

Jump! And we may catch you

Despite being enshrined in law, social security contributions in China change from city to city and many firms pay little if nothing, reveal *Xiaolei Qian* and *Russell Smyth*.

One of the major challenges for foreign companies in China is working out what their social security obligations are under China's Labour Law. At present, all China's employees are entitled to industrial injury insurance, maternity insurance, medical insurance, old age pension insurance and unemployment insurance.

WHAT ARE THE BUSINESS SOCIAL SECURITY OBLIGATIONS ON BUSINESS?

The levels of contributions vary from city to city, however. Table 1 shows specified contribution rates in 2005 for five Chinese cities that have been major destinations for foreign direct investment (FDI). In not all of the five cities are employers required to contribute to the full range of social insurances.

In Beijing, Guangzhou and Shanghai, employers must contribute for each of the social insurances, but in Dongguan and Shenzhen there is no provision for maternity insurance. In both Beijing and Guangzhou there is an additional levy on employers for a 'serious illness' fund. In Beijing and Shenzhen, the applicable rates for industrial injury insurance depend on the type of industry and the actuarial computed risk of injury in the workplace, while in Dongguan flat rates are adopted for industrial injury insurance.

For old age pension insurance both employers and employees have to contribute in all five cities. None of the five cities require employees to contribute to industrial injury insurance. For maternity insurance, medical insurance and unemployment insurance whether the employee contributes varies from city to city.

Table 1:
Contribution rates of five Chinese cities in 2005

Cities	Average wage 2004 (RMB)	Old age pension (%)		
		Contribution	Employer	Employee
Beijing	2362	28	20	8
Dongguan	820	18	10	8
Guangzhou	2585	28	20	8
Shanghai	2033	30	22	8
Shenzhen	2661	14	9	5

Challenges for a developing legal system

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The OECD White Paper on Corporate Governance (2003) highlighted a number of measures that all Asian governments should introduce or consider strengthening as a matter of priority. The Paper pointed to the need to address such matters as disclosure and transparency, director self-dealing, strengthening regulatory capacity and enhancing the fiduciary duties of directors.

Employer contributions are based on the average wage of the previous year, but vary from city to city. So firms need to monitor the average wage in the city in which they have invested.

WHO COMPLIES WITH SOCIAL INSURANCE OBLIGATIONS?

Table 1 also reveals that social security costs in China are relatively high compared with the rest of Asia. The World Bank estimates that 40-50 per cent of an employee's salary goes into social security and fringe benefits, compared with 16 per cent in India, 12 per cent in Malaysia, 10-15 per cent in Indonesia and 20 per cent in developed countries like Australia. Enforcement however is a different matter, with many municipal governments reluctant to enforce compliance for fear of losing investment to other locales in China or even offshore to other low labour cost countries in Asia, such as India

and Vietnam. Multinationals such as General Motors, Honda, Intel and Motorola have already shifted manufacturing operations to the central and western provinces of China to take advantage of lower labour costs.

Evidence suggests that municipal governments in China are turning a blind eye to employers' failure to meet social insurance obligations and indeed are even using this as a means to lure investors. Some local governments in Guangdong have declared that foreign-invested enterprises do not have to pay social insurance at all and in Shanghai the fear of losing investments to surrounding provinces like Jiangsu and Zhejiang weakens enforcement resolve.

The sensitive nature of compliance rate data makes any information rare. The data from this study on the level of firm compliance with social security obligations in Shanghai for 2001 and 2002 was provided by Shanghai's Ministry of Labour and Social Security. As

Medical insurance (%)			Unemployment insurance (%)			Industrial Injury insurance (%)			Maternity insurance (%)			Serious illness (RMB per person per month)		
Contribution	Employer	Employee	Contribution	Employer	Employee	Contribution	Employer	Employee	Contribution	Employer	Employee	Contribution	Employer	Employee
12	10	2	2	1.5	0.5	0.4	0.4	-	0.8	0.8	-	3	-	3
2	2	-	2	1.5	0.5	0.5-1.5	0.5-1.5	-	-	-	-	-	-	-
10	8	2	3	2	1	0.7	0.7	-	0.7	0.7	-	5	-	5
14	12	2	3	2	1	0.5	0.5	-	0.5	0.5	-	-	-	-
9	7	2	0.4	0.4	-	0.5	0.5	-	-	-	-	-	-	-

Significantly, however, the White Paper also referred generally to a number of features of the Asian business landscape that are pertinent to the process of legal and regulatory change. The historical, cultural and social traditions of country, as well as the interplay between the political and legal systems all come to mind in this context. The People's Republic of China (PRC) has recently undertaken a comprehensive corporate law program to reinforce corporate governance measures applying to its listed sector.

