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**Reforming the Philippine Labor Market**

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## *Abstract*

Philippine labor market policies, in the presence of a high degree of excess labor supply, are highly regulated and they tend to be along standards of highly developed markets. The policies adopted by the government are more pro-employed labor than to promote the overall employment of the labor force. These policies made the country to miss the path of labor intensive development in industrial enterprises, a pattern typical of the early growth of East Asian economies. These policies strengthened a powerful labor bureaucracy in the government. Side effects of the regulations and the culture surrounding the disposition of labor management issues encouraged rent-seeking and other motivational distortions in the behavior of labor when employed. The welfare policies as developed have contributed to the distortion in labor skill formation, the tendency to provide an increase of emoluments without any link to productivity growth, and so on. The last part of the essay focuses on the areas of reform suggested by this state of affairs. The balance between welfare and employment creation needs to be continually brought in the forefront. In undertaking reforms, productivity change needs to be placed in the center stage of reforms. Finally, it is argued that the labor sector would find it in its interest to deal positively with the challenges of globalization. This means recognizing that labor market policies need to adjust to global competition. This further means that it emphasize the need to accept that economic liberalization would require encouraging the growth of investments from all sources – including foreign direct investments. Such a route will create jobs and improved welfare for the working man.

*Key words:* Philippine economy, labor market policies, economic reform, employment.

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**Gerardo P. Sicat\***

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## I. Introduction

This paper analyzes the reasons for the high level of unemployment and underemployment in the Philippine economy. The Philippine labor market has been unable to facilitate a high level of employment for the growing labor force. As a result, the economy has failed to provide sufficient jobs as the population expands. The result of this poor performance is the increasing scenes of poverty in the country. This is evident both in urban and rural settings. This unsatisfactory performance has fueled a continuing debate on what ails Philippine development. Many aspects of government approaches to development need to be fixed. A prime candidate for reviewing policies is the labor sector.

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\* Professor Emeritus of Economics, University of the Philippines. I have benefited from discussions and interviews with officials, too many to mention, of various enterprises in the course of several years during travels around the country visiting companies engaged in services and in manufacturing activities.

This essay is focused on labor policies – those aspects of government policy that regulate the employment and the welfare of labor. The discussion is centered on the mainstream economic policies that affects the employment of labor as a factor of production. The refusal to recognize that labor is a part of the productive process in any economy has led to the enactment of laws that often hamper that process. There is a strong link of labor regulations and policies with the manner in which a country's growth and development proceeds. The flow and quantity of investments that are made in an economy depends on how productive the labor sector is. Part of the calculation of that productivity is the wage of labor. The wage issue needs to be highly linked with productivity in that context.

Two accompanying essays have dealt with other aspects of the labor market and the country's economic performance. In the first of these essays [Sicat (2004a)] gives the historical background and political economy of labor issues. The second makes an attempt to analyze the "successes" that have been experienced despite the labor policies that had been in the way of that performance [Sicat (2004b)]. A major finding of these successes is that most of them were reactions against the unwieldiness of the labor market. Many of them have occurred as a result of efforts to avoid the jurisdiction of the mainstream labor market.

In this final essay, the objective is to analyze the continuing problems of the labor market. It makes an effort to probe deeply into factors that have contributed to the unsatisfactory performance of the labor market. After concluding that the problem lies in the inflexibility of the Philippine labor market, the areas of reform are finally suggested.

## **II. Problems of the labor market**

In almost sixty years of independence, the Philippine population has grown at an annual rate of growth that is among the highest in the East Asian region. The labor force is a subset of the population at any one time – that part of "the population 15 years old and over whether employed or unemployed who contribute to the production of goods and services in the country." This is the current definition of the labor force by the National Statistics Office (2003).

The growth of the population can be viewed in perspective through three censuses taken across decades. The 1939 census of population counted 16 million Filipinos. In the first census after political independence (in 1946) that was taken in 1948, the count was 19.6 million Filipinos. The 2000 census enumerated 76.5 million Filipinos. With population growing at 2.36 percent per year (latest census estimate), the estimated count in 2004 is around 84 million people.

Although the labor force definition has changed over this period, using the current definition of the labor force to be the population of 15 year olds and above and taking the calculated average labor force ratio to population for the recent period and applying this ratio to the rest of the population series, the labor force has grown by this amount over this period: 1939, 6.5 million; 1948, 8.0 million; and today (2004) 34.0 million. The growth of the labor force shows at once that the challenge to provide employment in the Philippine economy is daunting.

The country has crafted – over the years – a set of labor policies that are designed to create social justice for the working man. This set of laws have followed labor standards that are relatively close to the modern labor standards, at least in written form, that are found in advanced industrial countries. It has developed, in addition, a large labor department bureaucracy and a long jurisprudence on labor issues, based on the strictures of the labor policies. A list of the basic rights of workers is attached as Table x1 in the appendix.

### **The excess labor supply**

#### *A statistical picture*

According to the National Statistics Office, the rate of unemployment in the labor force in 1992 was 8.6 percent representing 2.26 million workers. In 2002, unemployment was 10.2 percent of the labor force representing 3.42 million workers. The amount of urban unemployment is much larger than rural

unemployment. In 1992, this was 11.4 percent and in 2002, 13.2 percent of the urban labor force. The unemployment rates in rural areas is around half of these rates.

Even these figures of unemployment are misleading. Among the employed workers, there are many workers (according to the statistics agency) who consider themselves *underemployed*. Among those employed in 1992, 22.1 percent of them considered themselves underemployed. In fact, 10 percent of these are considered *visibly underemployed*. In 2002, of the employed workers, 15.3 percent considered themselves underemployed, with 10 percent of them visibly underemployed.

### ***Anatomy of low income employment***

On the basis of the roster of government pension fund employee members of the Government Service Insurance System (GSIS) and the Social Security System (SSS), on very conservative assumptions, I once estimated that 34 percent of the employed Filipino workers receive incomes below the minimum wage. There are no estimates of income groups, but most of those receiving incomes at or above the minimum wage are concentrated at the lower end of the income spectrum.

Once we add to these income earners those who are unemployed and underemployed to the 34 percent above, then the total amount of income earners at the low end – below the minimum wage income – rises to around 50 percent of the labor force. This amount is consistent with estimates of the GDP per head in the country.

### ***Unionized labor***

The total labor force is Labor unions account for about 11 percent to 12 percent of the labor force. To put this another way, 89 percent of the labor force is not unionized. The mainstream labor force is mainly outside of the labor union sector. However, there is a tendency for the labor laws to be designed in response to the policies and proposals that are associated with labor unions.

### ***Endless opportunity and availability of labor for employment***

Most of the literature on poverty reduction is about raising incomes for the poorest among the income groups. This is where the poorest groups are located, and they reside in the rural areas and also in the towns, but more so in the big cities where poverty has sprung in poor human settlements – squatter areas, marginal areas where limited incomes could be generated. This literature should be appreciated for the immensity of the problems of providing growth and employment in the economy. It is discussed in such studies where Balisacan has made many interesting contributions. [See, for instance, Balisacan and Fujisaki (1999).]

Much of the discussion in this paper is related to the other tradition: the creation of jobs in the economic sectors. The discussion will be focused on the growth of jobs from industry, agriculture, and services, mainly from the organized activities that emerge in an economy as a result of its development.

My on-going research notes on labor and employment based on plant visits and interviews that I have conducted focus for instance on where and how employers find the sources of their labor force. Enterprises in general find more applicants for their openings. They have flexibility in the choice of whom to hire because of this. Some of these can be generated from conclusions derived from plant visits and from interviews conducted with officials of these companies.

The establishments include many that are owned by foreign direct investors (American, Japanese, Taiwanese, Singaporean, Hong Kong, English, Australian, Malaysian) although they have included Filipino owned enterprises. Many of these enterprises are located in Subic, Clark, Baguio, Calabarzon, and Mactan were industrial export zones and industrial estates are located. Some of these companies are among the largest employers in the country and are mainly geared to earn exports and therefore are mainly competitive operations.

In all lines of work, whether these be garments manufacture, computer and semiconductor assembly, wood processing, artisan wood works, integrated circuit works, shipbuilding, and so on, the companies did not have much difficulty in finding labor to be hired from the labor supply sources that they tap. There are always available applicants that can be tapped quickly. There were no cases of companies that had a concern about the scarcity of labor requirements whenever there were available openings to be filled.

A large labor supply is available from within the ranks of the unemployed and underemployed. The needed skills of these companies could be amplified when they hire less skilled workers through investments in training that they themselves conduct in-house. This supply is readily found in schools operating within the area or region, in job fairs that are often conducted by the export processing zones, in files at labor recruitment offices, and in the labor networks already available from those who are currently employed workers within the company. The extent of the labor unemployment problem is gauged from the softness of supply and also the fact that the wage rate is not a major issue for workers. The major issue is getting hired or not.

In short, for laborers at the low end of skills, there is no long time search for potential hires. Applicants for jobs are normally available for the firms looking for workers. The problem of hiring is one of the laborers finding their job fits at wages that they (often would readily) accept. These wage rates hover around the minimum wage or slightly above. For more skilled workers, the market has a higher rate of reward. That level of employment is matched by educational background, innate capacity for the work skills being demanded, and, later on, through work experience.

The institution of work training and apprenticeship arrangements has helped to supply these types of workers. Apprenticeship programs from some schools are the gateway for some of the entry into skilled labor employment. The apprentices, paid at minimal cost in terms of allowances at a fraction rate of minimum wages, would later on find their entry into the entry wage level. The pools of trainees and apprentices and other labor supply are often provided within the schools and training institutions in located near the location of these companies.

