dealing with compradors—did they strike the interviewees as high priority. Regarding compradors, policy shapes the FIEs' problems in fairly indirect ways; it is just as much a problem that the FIEs bring on themselves.

In most cases the policy element derives from central authority, either the Ministry of Labor (which is slated for future merger with the Social Security Administration) or the line ministries that also have a say about the employment contracts. Operationally, however, labor issues and policy clash entirely at the local level.

Market Structure

None of the problems addressed in this chapter necessarily result from competition policy, but the overall situation does have a market structure aspect. An inefficient market structure, which is likely when governments tolerate monopolies or oligopolies, lowers the quality of the labor market and diminishes leverage for labor as well (Graham and Richardson 1997c, 36–37). Such market conditions reduce competitiveness and erode productivity.²⁹ Through their inaction, central authorities fail to restrain lower levels of government from dampening competition. Labor contracts require approval from local authorities with parochial priorities, and the results serve Chinese workers poorly in the long run. Social insurance

29. Ironically, in a rare exception to the protection of competition under US antitrust law, the Clayton Act specifically permits workers to collude together to bargain over wages—that is, to form unions; but in negative symmetry, this is one area in which Chinese authorities have certainly *not* permitted collusion (Fox and Pitofsky 1997, 261).

schemes are still funded haphazardly and the profession of pension fund management barely exists. Until the central authorities enforce the rights of FIEs and local firms alike to choose labor solutions, as well as create the conditions and regulatory framework necessary to support the pension and benefit needs of a national labor market (instead of innumerable local ones), labor problems rooted in competition policy will worsen.

A Concluding Note

This review of FIE labor experiences in China underscores the importance of developing the human assets of the firm in order to succeed in China. Though Chinese government policy hampers the ability of FIEs to meet the challenge, firms are playing an important role in building China's human resources capacity. Cooperative efforts to increase training and educational programs (e.g., producing MBAs) also increase the supply of skilled labor at the margins. Bilateral and multilateral government interactions that address the centrality of building human capacity to China's development could support several agendas (much more effectively than simply complaining about policy impediments).

That foreign firms engender a model of greater firm reinvestment than domestic enterprises has a macroeconomic significance worth considering. Recent efforts to measure household income in China (Khan and Riskin 1998, 235) suggest that the growth of personal income has lagged behind GNP growth considerably between 1988 and 1995. The explanation lies in relatively greater income accumulation by businesses than by the government or household sectors. Because personal income is a better indicator of poverty than GNP, analysts should be concerned with developing a marketplace in which profits are distributed and invested as productively as possible.

The human resources puzzle clearly has a human rights dimension. The relatively high salary and benefits, intensive training efforts, home financing experiments, and corporate culture of many (especially Western) FIEs have a virtuous impact on workers in China; as noted in chapter 7, foreigners create more of these higher-value-added opportunities as they become more deeply involved in the Chinese market. American firms, perceived to be most socially conscious in terms of the employer-employee relationship, are ironically under the greatest pressure from home-country special interests to delay deepening their operations in China. Indeed, probably only the withdrawal of foreign participants from China's marketplace could reverse the current positive trend; it would be ironic if that came to pass *because of* a concern for human rights. To be sure, the Chinese human rights and labor conditions do not resemble those in Japan, Europe, or the United States. But the improvements in labor practices in China since reforms began are manifest to most foreign observers who live and work there, and they themselves have something to do with the change.