

# **Labor Dispatch in China: The End of an Era**

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## **Labor Dispatch in China: The End of an Era**

By Jeanette Yu

In China, labor dispatch refers to the employment method enterprises use under which employees are dispatched by a human resources agency specifically engaged in the labor dispatch business. The client enterprise does not have a direct employment relationship with the dispatched employees, but uses them for work based on a service contract with the human resources agency.

In recent years, labor dispatch has become an important method of recruitment for enterprises doing business in China. The situation began to change, however, with the amendment of the Labor Contract Law by the Standing Committee of the National People's Congress on Dec. 28, 2012, which became effective on July 1, 2013 (Amended Labor Contract Law), and the Interim Regulations on Labor Dispatch (Interim Regulations) issued by the Ministry of Human Resources and Social Security and effective March 1, 2014. Those two regulations provided new requirements on the use of dispatched employees in China.

### **Background Information**

Before 2008, labor dispatch was not a very common employment method for most enterprises in China. It merely applied to representative offices of foreign enterprises because, as foreign legal entities, they are not allowed to directly hire Chinese employees in China.

Since the 2008 enactment of the Labor Contract Law, many Chinese enterprises have started to use dispatched employees for various reasons. One of the reasons is that employers are required to sign indefinite-term contracts with directly hired employees who have worked for a certain period of time. Enterprises using dispatched employees have more flexibility on headcount and thus better budget control.

Another example is provided by engineering companies, which can encounter difficulties in handling the employment relationships of employees in different locations due to different local practices.

By 2011, there were 37 million dispatched employees, accounting for 13.1 percent of total employees in China. <sup>1</sup>

Frequent use of dispatched employees has caused a number of problems in recent years. For example, many dispatched employees have not been paid commensurate with their work. In addition, the health and safety rights of dispatched employees have not always

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<sup>1</sup> [http://www.npc.gov.cn/npc/zgrdzz/2012-07/09/content\\_1729315.htm](http://www.npc.gov.cn/npc/zgrdzz/2012-07/09/content_1729315.htm)

been well protected. To address these problems, the Chinese government determined to change the situation by implementing new regulations.

### **New Requirements on the Use of Dispatched Employees**

- **Limitation on the use of dispatched employees**

The Amended Labor Contract Law emphasizes that direct hiring of employees under an employment contract should be the primary means of employment in China. The method of labor dispatch can only be supplementary. Further, as required by the Interim Regulations, the number of dispatched employees used by a company cannot exceed 10 percent of the total number of employees.

In addition to the limitation on numbers, under the Amended Labor Contract Law, an employer can only use dispatched employees for work positions that are temporary, auxiliary or substitute in nature. As defined by the Amended Labor Contract Law, a “temporary” work position refers to a position that lasts no longer than six months, an “auxiliary” position refers to a position that provides supporting services to the core business positions of an enterprise, and a “substitute” position refers to a position that is temporarily vacant due (for example) to an employee taking leave.

Under the Interim Regulations, the scope of “auxiliary” positions must be determined by the enterprise following democratic procedures provided by PRC labor law. In other words, the enterprise must consult with its employees, negotiate with them if they have different opinions and then make a final decision on the scope of “auxiliary” positions and announce it to the employees.

These requirements make labor dispatch unsuitable as the principal employment method for most enterprises. These restrictions, however, do not apply to the representative offices of foreign companies and shipping companies using international seamen.

- **Equal pay for equal work**

The Amended Labor Contract Law requires that an enterprise apply the principle of equal pay for equal work to dispatched employees. This means that dispatched employees doing the same work as directly hired employees must enjoy the same salary allocation system. If there are no directly hired employees doing the same work, the enterprise must base remuneration paid dispatched employees on what employees doing the same or similar work in the area where the enterprise is located are paid.

The Interim Regulations also require that the principle of equal pay for equal work

be applied to the work-position-related benefits dispatched employees receive. In other words, dispatched workers should receive the same benefits which are related to their work positions as directly hired employees doing the same work.

Legally, employees' benefits include not only the statutory ones such as social insurance and housing fund, but also those provided by the enterprise voluntarily such as commercial insurance, various allowances or subsidies. The Interim Regulations specifically require that employees dispatched from other geographic areas rather than their actual work locations be provided with statutory social insurance at their actual work locations in accordance with the local regulations.

Unfortunately, the Interim Regulations give no guidelines on how to determine whether a benefit is related to a particular work position or not.

- **Qualification of human resources agencies**

The Amended Labor Contract Law also imposes new requirements on human resources agencies in the labor dispatch business. Starting July 1, 2013, a company providing labor dispatch services must have a minimum registered capital of 2 million yuan, fixed office premises and facilities, as well as relevant management rules on dispatched employees. In the past, the minimum registered capital of such agencies was only 500,000 yuan.

To engage in labor dispatch business, a human resources agency must also obtain a special license, a Labor Dispatch Operation Permit, which is issued by the labor administration authority. A company that fails to get such a license will not be allowed to engage in labor dispatch business.