A study of 227 respondent women employees from 172 firms operating within the Calabarzon region focused on women employees. [See Edralin (2003)]. This study was designed mainly to survey the condition of women workers in export manufacturing companies in the industrial estates and zones. The major point to be made about this study is that women workers are prevalent in labor intensive types of manufacturing operations. They are, by virtue of their numerical superiority in the enterprises studied, the preferred employees in these job specifications. They tend to be more steady workers, are perceived to be less troublesome than men in the work place and are known to be very diligent and focused in their work. They do not get enmeshed in labor union activities and in other side activities that are often considered as inimical to the work discipline. They are known to be very suitable for the work that they are hired in. They also belong to a large pool of labor still available at the wage rates for which these women workers are employed.

Although the study asked about the problems and working conditions of these women workers, it failed to pose the important question which is often the problem in welfare oriented studies about labor conditions. What if these women were not employed, what would be their condition of personal and family welfare? If these women did not have the jobs that they were hired in, what could have been the condition of life of their families?

The answer of course is obvious. These women would be out of work or in other less remunerative occupations, perhaps even in conditions of exploitation and abuse. The large supply of applicants indicates that positions are competitively filled among applicants from whom the hiring company selects its employees.

### **An over-regulated mainstream domestic labor market**

The mainstream labor market of the country is excessively regulated. The regulation has caused the unit cost of labor to rise artificially by government fiat and by regulatory rules as well as by the

jurisprudence on labor issues. The philosophy of caring for the welfare of labor has sometimes led the government to impose benefits that are shouldered by the employer that are out of line with what other countries that other countries in the East Asian region offer their workers at the same stage of industrialization. Labor policies concerning the rights of employment has made it difficult to employ new workers because the unit cost of regularly employed labor has been made expensive.

All countries have labor regulations and standards that protect labor. Some of the standards are accepted pretty much across countries – for instance, workmen’s compensation, social security, on holidays, on the employment of women and of children, on workplace safety, and so on. In fact, foreign direct investments often expect these standards to be part of the labor laws and to comply with them. In other words, up to a point, the labor laws put in place in the country are in line with what appears to be just, humane and expected – to raise the standards by which labor would be accorded greater consideration in the work place.

But in most other countries, the government does not determine rules and regulations about bonuses nor intervene aggressively in determining the nature of the fair wage. The government also gives enormous leeway for enterprises to hire and to fire their employees. The dismissal of workers in an enterprise is not a national concern but one that belongs to processes that may be developed between labor and management in the course of their engagement within the enterprise.

Philippine labor policies require employees to be granted job security. Job security is possible up to a point. In this, it is important that the prerogatives and judgment of management are not interfered with. Job conduct and continuity of employment within an establishment are better left within the labor management processes of particular firms. A firm cannot guarantee jobs if it faces a harsh market for its own survival.

But the government has intervened by making it difficult for the employer to dismiss or to end employment of workers. This is essentially a micro-level problem of the firm. An employee can only be dismissed for cause that had to be justified to the government, requiring the labor department’s permission. The dismissal of workers takes an enormously long and costly process. What should be a matter of industrial relations issue at the company level becomes a bureaucratic process that requiring the attention and support of the government bureaucracy.

Philippine labor policies contain more government interventions on wage supplements and other benefits than do the other countries in the Asian region. Legislation or executive fiat is used much more often to raise the wage level rather than allow the market and collective bargaining at the company level to determine it. This is historically related to the minimum wage law that was enacted in the early 1950s. Fortunately, by the late 1980s, the government adopted the regional minimum wage law, which helped to blunt the tendency to use centralized decisions on the national minimum wage. Unlike in other countries that adopted minimum wages, the basic daily rate allowed had tended to be at variance with what many workers would be willing to work if they had a more steady employment opportunity.

The 13<sup>th</sup> month pay is a unique component of the wage setting process in the Philippines. Initially the 13<sup>th</sup> month pay was designed to give temporary income support to the group of low-wage earners during times of relative income turbulence in the early 1970s. Eventually, it was made to apply to all wage earners as a temporary relief. But in 1987, a populist surge led to the regularization of the 13<sup>th</sup> month pay being made into a benefit for laborers in the payroll. This hurried effort to translate it as an entitlement simply ignored the main principle for which bonuses are really given.

The adoption of regional minimum wage rates helped to reduce the tendency to change wage levels as a national decision. This introduced an element of moderation in minimum wage setting. Regions have adjusted less frequently and often take into account capacity to pay of enterprises and local governments. Regional wage boards were set for the administrative regions of the country composed of tripartite representation of government, labor and employers groups. The regional director of the labor department is chairman and has the regional directors of NEDA and the department of trade and industry as members, together with the appointed members (two each) from labor and from employers.

One effect of the regional wage setting process is to provide a drag on the process of minimum wage adjustments. Whereas when pro-labor advocates seek adjustments in minimum wage rates, the central government had a tendency to respond more quickly to pressure. But the regional institutions are not as easily swayed. They take their time to study the issue at the local level, and start only to do this once the Metro Manila area truly began the process. As a result, the periodic minimum wage rate adjustments have been reduced.

The cost of living allowances (COLA) continue to be undertaken by fiat on a national basis, although less frequently too. The COLA venue would adjust more to market realities if they are made the product of collective bargaining within the establishment or if they would be, like the minimum wage, undertaken at the regional level. The demands for minimum wages have been partly met with some COLA adjustment. Recently, they were made the answer to hold back the adjusting the minimum wage.

In general, as a result of the labor policies covering wages, and especially because those levels were set at a high basis at the very beginning, the unit cost for labor in the Philippines has risen artificially, out of line with the economic realities of abundant labor. To find a link of wage rates and productivity enhancement is desirable. Raising the average wage by government fiat is not likely to strengthen discipline and the growth of productivity. By being mainly directed towards raising the average benefits to all of employed labor, the government inadvertently created a barrier for the promotion of highly labor-using industries. In the process, it pushed the unit cost of labor for Philippine industry higher than warranted by the market realities.

#### *Missing the labor-intensive industrial route*

The policies that dominated Philippine labor policies are responsible for reducing the country's competitive position in labor-intensive activities. That potential competitive advantage could have been developed. The Ranis Report (1974) tried to advocate this. And what many Filipino economists as early as the 1960s, the present writer included, had wanted this to happen. The garments, shoe and other labor-intensive industries that propelled the early economic development of countries like Japan, South Korea, Taiwan, and Hong Kong and, now China and Thailand, did not prosper in the Philippines as they had in these countries. The country essentially shot itself in the foot with policies that were detrimental to the rapid employment of labor.

To say that the above was the outcome only of labor policies is, of course, not entirely correct. For that outcome had received re-enforcement from the string of nationalistic laws that promoted protection for import substituting industries [I recently had occasion to reflect on this issue; see Sicat (2002)]. There was therefore an unintended alliance between the highly restrictive welfare laws of labor and the policy of protection for industry that discouraged growth based on comparative advantage.

In fact, some part of the pro-labor union leadership was also one of the promoters of highly restrictive laws that consigned the country to a dominantly inward looking kind of industrial development for decades. The same was complemented by limitations (until recently) made on the participation of foreign direct investment in participating in many areas of economic activity. Thus, the country missed the big boat that propelled exports of other countries that depended on these types of goods for early specialization in trade. For these countries, the labor intensive export industries became the stepping stones for building an industrialized economy.

The policies for the mainstream labor market are very different from those that the government pursued to promote the overseas contract labor market. The government strongly facilitated the process of encouraging overseas labor contracts. When it discovered that the initial effort of getting the government at the center of the recruitment process was faulty, it ceded the work to the private sector. Of course, this was in response to a demand for private sector participation. The government listened to the private sector that was interested in promoting labor recruitment for overseas contract work. The government succeeded in building a beachhead for Filipino labor for employment in other countries by playing a very supportive



role. This successful niche was found by allowing the market to work and extending participation of the recruitment of contract workers to a wide variety of private sector recruiters.<sup>1</sup>

By contrast, within the domestic labor market, the government has introduced a high degree of intervention on industrial relations and on the costing of labor. When the labor regulators and policy makers discovered the great gap in what they want to achieve with what is appearing in the market – a gap in the implementation of the unrealistic labor laws – they saw the gap as criminal violations of law rather than the impracticality of the laws. So, their solution was often to try to plug the loopholes that were perceived to be the cause of the violations. The result was more regulation and more restrictions. The wrong perception that rigidity in legal provisions would help achieve favorable outcomes for labor only worsened the outcome in terms of raising the cost of labor.

The sum of these interventions has led to the erosion of the country's competitive position as a potential provider of labor intensive goods in international trade. Through welfare and protective labor laws and regulations, the government shut the economy out of taking advantage of the main line of labor-intensive industries that could have led to bigger employment.

***Employment policy: pro-employment vs. pro-“employed labor”***

There is a difference in labor policies that favor employment of labor compared to one that emphasizes the benefits and welfare of the employed sector of the economy. The first type of policy is more likely to promote overall welfare faster when a country faces an excess supply of labor. Getting the unemployed into conditions of sustained employment raises income levels, economic security and economic welfare of the poorest members of the labor force. Focusing policies on the benefits of the employed sector creates a tendency to focus on inequities enjoyed by the employed sector. This leads to the neglect of the problems of generating more jobs as an objective of government policy.

These are the paradoxical but predictable outcome of the labor policies in the country. *The policies predicted to favor labor in the short run by raising the incomes of the employed sector through government actions have produced the failures that were critical for the long run adjustment of providing more jobs in the economy.* In a manner of speaking with respect to labor issues, the cart was placed before the horse.

Pro-labor advocates among politicians often directed their attention to what the employed sector sought from the government – to make the government to intervene in the wage setting and industrial relations setting in order to help their interest. That is very different from being pro-labor. To have the pro-employment policy, the policy has to encompass the interest of the large amount of workers who are employed outside of the organized sector and also the interests of the unemployed and underemployed.