This paper maps out the background and historical context in which the corporate law framework has developed and provides an overview of recent developments in corporate law reform, indicating scope for further research to identify potential 'rule of law' barriers and impediments to the effective implementation of the PRC's corporate law reform programs. The paper considers whether the recent corporate law reforms implemented after China's accession to the World Trade Organisation (WTO) represent

early progress towards 'rule of law' or strategic window dressing.

The conclusions drawn from this study were that many leading Western experts on the Sino legal system believe that even in the long-term, substantial progress towards rule of law is not foreseeable. Others argue more optimistically that the PRC is in transition from rule by law to a 'thin' version of rule of law. Presently, however, there are powerful structural and cultural impediments to real progress towards rule of law in

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China's richest city, with gross domestic product (GDP) almost double that of Beijing, Shanghai is not representative of the rest of China. Its municipal government has traditionally been very powerful with enviable resources compared to almost every other Chinese city. Because of this privileged position one would expect compliance rates in Shanghai to be higher than the rest of China but an independent audit of 2,600 companies there found that at least 80 per cent were not paying what they should. If this is true in Shanghai the rest of the country may just as well be worse makes Shanghai's non-compliance figures all the more shocking.

The data on compliance rates according to industry and ownership type are reported in Tables 2 and 3. Table 2 contains information for 12 industries for 2001 and 2002. Over the two years the highest rates of non-compliance were among electricity, gas and water, real estate and scientific research companies. Banking sector non-compliance was relatively high in 2001, but did not increase much in 2002. In 2001 there were no industries in which the rate of non-compliance exceeded 80 per cent; however, in 2002 the rate of non-compliance exceeded 80 per cent in 10 of the 12 industries.

Table 3 contains data on compliance rates for five ownership categories: state-owned enterprises (SOEs), collectively-owned enterprises (COEs), shareholding firms, private firms and foreign invested enterprises (FIEs). Non-compliance is highest among FIEs while COEs and SOEs are lowest.

Despite some progress the Chinese authorities have made on paper in setting up a social security regime, many companies enjoy the cost advantage of either not paying anything at all or paying less than they should. The challenge for Chinese authorities is to balance the pressure to keep costs low to attract and retain further foreign investment while ensuring the safety net all its citizens deserve.

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FROM PREVIOUS PAGE

terms of public governance, even applying a 'thin theory' of rule of law. Meaningful restraints on government power are not yet in evidence.

However, while it is fair to say that reform initiatives in the corporate sphere have been compliance-driven for the purposes of international trade obligations following China's accession to the WTO, they show some promise as early examples of stage one commercial law reform in terms of the 'rule of law' framework (outlined in the full paper).

The Code of Corporate Governance provides at least symbolic expression of best internationally bench-marked principles of corporate law, with the Chinese Securities Regulatory Commission (CSRC) being more proactive recently in enforcement

and providing guidelines to facilitate compliance. The 2006 law is a surprisingly well-developed law considering the transitional difficulties facing PRC in moving to a market-oriented economy. Nevertheless, some significant gaps and deficiencies are evident, particularly from an investor protection perspective. Directors and managers are not subject to an objective duty of care and whether the 'duty of loyalty' equates to a full-blown fiduciary duty is unclear, as are the rules for shareholder suits and related party transactions with the company.

In practice much more is to be done. Below the surface, rule of law progress, other than so-called commercial rule of law, is slow. Rule of law scholars and practitioners would have been encouraged, however, by the recent

decision of the National People's Congress (March 2007) to develop detailed laws for the protection of private property. This is seen as significant to reinforce the symbolic recognition of property rights provided by the PRC Constitutional amendment of 2004.

Further empirical research is necessary to identify specific mechanisms which might be failing shareholders and investors in this regard. Factors which impact on disclosure and investor protection, such as the role of whistleblowers, minority shareholder groups and the financial press warrant further evaluation. Finally, and perhaps most importantly, some follow up research into the implementation of the 2006 Company Law will be necessary, looking particularly at the adequacy of shareholder suits and of regulatory tools and powers.