### **Legal Risks of Noncompliance With the New Requirements**

According to the Amended Labor Contract Law, if a company fails to use its dispatched employees in compliance with the law, the labor administration authority can order the enterprise to rectify the situation within a prescribed period. If the enterprise remains out of compliance, a penalty of from 5,000 to 10,000 yuan may be imposed on the enterprise for each dispatched employee.

In addition to administrative sanctions, dispatched employees working in positions that are not temporary, auxiliary or substitute can bring claims directly against the company. In the original draft of the Interim Regulations released for public discussion, the labor administration authority could have required an employer to establish a direct employment relationship with the employees dispatched for nonqualifying work. The fact that these provisions were left out of the final version does not lessen employer liabilities. On the contrary, this gives the labor arbitration commissions or the People's Courts in various locations more discretionary power to make a judgment on the factual

employment relationship, which can increase the legal risks for enterprises using dispatched employees.

Further, if an enterprise using dispatched employees does not comply with the equal pay for equal work requirements, the dispatched employees are entitled to bring claims against the enterprise and ask for compensation. It is likely that in the future, labor disputes will be raised on this issue, in particular regarding benefits because the connection between particular benefits and a particular work position has not been made clear.

### **Government's Attitude Towards the Enforcement of the New Requirements**

During a press interview, an official of the Ministry of Human Resources and Social Security said that the government hopes employers not in compliance with the new rules on dispatched employees can adjust their employment practices in a gradual and orderly manner<sup>2</sup>. To achieve this goal, transition measures are provided in both the Amended Labor Contract Law and the Interim Regulations.

- Labor contracts and secondment agreements that have been signed before the issuance of the Amended Labor Contract Law, i.e. Dec. 28, 2012, are allowed to continue in force until expiration. Employees holding such contracts will not be considered in the calculation of the percentage of dispatched employees.
- If an enterprise has used 10 percent or more dispatched employees after the effective date of the Interim Regulations, i.e. March 1, 2014, it cannot hire new dispatched employees and should adjust the percentage to 10 percent or below within two years, i.e. by Feb. 29, 2016, by making a schedule and filing it with the relevant labor administration authority.
- All existing human resources agencies engaging in the labor dispatch business are required to reregister before July 1, 2014, i.e. one year after the effective date of the Amended Labor Contract Law.
- If a human resources agency providing labor dispatch services does not obtain a Labor Dispatch Operation Permit before July 1, 2014, but has signed labor contracts with dispatched employees before July 1, 2013, when the Amended Labor Contract Law became effective, the agency can continue to honor existing contracts until expiration. Without a Labor Dispatch Operation Permit, however, the human resources agency cannot hire new employees or continue to provide labor dispatch services after the labor contracts of the existing employees expire.

The adoption of these transition measures does not mean that the government will

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<sup>2</sup> [http://www.mohrss.gov.cn/SYrlzyhshbzb/dongtaixinwen/shizhengyaowen/201401/t20140126\\_123302.htm](http://www.mohrss.gov.cn/SYrlzyhshbzb/dongtaixinwen/shizhengyaowen/201401/t20140126_123302.htm)

tolerate labor dispatch practices in breach of law in the future. According to the Ministry of Human Resources and Social Security official,<sup>3</sup> the government takes the enforcement of the new requirements on labor dispatch seriously and will make specific inspection on the enforcement and impose punishments on enterprises using dispatched employees in breach of the regulations. Some local governments have already started to take action. Recently, the Beijing Human Resource and Social Security Bureau made a public announcement requiring enterprises using 10 percent or more dispatched employees to submit their adjustment schedules for filing before Aug. 31, 2014.

### **Alternative Employment Methods**

In the future, labor dispatch can no longer be the principal method of employment in China. An enterprise using 10 percent or more dispatched employees needs to consider now how to transition to the new employment regime. The enterprise may either change the employment relationship of the dispatched employees from labor dispatch to direct hiring or change the business model of a part of the business from direct handling to outsourcing.

The Interim Regulations specifically emphasize, however, that any enterprise calling a work relationship outsourcing when it is in fact labor dispatch will be punished according to the Amended Labor Contract Law and the Interim Regulations. Unfortunately, however, PRC law does not provide a clear definition of “outsourcing,” and the nature of any particular employment relationship can only be determined by the relevant labor administration authority. Enterprises should therefore be very careful when changing their employment method.

### **About the Author**

*Jeanette Yu* has more than 15 years’ experience advising clients on Chinese employment and commercial law. She joined CMS China in 2005 after working for local law firms in Beijing.

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<sup>3</sup> [http://www.mohrss.gov.cn/SYrlzyhshbzb/dongtaixinwen/shizhengyaowen/201401/t20140126\\_123302.htm](http://www.mohrss.gov.cn/SYrlzyhshbzb/dongtaixinwen/shizhengyaowen/201401/t20140126_123302.htm)