The issues that often distinguish Philippine labor policies from those of other developing countries concern the extent of the government interventions that have an impact on the unit cost of labor. This arises from the interventions on the level of the basic daily rate for the minimum wage and the various add-ons that are considered benefits and entitlements of the employee. Aside from these direct cost related matters, those matters that restrict the decision-making independence of business are important. In this context, it is important how management-labor disputes are handled.

There are many situations in which it is difficult for business to act, especially in matters pertaining to employment. Through regular employment in an enterprise the labor laws provide some guarantee of tenure. Employees cannot be removed except for cause, which is spelled out in detailed procedures where the employer has to justify the cause for removal. It becomes expensive just to do this. The business has to interact with the labor bureaucracy on matters of removal of employees. Under the labor laws, there is no symmetry between the hiring and dismissal of labor. It is easy to hire laborers, but it is difficult to terminate an employed worker.

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<sup>1</sup> Initially, the government heavily participated in the recruitment and hiring of applicants for contract work abroad. An outcry of criticisms led the government to allow the system be essentially governed by a system of private recruitment agencies to undertake the process of attracting applicants for overseas contract work.

If the government wants to benefit the labor sector with employment and economic progress, it should listen to the job providers rather than to those already with jobs. It should listen to those who want to move forward rather than those who want to protect their jobs shielded from competition. For years, it has listened the other way. For instance, many of the complaints of various chambers of commerce – both foreign and domestic – focus on the improvement of labor relations and on the cost of labor. And those investors who were still not positioned in the country demand an improvement of the labor policies so that they could be protected from arbitrary changes in the cost of labor as a result of government action.

Often, their commentary is not really on the unit cost of labor. They cite a variety of issues, such as governance, the implementation of laws, lack of infrastructure, and peace and order. Actually, all these add to the cost of labor in an indirect manner. But labor unit costs is a major issue that continues to hound the Philippine economy. It may not be the major point harped on by those already established in the Philippines as enterprises – for in their case, they have begun live with some realities of the current labor market. These enterprises have adjusted their operations through mechanisms such as outsourcing and other techniques already discussed briefly.

The evidence that labor cost matters is that some companies with labor intensive operations in the country have relocated to other countries from the Philippines despite the fact that there are many unemployed Filipinos. Those that remain operating in the country had found use for innovative tactics to make labor and other costs as cheap as possible. In fact, in the matter of the decisions of foreign direct investments, it might be generalized that the company, when other things are set equal, especially when the market for production is destined for international markets, chooses to locate in the least regulated country. In this decision, labor policies are taken as a principal component of that decision.

### *Productivity and labor discipline*

Without a handle on discipline, management has a weak hand in improving the productivity of labor in the work place. Business wants to control its costs for efficiency reasons. As far as labor is concerned, the unit cost of labor is important. Business is wary about the extent to which the government undertakes direct interventions that affect the wage bill. On this point, the Philippine government has a record of more intrusive intervention on labor costs. There are rules that require the integration of a worker into the regular payroll after six months of continuous employment. The disciplining of workers is related to the issue of productivity. Management is wary of the importance of decision-making on firing and especially firing of labor on the issue of discipline.

Any firm that operates in the domestic labor market is affected by market conditions and by policy restrictions that lead to higher costs. Regulatory restrictions of government bodies including those of the labor department reduce the flexibility of the enterprise to make adjustments essential to its survival or growth. The room for maneuver at the firm level could be limited by the power of the labor department to require integration of workers or to prevent an employee from being dismissed because of the requirement of proof for the action.

The idea behind this regulation is the protection of the worker. But grievance mechanisms could be developed within the firm so that such topics would not need review and consent of authorities outside the firm. For instance, grievance mechanisms can be worked out within labor-management councils. In this connection, the labor management council has become, especially after 1986, an alternative avenue for conflict resolution at the enterprise level. [See, for instance, Gatchalian (2000).]

This, of course, has a telling effect on efforts to raise productivity of labor within the firm. If a firm is limited by regulations to retrench as far as it deems necessary, then it could deter the growth of productivity within the firm. There is, of course, the other side to this issue: the need to protect the worker from arbitrary treatment from management. These matters are best handled within the collective bargaining or labor-management dispute settlement mechanisms of the firm.

The strong hand rendered by the labor bureaucracy to protect the laborer, together with the long jurisprudence that has developed on the rights of workers in contrast to the rights of employers, has made it more costly for companies to trim their work force for economic and other reasons. This tradition has hampered mainly the formal industrial sector serving the domestic market and could, possibly, has contributed to the paternalistic attitude developed in enterprises, sometimes at the cost of internal

efficiency. As a result, the disciplining of workers through the enterprise system has been adversely affected.

### ***Heavy labor bureaucracy***

The labor department has been transformed into a powerful regulatory department. Its posture has been traditionally designed to protect the rights of labor. The management sector is a co-equal clientele before the law, but in general, the latter tends to get the short end of dispute settlements.

Take the example of labor regulations that make it difficult for firms to remove employees without the approval of the department of labor. This rule has conferred enormous power to the department of labor. In a positive way, this power could be interpreted as providing the forum for the dismissal of an employee for cause. But its existence as a rule has only made it difficult for companies to integrate workers more fully into the work force as regular employees.

In addition to this, the jurisprudence of the courts on labor issues has often led to long wait for decisions to be rendered. In a majority of cases the decisions were often costly to the enterprises so that the burden of decisions on labor cases fell mainly on the management. As a result, companies with large payrolls maintain a legal defense panel at large expense, of course, for their own insurance against labor disputes. It takes a period of 10 years on the average for cases involving labor disputes that go to court before a verdict is rendered. This is one purgatory that an established an employer would wish to avoid.

A labor case put before an enterprise could become a heavy burden on the employer. It is often an invitation for a labor settlement, in which supposedly aggrieved labor gets a settlement with the help of the labor bureaucracy and labor lawyers. Some labor cases are part of the normal operations of industry in that labor-management issues always arise. Companies deal with labor issues as a fact of life.

The complexity of legal processes and the nature of regulations and bureaucratization of labor issues often unnecessarily give rise to labor cases for which companies need to allocate far larger budget for the cost of legal defense and maintenance. The potential hurt that labor cases could render to an employer has led to recourse to alternative forms of labor settlements, often through compromise agreements in order not to prolong the cases.

Arbitration serves as recourse for labor dispute resolution when compromise settlement under the guidance of the labor department cannot be secured. Arbitration is not any cheaper as a method of settling disputes. But it could be a much quicker method to end a potentially harrowing labor case that drags on and on.

To settle labor disputes requires the interaction of the employer, the laborer in question, and of course the institutional mechanisms and processes designed to deal with the problem. They arise often from the regulatory powers that are handed to by law to the institutions designed to protect the laborer. More recently, arbitration has been utilized as a recommended means of settling labor disputes, partly to relieve the courts of the case load and also to assist the litigants in getting settlement undertaken sooner.

The National Labor Relations Commission was established to deal with compulsory arbitration cases. Its disposition rate is about 75 percent of the cases over a period from 1975 to 2000. This is the dispute mechanism with supervision of disputes arising from the problems of individual workers and non-unionized workers.

### ***Rent-seeking as an outcome of monopoly power***

Although not intended, rent-seeking activities accompanies the adjudication process. Rent-seeking is not corruption. In some of its manifestations, rent-seeking reeks of the flavor of corruption. The monopoly of the regulators in the matter of jurisdiction provides the temptation to extract costs that are unbearable to the employer. This has given rise to an industry of legal fixers of labor cases – an invitation to get the employer to move to lower costs of labor settlement. Even then, such costs could in fact be a threatening, long-winded legal dispute.

A large industry surrounds the labor relations sector. And it is home of many rent-seeking activities. Fixers of labor issues, consultants, and lawyers who specialize in labor cases are there to make

“difficult cases” easier to deal with, in the labor courts and in the labor bureaucracy. In fact, it is possible that easy labor cases, where the laborer is only happy enough to get a small amount of termination benefits, are made into difficult cases – the tendency to create a *cause celebre* – because of the intervention of the fixer industry.

Some of these difficult cases would not arise if the labor laws had been less complicated. Naturally, the provisions of these complex laws and regulations would produce an industry of specialists and fixers who essentially trade on the settlement of cases arising from labor issues of the firm – of hiring, firing, and collective bargaining and other labor-management disputes.

The big enterprises in the country in addition find it necessary to have a large battery of lawyers to retain or to hold in their rosters if only to avoid getting unsettled by labor cases dragging on. Often, those could spell trouble in that they bring in uncertainty and also higher costs. Small employers, whose productive activities are more fragile because they have no legal defense funds, could be sideswiped by a labor case.

The growth of rent-seeking activities arising from regulatory activities on labor cases has hampered the growth of more efficient adjustment of the labor market. It has introduced more costly delays on the resolution of cases. This has probably deterred quite a few potential expansions of existing investments, if not discouraged the investments of new comers.

The problems emanating from the high cost of the regular employee protected by minimum wages, various benefits of welfare legislation, entitlements to legislated bonuses and other kinds of legally mandated regulations have encouraged the growth of contingent labor employment contracts. These are mechanisms that avoid the regular employment contract. Some of these have been recognized either in the law or in the jurisprudence.

For instance, many employees in commercial establishments are employed on a rotating basis so that they are not hired continuously for more than six months. Otherwise, the jurisprudence would impose the interpretation of regular employment on the employee. The government as well as the private sector has been seeking alternative employment arrangements in order to avoid the regular employment issue. This accounts for a lot of casual employment arrangements.

### ***Regular vs. casual employees: unit cost of employment***

One of the major provisions on employment refers to the probationary period of employment. Any worker who has been employed for a continuous period of six months becomes a regular employee by force of labor law. The present labor law requires that an employee who has been in continuous hire for six months be integrated as a regular worker.

Regular employment confers all the guarantees of various benefits, including membership in labor unions, and freedom from dismissal except for cause. The objective of the welfare law is to protect a laborer’s right of security of employment. But an employer often has many reasons for wanting to remove some workers, often mainly for economic reasons related to the survival of the firm in the market.

That an employer cannot terminate a regular employee except for “just cause” needs further elaboration of this issue. This requires a process of justification by the company to the department of labor, a situation that is not only very costly to a company but also irritating. It has taken away the inherent right of the employer to remove an employee when he deems it essential.

Proving rightful cause is one of the intricate problems faced by a firm in dealing with the labor department bureaucracy and, ultimately, if the judicial case is filed, before the courts. In order to remove a regular employee for cause, the employer has to establish that the cause is justified, and this, in addition, has to be approved by the secretary of labor. This has put enormous amount of power on the secretary of labor and it has been criticized as having had a deleterious effect on discipline.

In other countries, the mechanism for firing undesirable employees is simple and relatively fast. In the Philippines, the labor laws and the regulators have made this a difficult and convoluted process. And the labor law jurisprudence has made it all the more difficult. In such an environment, the burden of proof

has to be established. In a changing environment, delays in the removal of employees that hamper efficiency within a company's operation could be costly.

The private sector is not the civil service, and yet the government has taken an active role in issues that are almost the same as the civil service. What is needed is for companies, using their own traditions, history, and circumstances should be left to deal with their own problems of employment. They have their own industrial relations set up and the government should encourage this to evolve on their own.

Professions and industries have evolved standards of tenured relationships between employers and employees, often with the active participation of the employees. An example is the tenure institution in the teaching profession in academic institutions. In the Philippines, such a system has been practically destroyed by labor and civil regulations and – of all things, control on the standardization of wages within the government, within government institutions – in the field of education, especially in the state supported academic institutions.

The requirement of retention and regularization after a period of short term employment – along the lines of labor laws – has kept a large roster of teachers in the teaching profession but has failed to prevent the exodus of very talented persons from the teaching profession into other activities. This is another issue that deserves analysis for another occasion. The interventions by the government often upsets the evolution of wise and long held traditions in improving productivity and skill differentiation through appropriate wage policies.

The provision on regularization of employment in the private sector has encouraged mechanisms of employment that promoted shorter terms of employment for a lot of workers rather than more secure employment. The penalties of regular employment to a firm are not only the sudden jump of the unit cost of labor since regular employment has a lot of benefits compared to temporary employment. It has also brought *rigidity* in the employer-employee relationships. The employer is now much restricted in disciplining the worker because of the legal guarantees of regular employment. In theory, the guarantee to discipline the worker is there. But in practice, it hardly happens, given the known cases of how difficult it is to terminate regular employees.

The unit cost of labor and the flexibility with which the employer can extract discipline from the employee are major determinants of the employment within enterprises. In many ways, this is what happened to Philippine labor. The series of welfare legislation over time has made the cost of a *regular* employee in the firm grow out of line with market realities because many workers are available to work at far lower rates of wage.

The regular employee enjoys many entitlements that represent costs to the firm beyond the calculation of the regular wage as provided in the labor laws.<sup>2</sup> In the presence of companies with very progressive labor policies, these benefits could represent substantial cost adjustments. Among foreign direct investors, one of the aspects that they bring often is the relatively good system of company wage policy inherited from their home offices. When they are required to provide regular employment after a short term of employment, these companies are put in a situation of calculating a much higher wage bill than would be easily calculated from market conditions. It reduces the attractiveness of labor in the country from the viewpoint of wage calculation.

Depending on the nature and history of the company, such benefits could range from 10 percent to 30 percent of the unit cost of the casual laborer who does not receive the same entitlement. The benefits

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<sup>2</sup> It is estimated that the package of benefits use the minimum wage rate as a base. Then they follow all kinds of legal imposts. Social security contributions are a major bite. In addition, however, there are vacation and other types of leave entitlements, contributions to company based retirement programs, group life insurance if the company has a program, and so on. Some of these benefits are sound programs for raising the well-being of employed labor – and many countries tend to have coverage of these social security programs. Some company benefits are exclusively calculated only for regular employees. The benefits once extended to a particular worker cannot be retracted.

going to regular employees begin to escalate in relation to what might be considered the competitive wage rate – the rate at which many laborers are willing to enter employment.

In time, this led to the idea of temporary – in contrast to regular – employees. These employees could be hired at the going minimum wage – already loaded with mandated wage rates and other wage entitlements – but not for the usual benefits of regular employees.

This led to the increasing phenomenon of casual employment as a major presence in the industrial and government labor market. Private companies and even government offices are saddled with budget constraints. To cut costs, they look for alternative employment arrangements that make economic survival possible. To close this “loophole,” the law required that companies be made to regularize the employment of workers employed for a continuous period of six months.

The unit cost of a regular employee compared to the casual employee represents a significant escalation that discourages regularizing of a worker’s employment. many distortions in economic behavior within the firm could result. For one, the labor disputes on regularization of status of employment has created not only a rich jurisprudence on labor-management. This has increased the relevance of the legal machinery to stay abreast with labor law regulations at the department of labor.

#### *Motivational distortion arising from labor protection laws*

It is not surprising then the labor laws have caused a distortion of incentives. One distortion is related to employee behavior. Once regularized, the employee’s desire to perform to the edge of his ability is adversely affected. Moral hazard could be an outcome of the regularization process. Employees who would otherwise behave with high motivation to keep their jobs and keep up performance in order to be noticed for their abilities and skills could have a change of attitude once they become regular employees. Complacency and low productivity that has been the universal experience of economic systems operating under socialism, which led to the collapse of that system in many countries, is the result.

One aspect of the regularization issue for employees is the effect on the company’s internal productivity. The firing weapon in an enterprise provides management with a tool for raising productivity. If it is weakened, it reduces the company’s ability to compete with other enterprises. The objective of protecting the employee from dismissal is the possibility that an employer could be whimsical or arbitrary in dismissal cases. This reason fails to understand that, in general, an employer who finds a worthy employee would always be motivated to keep that employee in the roster. In fact, the effect on worker attitude to work could be different, and the result would be poorer discipline at the work place.

This point is so important that I use the introspective observations of a Filipino manager<sup>3</sup> who has managed for many years on separate assignments a factory in the same line of production in Taiwan and in the Philippines. He observed how well disciplined in the work place is the behavior of Taiwanese workers.

He also observed the common impression now well known that the Filipino worker when placed in a disciplined workplace environment of other countries (the well-known overseas contract worker experience) is also very disciplined and is praised to be among the very best. He contrasts this with his direct encounter with the Filipino workplace when working in a Philippine setting. The factory worker in the Philippines often feels entitled to the protection of tenure as a regular worker in the company (protected by the welfare laws of the country). If his company is further assisted by membership in a labor union, his behavior is further diminished in work place discipline.

This difference in attitudes cannot simply be cultural in nature. It is the result of the environment in the work place that has been encouraged by the protective labor policies that have been especially promoted and enhanced over the years in the country. The record of Filipino workers when they work outside of their country reflects the best about what Filipino workers can achieve. In their own workplace in the Philippines, they are encouraged to behave differently. This change in behavior can be explained by the umbrella of labor welfare regulations that encourage a different type of behavior in the work place.

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<sup>3</sup> This is based on discussion with Jesse Alto, a manager who once worked for SGV. Later, he became the head of the operations of manufacturing the electronics firms located in Taiwan and in the Philippines.

In particular, the observation is contrasted by the worker on a probationary period of employment and the regular employee. Workers on probation work very hard and are very productive. Oftentimes, that is the reason they become regularized. But once they achieve the status of regular employees, their attitudes change. They become less efficient and, at times, even combative, against company rules and regulations. This becomes even more so if they belong to unionized companies. Many ask for unreasonable pay increases when their efficiency and output are below expectation. Slack in productivity could be the result of an effort to hold back productivity since there is no reward for attaining a higher output target. This is one reason why piece rate arrangements tend to be more satisfactory in identifying improvements in productivity. With piece rate arrangements, additional output is rewarded by an increase in pay.

### ***Distortions affecting wage differentiation for different skills***

Efforts of the government to intervene in wage rates has caused a process of averaging of wage levels that reduces the ability to reward performance and skills, including learning from experience and work. There are less skill differentials because the money reserved for skills is directed towards paying mandated wage supplements and benefits. The fund that could be allotted for the payment of skill differentials was consumed to take care of the pay of those entering at the minimum wage level.

In the Philippine practice, the government established the standards for the minimum wage at the national level (at least before the advent of regional minimum wage setting). As a result, where skill differentials would have been used to reward productivity and contribution to the company's welfare, the wage rate setting regime encouraged an averaging of the wage rate toward the lower end of the wage scale, near the minimum wage. The wage budget allotted that could go for differentiating skills was consumed by satisfying the lower end of the wage scale and where skills were not well developed.

The effect of such laws is worse on the civil service. And it is useful to touch this subject briefly. The standardization of pay in the government service – has also created the same effect on wage differentiation. In the civil service, the problem is not so much standardization per se, but standardization of *low pay* for various skilled services. The other problem is the over-employment that has resulted in the government at the low-end of the employment roster and the scarcity of skills at the higher end of the civil service.

The problems of civil service salaries are an entirely different topic that deserves discussion under the issue of government administration and budgeting reform of government expenditure. But the labor market policies in the private sector echo their effects to some extent on how government pay scales for *scarce* public officials not the rank and file of the civil service.

The standardization of pay, to some extent, is more serious in the government sector. Standardization of pay is useful if it is in tune with market realities about wages. Especially in the public sector, the budget deficit – another problem that deserves a separate analysis but important in the context of wage policy discussions – has constrained the government so much that pay standards have failed to move together with market realities. The result of minimum wage adjustments in the government worked all the more to constrain the adjustment of the pay standards for across the spectrum of civil servants with different skills, responsibilities, and accountabilities. A result of this is the erosion of their incomes while at the same time, budgetary increases were made to meet adjustments of pay for the lowest end of the pay scales – those receiving the minimum wage.

### ***The 13<sup>th</sup> month pay supplement without basis in productivity***

The 13<sup>th</sup> month pay is an anachronism. It is paid at the end of the year, pro-rated to the amount of work performed by the worker during the twelve months of employment, or less. It is calculated as one-twelfth of the yearly salary, so it is equivalent to one month of pay during the year. But as conceived today, it is a pure addition to the wage bill.

Over the years, the unit cost of labor was made artificially higher by decisions in minimum wage adjustments. Way back during the crisis years of the 1970s, the 13<sup>th</sup> month pay was devised to help

alleviate low pay in the private sector. But this was temporary. It was patterned after the practice of some private companies and government financial institutions to provide a bonus for workers at the end of the year. The 13<sup>th</sup> month pay was initially conceived a performance bonus not a simple added wage. Within the government financial institutions, it was a means to redress the low salary structure of government workers in relation to the private sector.

Once it became part of the legal books, the labor department tenuously insisted on making it a more permanent addition to the wage level of the regular employee. Eventually, the 13<sup>th</sup> month pay was made into entitlement for any worker, with the pay pro-rated to the year's work, whether paid by monthly salary or by piece rate. What began as a temporary measure was integrated into a new cost of labor, although postponed. The 13<sup>th</sup> month pay has become an added impost on all employers. It is postponed income paid at the end of the year but it has no connection with employee performance or productivity. It is simply an added to the cost of labor.

When the market fails to distinguish among scarce skills, then it is unable to create signals for market allocations in the preparations for training and for formal educational programs. The 13<sup>th</sup> month pay further aggravated this effort to reward the lowest end of the employed labor force. Initially, the 13<sup>th</sup> month pay was used to reward performance. It was a year end bonus for workers with proven contribution to the firm's performance at the end of the year. It was not a fixed formula for payment in relation to the gross pay. It was a differential entitlement for good performance, for being a productive member of the company's labor force.

The idea that a bonus is deserved for contributions to the company's year-end profits or performance no longer holds. With the institutionalization of the 13<sup>th</sup> month pay as an expected additional income of the worker, it does not function anymore as a reward mechanism for high performance as an employee. Simply, the 13<sup>th</sup> month pay is seen as a postponed wage payment that is paid at year's end. A firm that wants to reward an employee for exceptional service would have to pay out a bonus that is outside of the 13<sup>th</sup> month pay.

### *Industrial management styles and productivity*

Studies of the work place undertaken by the UP School of Labor and Industrial Relations detail various practices that have developed in the course of the country's recent industrial relations. [The volume of Amante, ed. (1994), in particular, the articles of Amante (1994a), Aganon (1994), and Ofreneo (1994) are particularly helpful in this context.]

Focusing on the comparison of Japanese, Filipino-Chinese, and Western-owned firms, the cases studied concern workplace dynamics between management and labor especially taking account of the cultural and industrial backgrounds of the investors. The establishment in the sample is more representative of the industrial milieu that has been dominant in the Philippine industrial pattern. They represent companies that have been around longer in the country, with markets oriented essentially to meet domestic demand, although some export demand has entered part of their markets in later times. They represent the kinds of companies nurtured essentially by the highly import substituting framework of past industrialization.

These studies were observed through the prism of cultural or national experience of the investor's main nationality. From the viewpoint of this essay, what would be relevant for the present purpose is to understand current practices within the firm that relate to the recruitment, promotion, hiring, and integration of the laborer within the firm. In addition, the manner of conflict resolution in the work place, most especially those issues that often lead to collective bargaining or to the use of more drastic means of redress.

As in other cases, Filipino-Chinese firms evolve in their practices according to circumstances. The older and more traditional firms tend to depend more on personalistic values in their approach to wage, pay, promotion than the more modern firms. Personalistic loyalties are still relied on by more modern firms. Hiring and contracting no longer indicates reliance on such subjective factors of ties and family and



friendship networks. For the same reason, these firms display greater transparency in their actions. In fact, some of them are more inclined to accept unionism as an element of the labor-management relations.

In contrast, foreign companies, with Western-oriented background, behave more on the basis of values that are less personalistic and more on objective factors that are weighed in the work place. For instance, performance at work is important and wage policies are more transparent. There is greater acceptance of mechanisms for redress of labor's demand through unionism. Western firms have been more comfortable with the labor standards to which the labor laws strive. To some extent, some of these standards are quite common in their own work settings.

Over the postwar period, with the coming of Japanese investments (and other Asian companies, not indigenous Chinese Filipino companies), the Japanese style of management has found its mark in the Philippine setting. The work traditions of the Japanese company are different from the usual models. Japanese firms are more attuned with systems in which wages determined from within the firm with due regard to skills developed over a variety of tasks. They are more used to an evolving wage structure that is dependent on the development of skills, work experience, overall contribution to company welfare, seniority and job flexibility within the workplace. Workers in such an industrial work place are often allowed to do a variety of related tasks. This arrangement leads to work among teams of employees especially in relation to the problems arising out of the production line. This enterprise system is very productive in Japan.

The Japanese system is still in its infancy in the Philippines. There is yet no strong evidence that skill differentiation within the industrial firm that is part of the success in Japan has been successfully transplanted already in the Philippine plant. This is the direction of studies that should be encouraged in understanding the Japanese enterprise model in the Philippine setting. The Japanese firm in the Philippines is relatively recent. The rate of turnover of workers (especially among the skilled who have moved on to overseas contract work) and the relatively small volume of integration of industrial operations within the domestic economy (many are producing for exports) has possibly affected part of the deepening industrial experience. This is also related to the presence of a network of supplier firms that enables the firm to reduce costs of material inputs. But this evolution is apparently in the offing.

Each of these styles of management undertakes decisions about labor allocation in different ways. Each has ways of motivating the worker according to certain methods inherited from past practice. Unfortunately, these studies have not focused on the measurement of productivity of labor or even measures of total productivity of the enterprise that are relevant to the styles of labor-management relations that they tried to evaluate. Such studies would be of great value because the different styles of management are likely to show also differences in firms and in worker productivity. They operate under the conditions of the domestic labor market which is affected by the many provisions of law that affect the work place at the same time that the companies are interacting with market developments relevant to their output and operations.

All these styles of management would eventually evolve according to the demands and stresses that take place within the economic and business setting. Labor market policies would eventually dictate their evolution into management systems that would end up either productive or dysfunctional. A set of policies that encourage innovation and productivity would give rise to labor productivity rising over time. Observe, however, that Philippine labor productivity has not been impressive over many decades. In fact, this has not been a feature of the Philippine economic growth scene.

Productivity growth does not register in studies on the the economy on the aggregative level. Estimates of total factor productivity growth, such as those undertaken by Hooley (1975), Cororaton (2001), present discouraging results especially for the more recent periods in Philippine economic performance. Total productivity growth has been low, even negative, in these more recent periods. This bleak record of underlies the failure also of the factor markets to contribute efficiently to output. In the case of the labor market, the discussion of its over-regulated part accounts for this result.

These different models of industrial management have produced high rates of productivity in other settings. The productivity growth numbers in studies of Japan, South Korea, Taiwan, and even the other

East Asian countries, indicate that similar styles of industrial management have produced high productivity growth rates in those countries. What holds back these styles of management in being more productive when transported in the Philippine context?

The explanation could be tied up with the excess supply of labor. Firms find it easy to get new workers because of the large amount of workers applying for work at the going wage rate mandated by the government. Labor policies on employment explain why the excess labor supply continues. They have not been focused on creating employment but on raising welfare standards and dealing with government initiated measures to raise incomes and wages.

*The labor market and the effects of a domestic procurement for foreign investments*

The productivity and growth of companies depends on the network of support industries that are part of the supply chain. In a survey of Japanese foreign direct investment across Asian countries, undertaken by the Japan External Trade Organization, [see JETRO (2002)], it is reported that Japanese firms located in the Philippines have a low percentage of purchasing from other suppliers in the domestic market. This survey covered 1,519 Japanese companies located in ASEAN countries, South Korea, Taiwan, China, Hong Kong and India.

Of 150 Japanese company respondents located in the Philippines, only 26 companies which are mainly located in the larger Manila and Cebu, or 17 percent of these respondents, buy requirements to the extent of 51 percent or more of their raw materials inputs locally. The same survey has shown that that Malaysia, Singapore, and Thailand in ASEAN have reported that between 40 percent and 49 percent of their companies have local procurement ratios of 51 percent or more. Half of the respondents in Taiwan and 47 percent of the 384 respondents located in China said that more than 51 percent of their raw material requirements are bought from factories and suppliers located in the host country.

In short, of these countries, the Philippines has a low procurement ratio and the room for improvement is very large if the government takes an aggressive stance in the invitations of foreign direct investments. The implication of this finding is that the Philippines needs to develop support industries in critical investment sectors where Japanese investments are already located. This is essential in improving the competitiveness of existing Japanese companies already located in the country. It will also attract more investments from that country and also from other countries. The analysis here would be relevant for other types of investments from any country including those from Korea, Taiwan, United States and other countries.

In part, foreign direct investments come in waves involving related companies that are accustomed form a supply network among each other. The lead investor is the critical one, but policies that allow the entry of the supporting cast of investors are also very important. The other side of the story is that foreign direct investments have to learn to develop the supply network within the economy, by inducing local companies to bid for and supply parts that are needed in the course of operations. The quality of the supply of raw materials determine the success of the whole flow of investments in reducing costs and in further improving competitive advantage for the industry. There are some success stories of supplier firms in the Philippines that need to be replicated many folds.

If the lead foreign investor is capital intensive, the subsidiary supplier of parts and services are likely to have more labor intensive operations. These are the companies that will benefit a lot from a country with a high track record for industrial peace, where wage policies are competitive, and where there is a supportive business environment for economic growth. The implications on the presence of sound labor policies are self-evident.

Thus, the success of recent manufacturing exports from the Philippines in semiconductors and industries based on electronics is only still in its infancy even though the range of exports is now extensive. There is a lot of room for expansion. To achieve further growth requires an enormous amount of attraction of new foreign investments that support the initial successes. Some of that investment will spill into domestic investments of companies that are synchronized with the material needs of the foreign direct investors. Perhaps, the resulting supplier companies will become joint ventures and others new investment by Filipino companies with technical support from the company with a stake in the raw material.

The reason for the self-sustaining character of the industrialization of some ASEAN countries like Thailand and Malaysia is the large presence of subcontracting networks of suppliers in these countries and the continuous influx of support firms to what has already been set up initially. There is no reason why this kind of complementation among firms and suppliers cannot be shared on a region wide basis such as in ASEAN. In fact, this is one of the reasons for the various industrial complementation schemes invented and being tried within ASEAN. There is no substitute for closeness of the complementation schemes within a smaller geography if that could be done.

There is yet another effect of the strengthening of the supply networks. It often originates from the expansion of new supply arrangements between the large companies and the smaller network of enterprises that could be encouraged around those enterprises. There were local companies that arose out of the large influx of major foreign direct investments in South Korea and in Taiwan during the 1960s and the 1970s that became the basis of subcontractors of manufacturing activities for the large multinationals. The multinational investors who were mainly interested in cheaper sources of manufacturing ceded some of the manufacturing to domestic companies in these countries that could take advantage of the of large labor pools available then and encouraged them to become manufacturing sub-contractors. These sub-contractor companies created cheaper sources of manufacturing for the multinationals, using technology and supply arrangements that the foreign investors initially supplied. The growth of original equipment manufacturing (OEM) and own-design manufacturing (ODM) in these countries is well documented in the technology and electronics industry in East Asia. (See Hobday (1995, 2001.)

Enterprises that uniquely undertake manufacturing of special requirements of other industries belong to examples of networks of firms supplying an industry. The more tightly knit are these within a group of firms already established in a given area, the greater is the interdependence among the firms in their economic activity. The investors themselves make direct contacts with local companies, local suppliers, and local entrepreneurs that they do small business with initially.

The growth of regional supply networks relying on the trade in parts and components that lead to a major industry – like the car manufacturing industry or the computer – explains many success stories of industrialization spread across the East Asian region. The automobile manufacturing and the correspondent expansion of engineering based companies in Thailand is part of this experience. The Philippines, once far ahead of Thailand, Malaysia, and on par with Taiwan and South Korea in industrialization, is now far behind these countries because of a number of reasons, among which is the welfare-ridden labor market setting in the country.

The preference of some foreign direct investors to move into the other countries rather than the Philippines is conditioned in part by the expectations of business stability, lessened risk from political and other non-economic circumstances. Labor policies are important in the context of the investment decision.

### **III. Desirable directions of labor reforms**

The pressure for labor market reforms comes from many quarters. The presence of large unemployed and underemployed groups in the labor market – an indication of the excess labor supply that the country cannot employ – contributes to the gravity of the poverty problems of the country. In this scenario, the quality of life by any measure is very poor.

Globalization is another factor. As an open economy, the Philippines does not exist in isolation. It is affected by developments in the work place through the trade in goods and the movements of factors of production. Countries that take advantage of the opportunities that globalization provides will press for the gains that they can derive. The choice that our country faces is whether we act to harness the benefits that are in store or allow others, by simply standing still or waiting to react to changes, to dictate the way the future would evolve. The threat of being left behind is sufficiently clear to many policy makers. The experience of having lagged in development with neighbors already indicates the danger of being left further behind.

The urgency of reforms in the labor front is evident from the “successes” discussed in this essay and the analysis of the current problems that beset the labor sector in the country. The transfer of industry to other parts of the world where labor is cheap and productive could further affect the country if reforms

are neglected. One law of economics is that under competitive conditions, low costs drive out high costs. Efforts of the country simply to find fault with current developments by plugging loopholes that avoid reform will only cause harm in the long run. The main point of this essay is that the stubborn efforts to focus labor policies on welfare oriented policies has worked to defeat the long run prospects of multiplying job opportunities and the progression greater efficiency.

In this part of the essay, comments address simply three areas of reforms: (1) redressing the balance between labor protection and job creation; (2) introducing incentives that raise productivity; and (3) making an effort at attitudinal changes in policy among principal actors on the labor market issues.

### **Redressing the balance between welfare and employment creation**

The present labor laws are tilted too much towards raising the welfare of the employed workers by fiat and regulation. These policies have miserably failed in the objective of providing opportunities for employment. The policies have discouraged investments – both domestic and foreign – that would have raised the demand for labor in the country. They have set up mechanisms and processes that discouraged employment expansion in the country's operating establishments. They have galvanized the participants in the labor-management relations to focus on labor rights rather than on the overall wellbeing of the enterprises. The outcome of this is neglect of productivity as an agenda of concern between labor and management.

The government addressed the issue of minimum wage determination by reforming that system in the early 1990s with the adoption of a process of regional minimum wage setting. The outcome of this procedure was to introduce regional variations and competition in the determination of minimum wages. As expected, this defused the periodic rise of the minimum wage and brought in a lot of regional competition in the process. This reform has helped to put demands for minimum wage increases on a more reasonable footing.

More reforms need to be undertaken to reduce heavy regulation of the labor sector. The government needs to soften the regulatory powers that have stymied business decisions on employment, especially with respect to the dismissal of workers. The heavy rhetoric of socialistic policies has dominated the tone and focus of labor laws, including even the in the Constitution of 1987. The guarantees of jobs promised by the government have focused the discussion and legislation of labor issues on measures to keep on raising the bar of welfare and entitlements of labor. The result is a long list of labor entitlements that business cannot possibly be implemented if businesses have to survive. The government cannot force business to guarantee the job to its employees if, in doing so, that business is forced out of business by the force of competitive forces in the market.

The labor code's provisions requiring that workers be integrated as regular employees are not realistic. These regulations are harsh on business. They add the penalty of higher costs for every unit of labor hired. However, they are harsher still on laborers who cannot be integrated into normal employment and who lose their jobs periodically in cycles of six months of employment. It is unrealistic in the same way that the minimum wage laws had been, for many decades, unrealistic for many medium and small scale enterprises that could not afford the wage levels forced on them by government fiat. The labor regulators have turned a blind eye on the violations that are known to exist with respect to labor laws.

When laws do not produce the desired effects, something is wrong with them. They need modification. By being almost foolishly single-minded in pursuit of ineffective laws, the credibility of the whole system is put at stake. In fact, one of the complaints about the implementation of labor laws is that the process itself encourages corruption and rent seeking. The Joint Commission on Labor of the Philippine Congress has made a point about the problems of implementation of labor laws.

Contractualization of labor, the outsourcing of manufacturing tasks, the use of other contingent employment arrangements are signs that part of the system is not working and needs fixing. The regulators want to criminalize some of these adjustments when the proper response is positive thinking and reform, not plugging loopholes and harsher punishments. It is important to understand that business is trying to adjust to the market to reduce costs. It is in competition with other industries and companies with lower costs and some of these competition is not alone internal but with other countries that are out to attract investments that deserve to be welcome to the country to improve the job opportunities for more Filipinos.

Workers should only be removed from employment for just cause, as provided by law. But this does not require processes that involve the decision making of the national government nor even of the courts unless there are civil or other rights infringed. Just cause should end in the firm's industrial relations with the employees through the collective bargaining process and through the proper evolution of processes within the enterprise. The idea that the state knows better than the firm for the determination of just cause for termination has led to the compounding of costs of employment and has caused a resistance among firms to hire people on more regular basis.

The state has an obligation to make enterprises more flexible in their operations so that they can cut costs and take advantage of economic opportunities as they arise. This will contribute to the ability of the firm to become more innovative in competition with other firms. The state needs to promote competition. And part of the competition is also creating situations for labor to be competitive within the firm so that they can improve personal performance. The guarantees provided by the labor laws to the employed make the employee too powerful by simply resting on the protection of the state. This has in many cases created sloth in labor performance. Regularization of employment is seen as an objective in itself.

### **Putting productivity to the center stage**

Productivity is the neglected element in the way the labor laws operate. Almost every politician and labor official pay the appropriate lip service to the need for productivity growth. However, the labor laws discriminate against achieving productivity. And many of the labor welfare measures that are put in place would be undertaken at the expense of promoting discipline and accountability for performance in the work place. This is one reason why productivity growth statistics describing Philippine economic performance have been disappointing.

But why is the Filipino worker very productive when the labor markets in which he works is outside the range of effective coverage of Philippine labor laws? This was amply illustrated by the "successes" that were analyzed earlier in this paper? In these settings, the labor laws have either little contribution to make on the incentive mechanisms governing the employment situation or it has little relevance on the determination of the market wage. Growth of productivity is high of high capital investments. In these settings, workers need to train and learn the additional demand for added skills in the work place, and the establishments find that essential in order to survive and pull ahead.

Any meeting of business and labor on the problems of labor policies will yield a litany of issues that need amendment. The most important issues that center on redressing the balance between welfare and performance are pointed out in what follows. Placing them on the agenda requires deep commitment and high leadership qualities as well as strong political will.

The first of these reform issues concerns the question of who is the sovereign in the matter of determining just cause in the termination of employees. The state is concerned with many important issues, and it has no business being involved in the micro-affairs of employment within the enterprise. Within the enterprise, the sovereign decision maker should be the business leaders and the laborers who compose it. Businesses should be allowed to develop their own internal mechanisms to determine employment concerning justice and fairness. The heavy hand of intervention by the government could have untoward effects on the workings and survival of the enterprises and hence, on the fate of the larger employed roster. If the labor department and the courts need to stay out of the questions of dismissals of employees to provide greater flexibility as well as discipline for the firm, thus giving it improved resilience in the market place.

The second area of reform is related to the 13<sup>th</sup> month pay. There is no reason why salaries and wages would need to be deferred if they are not related to productivity or personnel performance. The logic of the 13<sup>th</sup> month pay is not right. Either it is considered a bonus for performance or it is a wage in the normal course of employment. If it is a performance bonus, it cannot be given as an entitlement of one-twelfth additional salary. It has to be considered a differential pay for labor in contributing to the firm's business objectives.

In short, if the 13<sup>th</sup> month pay is a simple emolument for work, it should be integrated as part of the wage, and it should not be postponed as a payment. Firms would need the freedom to determine

alternative schemes to improve performance within the firm of all laborers. This could be in the form of a bonus system or some form of profit sharing. The state could encourage these systems, but it should stay away from imposing its own views on how it should be done. Or else it deteriorates into a simple entitlement, with all the bad consequences that it has on productivity.

### **Changing attitudes: labor's interest in economic liberalization**

Attitudinal change is one of the most difficult reforms to undertake. Yet, major reforms begin with a change in attitude or the efforts at reform would collapse. It takes a combination of circumstances to make people, organizations and institutions to change the framework of thinking and adjusting. The inevitability of change sometimes helps to soften the resistance. It makes a big difference in the economic outcome when a country embraces reforms on their merits compared to being simply forced by circumstances to follow change.

There are circumstances that make reforms inevitable whether we want them or not. Globalization, or its manifestations, will change the world in which we live. We can criticize or decry what other countries do, but that does not make it any safer to simply do what we are used to doing. Competition and freer borders among the factors of production and among goods are part of the future – WTO and ASEAN assure that that happens, unless the country opts out of these. The benefits of being within these frameworks far outweigh the benefits of not being there. In fact, there are few benefits but a lot of costs to be outside these frameworks of the future.

The changes that have been introduced in the labor front in the past are an indication that there is some positive change that is taking place. But this is slow and quite inadequate to alter the overall picture of a labor market that suffers from the malaise of over-regulation and dominantly welfare oriented labor policies. The government's reform of the minimum wage institution into regional minimum wage and the efforts to move industrial disputes from strikes and collective bargaining to arbitration have been very helpful in maintaining industrial peace.

Labor's interest and advocacy needs to turn toward positive issues of investment attraction, strengthening Philippine competitive advantage, industrial reforms and overall economic reform strategy with respect to social peace. In fact, the advocacy of organized labor, if it focuses on the welfare of the larger labor force and not its own selfish interests alone, would do well to forge social contracts that assure industrial peace with business. Other countries have used social contracts to assure industrial peace within the economy, expected over a specified period of time. The advantage that other governments have undertaken by assuring the industrial peace through the strong hand of the state has made many economies in the Asian region prosper continuously.

For instance, labor's interest in investment promotion is less evident from its advocacy. In fact, many of the leaders of the labor sector are seen to advocate restrictive policies that cause alarm to domestic and foreign direct investments in the country. An example is alliance between protected industries and market opening moves. Organized labor tends to object to trade liberalization even when these measures strongly benefits consumers and promote greater efficiency.

Tariff liberalization issues and economic reforms related to the constitutional provisions pertaining to the role of foreign direct investments are part of the critical problems that require a breakthrough to improve overall growth performance and expansion of employment. To expand the opportunities available to labor, its leadership has to look to the further liberalization of the economy. Some of these issues go far beyond simply supporting globalization and improving the competitive posture of Philippine industry.

As the discussion of the "successes" of the Philippine labor market in this paper makes clear, Filipino workers do very well when they are challenged to test their skill and ability against others. It is the espousal of welfare oriented thinking that has set much of the progress of employment in the country.

The same problem of attitudinal change is required not only among the labor sector leadership but also in the labor bureaucracy of the government. When the government decided to change the name of the department of labor into a department of "labor and employment," there was only a cosmetic change. The bureaucracy continued its aggressive advocacy of what it considered to be its main mandate, which was to

continue to be the guardian of labor and it was there largely to continue to add to the bureaucracy working for the protection and enhancement of labor welfare laws and regulations.

There is really a need for the government to look into the recommendation of the Joint Commission on Labor of the Philippine Congress when it suggested that the department be simply called, Department of Employment. Such a change in nomenclature does not mean that the welfare of labor would not be looked at. It simply means a realignment of these welfare policies. Labor policies then would become a true source of enhancing the growth of employment so that the wide membership of the nation's labor force would experience having a secure livelihood.

#### **IV. Concluding remarks**

Nearly sixty years of political independence has led to an uneven record of employment creation in the Philippine economy. Despite the record of positive growth of income and output per capita, this has not been sustained at a high level and has failed to make a dent on the level of unemployment and underemployment. Productivity growth has been meagre and spotty. The country has lost its advantage as a developing country that once had the edge in the region to become a highly successful, high growth economy.

The labor policies that were crafted to oversee the growth of jobs failed to generate a domestic economy that had a strong record of job creation. Complemented by other policies that raised the regulatory framework for overall policy, especially in terms of industrial development policies, the domestic labor market did not get transformed into an engine that produced sufficiently large opportunities for job creation. Especially because of the restrictive policies in the labor sector, many distortions have arisen that contributed to this relatively inadequate record of job generation.

The challenge of globalization and more open borders – both for goods and factors of production – provides a continuing challenge for policy improvement. The evidence that Filipino labor can survive and thrive well under conditions of challenge and competition is amply shown by the examples of successes discussed in this paper. Providing for a labor policy regime that makes labor believe that welfare protection and government patronage guarantees their jobs just gives a false sense of security to labor. The government needs to liberalize policies that enhance productivity at the level of the firm. This has to be in the direction of less reliance on direct efforts to dictate supplements to wages and to raise welfare standards.

Welfare standards go up as a people achieves higher standards of living through economic development. This is made more easily possible as all remnants of excess labor are reduced effectively through the growth of jobs in the domestic economy. The government, in its effort to award labor all the welfare benefits that other countries have achieved through the hard work of their citizens in the field of economic development that took many years to achieve, tried to short circuit a process that cannot be rushed. It is a process that labor has to earn through employment and productivity growth. The result is the loss of the opportunity that other countries have achieved to wipe out their own problems of large labor supply through development policies.

But to make employment creation work well, the government needs to encourage business to thrive well and to have better control of discipline in the work place. This will improve their competitiveness externally with other countries and, moreover, will improve domestic competition among businesses. This will then encourage in the country higher productivity growth.

There is another reason why employment policies need to take precedence over welfare oriented interventions. The creation of jobs contribute to the eradication of poverty more quickly than when many people remain unemployed and depend on handouts from state and private sector institutions through their own social welfare programs.

Countries that have reduced the level of unemployment and underemployment have also created conditions for the onset of the demographic transition. This is a stage in the economy where natural economic forces make families want to have fewer children partly because they want to provide for the future of the children and because work demands require that they plan the spacing of children.

Religious and other factors have made family planning unsuccessful in influencing the reduction of the population growth rate. When families are very poor, unemployed parents desire to have more children as a means of social security. But that works in the reverse because poverty among families also reduce the opportunities for growth and education of the children. The natural economic forces of the demographic transition would help to achieve the reduction of family size where direct programs of family planning would fail.

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## Statistical Appendix

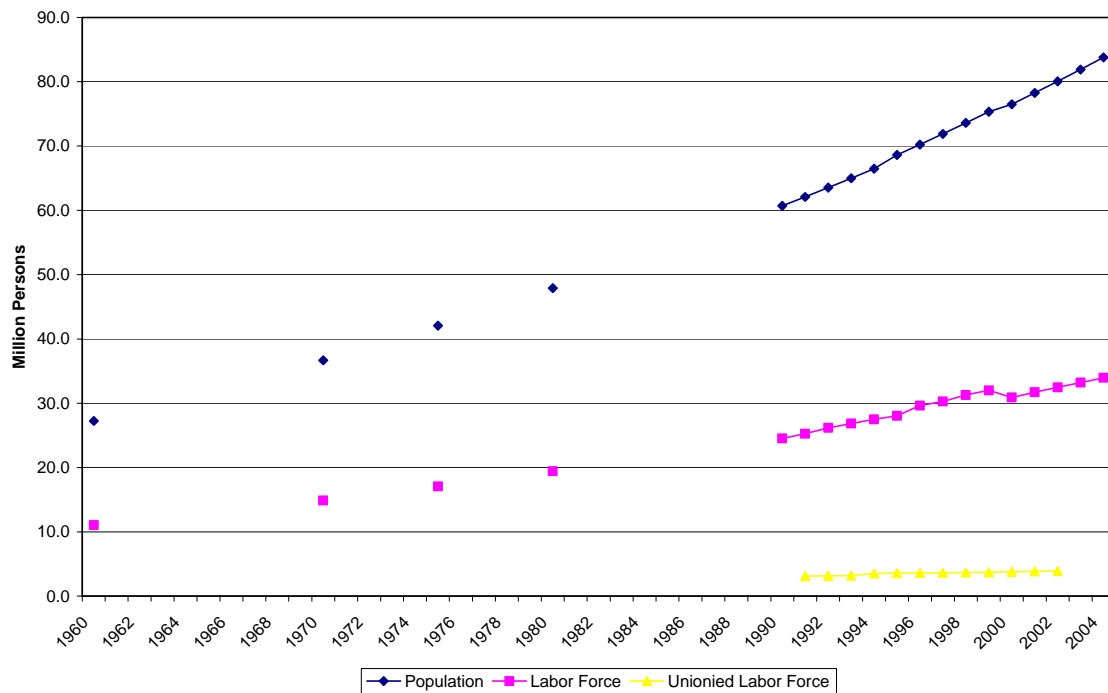
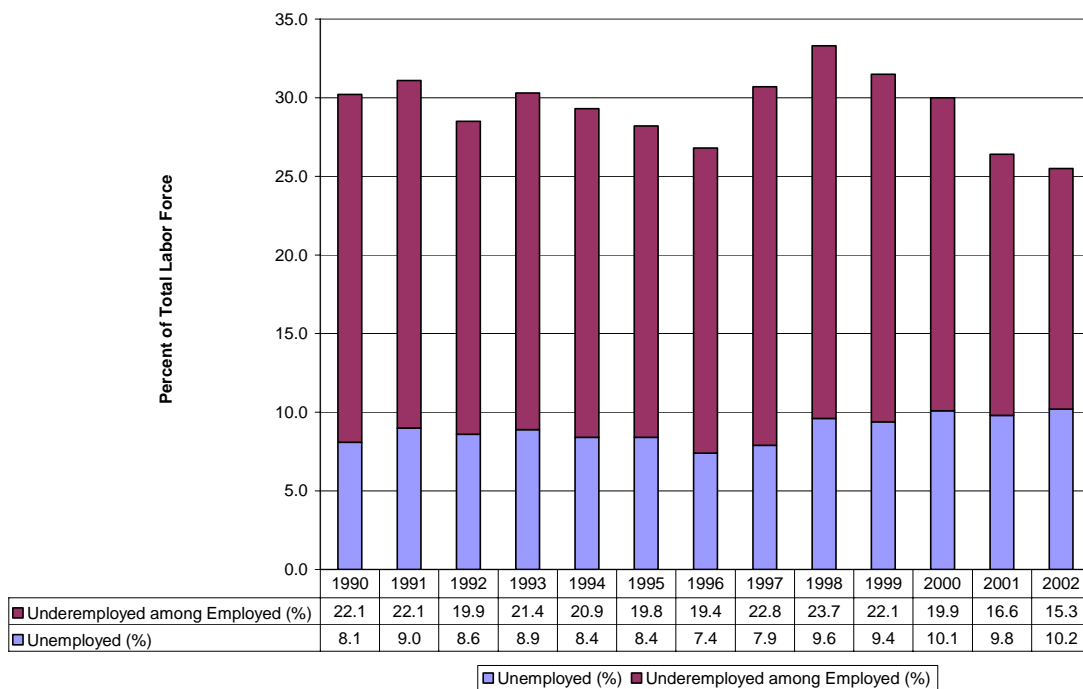
### List 1. Basic Rights of Workers (Selective list of the most important )

1. Security of tenure
  - a) Workers cannot be dismissed without just and authorized causes and due process.
  - b) Workers shall be made regular employees after 6 months probation.
2. Hours of work
  - a) Normal working hours of 8 hours a day.
  - b) Meal and rest period: meal break of less than one hour and short rest periods shall be considered compensable working time.
3. Weekly rest day
  - a) A day-off of 24 consecutive hours after 6 days of work should be scheduled by the employer upon consultation with the workers.
4. Wage and wage-related benefits
  - a) Minimum wage in the region/ sector or more.
  - b) Holiday pay: One day pay for every regular holiday even if unworked, subject to certain conditions.
  - c) Premium pay for work within 8 hours on a
    - i) Special or rest day: plus 30% of basic daily rate (BDR)
    - ii) Rest day falling on a special day: plus 50% of BDR
    - iii) Rest day falling on a regular holiday: plus 30 % of 200% of BDR.
  - d) Overtime pay for work in excess of 8 hours on
    - i) Ordinary days: plus 25% of the BDR
    - ii) Special days, rest days and holidays: plus 30% of the regular hourly rate on said days.
  - e) Night shift differential pay: plus 10% of the BDR/ regular rate for work between 10PM to 6AM
  - f) Service incentive leave: 5 days with pay per year of service
  - g) Service charges: 85% for distribution to rank and file employees; 15% for losses, breakage, or distribution to managerial employees (applicable only in establishments collecting service charges, as in hotels and in restaurants).
  - h) 13<sup>th</sup> month pay: one-twelfth of the total basic salary earned within the calendar year; for less, 13<sup>th</sup> month pay is pro-rated to months of the year served.
  - i) Paternity leave: 7 days with full pay to attend to needs of legal wife before/during/after delivery.
  - j) Separation pay: Minimum of ½ month pay for every year of service for authorized causes of separation.
  - k) Retirement pay: 22.5 days salary for every year of service for optional retirement at 60 under RA 7641 or under applicable agreement or for compulsory retirement at age 65.
  - l) For underground mine employees, optional retirement at age 50 under RA 7641 as amended by RA 8558, compulsory at 60.
5. Payment of wages
  - a) Wages shall be paid in cash, legal tender at or near place of work
  - b) Payment shall be made directly to the employees
  - c) Preference of workers' money claims over government or other creditors in case of bankruptcy or liquidation of business
  - d) Labor-only contracting is prohibited and the [so-called] contractor is considered merely as an agent of the employer
6. Employment of women
  - a) Nightwork prohibition unless allowed by the Rules
    - i) In industrial undertakings from 10 PM to 6 AM
    - ii) In commercial/ non-industrial undertakings from 12 MN to 6 AM
    - iii) In agricultural undertakings, at night time unless given not less than 9 consecutive hours of rest

- iv) Prohibition against discrimination (equal pay for equal work), promotion, training, scholarship grants
- 7. Employment of children (young workers)
  - a) Worker below 15 years of age should be under sole responsibility of parents or guardians; non interference of work with schooling
  - b) No person under 18 years of age can be employed in hazardous or deleterious undertakings.
- 8. Safe and healthful conditions of work and welfare services
- 9. Self-organization and collective bargaining
- 10. Labor education through seminars, etc.
- 11. Peaceful concerted activities in accordance with law.
- 12. Participation in policy and decision-making processes affecting their rights and benefits.
- 13. Free access to the courts and quasi-judicial bodies and speedy disposition of their cases
- 14. ECC benefits for work-related contingencies
  - a) Medical benefits for sickness/injuries
  - b) Disability benefits
  - c) Rehabilitation benefits
  - d) Death and funeral benefits
  - e) Pension benefits
- 15. SSS (social security) benefits
  - a) Maternity benefits
  - b) Sickness benefits
  - c) Disability benefits
  - d) Retirement benefits
  - e) Death benefits
  - f) Pension benefits

Source: Bureau of Working Conditions, Department of Labor and Employment; compilation made by C. A. Azucena (2002), with this author's (GPS) abridgment.

Chart 1. Population, Labor Force, and Unionized Labor, 1960-2004

Chart 2. Extent of Unemployment:  
Unemployed and Underemployed Among Employed Laborers

**Table 1. Population, Labor Force, and Unionized Labor**

<i>Year</i>	<i>Population (Million)</i>	<i>Labor Force (Million)</i>	<i>Unionized Labor (Million)</i>
1903	7.6	3.1	
1918	10.3	4.2	
1939	16.0	6.5	
1948	19.6	8.0	
1960	27.2	11.0	
1970	36.7	14.9	
1975	42.1	17.1	
1980	47.9	19.4	
1990	60.7	24.5	
1991	62.1	25.2	3.1
1992	63.5	26.2	3.1
1993	65.0	26.8	3.2
1994	66.5	27.5	3.5
1995	68.6	28.0	3.6
1996	70.2	29.6	3.6
1997	71.9	30.3	3.6
1998	73.6	31.3	3.7
1999	75.3	32.0	3.7
2000	76.5	30.9	3.8
2001	78.3	31.7	3.8
2002	80.1	32.5	3.9
2003	81.9	33.2	
2004	83.8	34.0	

**Table 3. Unit Cost of Labor Comparing Philippines, Malaysia and Thailand (1992=100)**

<i>Year</i>	<i>Philippines</i>	<i>Malaysia</i>	<i>Thailand</i>
1987	62.0	102.0	0.0
1988	67.0	93.0	0.0
1989	74.0	88.0	92.0
1990	79.0	86.0	93.0
1991	82.0	88.0	96.0
1992	100.0	100.0	100.0
1993	102.0	102.0	95.0
1994	117.0	103.0	90.0
1995	120.0	111.0	100.0
1996	157.0	116.0	101.0
1997	150.0	110.0	87.0
1998	119.0	83.0	66.0
1999	137.0	88.0	79.0
2000	137.0	91.0	82.0

Source: National Statistical Coordination Board, Philippine Statistical Yearbook, 2003.  
Labor force calculations for other years based on average ratios for 1991 to 2000.

**Table 2. Labor Force, Labor Participation Rates, Employment, Unemployment and Underemployment**

*Except for labor force, all numbers are in Percent.*

<i>Year</i>	<i>Labor Force (Million)</i>	<i>Labor Participation Rate</i>	<i>Employment Rate</i>	<i>AMONG THE EMPLOYED:</i>		
				<i>Unemployment Rate</i>	<i>Under- employment Rate</i>	<i>Visibly Under- employed</i>
1990	24.525	64.5	91.9	8.1	22.1	10.4
1991	25.246	64.5	91.0	9.0	22.1	10.7
1992	26.180	65.0	91.4	8.6	19.9	9.9
1993	26.822	64.7	91.1	8.9	21.4	11.1
1994	27.483	64.4	91.6	8.4	20.9	10.4
1995	28.040	65.6	91.6	8.4	19.8	9.8
1996	29.637	65.8	92.6	7.4	19.4	10.1
1997	30.265	65.5	92.1	7.9	22.8	10.5
1998	31.278	66.0	90.4	9.6	23.7	12.6
1999	32.000	65.8	90.6	9.4	22.1	11.4
2000	30.900	64.3	89.9	10.1	19.9	10.7
2001	33.361	67.5	90.2	9.8	16.6	10.9
2002	33.674	66.2	89.8	10.2	15.3	10.0

Source: National Statistical Coordination Board, Philippine Statistical Yearbook, 2003.

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