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POLICY BRIEF

GLOBALIZATION, ADJUSTMENT AND THE CHALLENGE OF INCLUSIVE GROWTH

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SEARCHING FOR THE BALANCE BETWEEN FLEXIBILITY AND WORKERS' SECURITY (IS IT TIME TO REFORM LABOR MARKET POLICIES?)

The protection of labor and the regulation of labor-capital relations are fundamental elements of Philippine labor policy. This protective posture is enshrined in the Constitution (Art. XIII), and reaffirmed in the Labor Code of the Philippines which provides the legal basis for all existing labor market policies and regulations.

In recent years these policies and regulations have been criticized for being either too restrictive, as to limit the growth of employment opportunities, or too lenient, as to expose workers to various sources of employment and income risk. Naturally the recommendations have also pointed towards either relaxing labor market regulations or tightening them.

The Philippines' unsatisfactory performance in job generation is often cited as an argument for reducing regulations in the labor market. Compared with other countries in the region, open unemployment continues to be high. The availability of a large pool of surplus labor is also suggested by the extent of underemployment. In the current period of internationally mobile capital, the fear of high unit labor costs chasing investments offshore has added urgency to calls for greater labor market flexibility. Business

organizations are under increased pressure to adapt to the changing environment for their survival. Shorter product life cycles, rapid obsolescence, and the greater preference for highly skilled, knowledge-based workers are causing firms to adjust their strategies with non-trivial effects on their organization and staffing. Advances in technology and greater market competition have attached a premium to agility. In a more dynamic situation, employers want more latitude in their hiring and firing decisions.

At the same time, jobs have become less remunerative and more precarious for workers. They are more vulnerable to income shocks as a result. But the uncertainty of jobs and the loss of entitlements typically associated with regular employment are not the only reasons for concern. The prospects for re-employment are also becoming more

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difficult for displaced workers. In light of the deteriorating quality of available jobs, there is a growing sense that mere expansion of employment may be too narrow as a policy objective. The promise of economic growth and faster job creation that accompanies the usual appeals to forego wage increases and better working conditions rings hollow in a scenario marked by macroeconomic instability, deepening poverty, and persistent inequalities.

A fundamental question that arises in connection with the current concern to promote growth of the inclusive kind is whether the current regulatory framework of the labor market supports or undermines that objective. Do existing labor market regulations inhibit firms from adjusting to the more competitive environment? Is it possible to achieve some measure of labor market flexibility and at the same time provide workers income security? This policy note explores the preceding questions with reference to the issues of minimum wages, contractual choice, and industrial relations in the Philippines. Noting the paucity of empirical studies in the Philippines, these issues are discussed in the context of the broader literature on labor market institutions and the international evidence regarding their effects on economic performance.

THE POLICY CHALLENGE

Wage and salary workers comprise about 52 percent of the Philippines' employed work force, placing the rest of the 34 million employed Filipinos outside the purview of most labor regulations. In addition, no more than 75 percent of these workers are employed in private establishments, of which 92 percent are either cottage or micro enterprises employing less than 10

workers, and another 7 percent are small establishments with 10-99 workers. Some two million of all wage and salary workers are also in agriculture. Understandably, union density is low at 12 percent (1.6 million workers), but coverage of collective bargaining agreements is even lower at about 220,000 workers as of June 2008. The inescapable conclusion is that the protective mantle of labor regulations does not extend far enough.

The preceding fact has been used to argue that labor regulations cannot be the cause of unemployment or underemployment in the country because they affect only a limited portion of the economy. As such, these regulations ought not to be the target of policy reforms. To an extent, there is a point to this in the sense that reforms ought to be directed at the more critical bottlenecks to employment creation, most of which have to do with economic growth and lie outside the labor market: the tight public finances, inadequate infrastructure, weak investor confidence, and the market failures that have spawned a narrow industrial base (ADB [2007]).

To argue as above, however, is not to say that labor policies and regulations should pay no heed to their employment effects on the pretext that they play only a supporting role to demand side policies which can more directly influence employment creation. Although they may not be responsible for the unemployment problem, labor regulations certainly cannot be relied upon to improve the status of the self-employed or unpaid family workers who are beyond the coverage of regulations. They may even exacerbate labor market dualism. But eschewing labor market regulation altogether is not the alternative. The point rather is to strive for

policy coherence so that economic growth leads to an expansion of employment opportunities and improves people's lives, while measures undertaken to improve people's lives do not become impediments to growth. Of course, this is much easier said than done.

Increasing workplace productivity and affording labor some protection are both critical to ensuring sustained growth of output and employment and increasing labor's income and welfare in the long term. However, these benefits are often blurred by the short-run destabilizing effects of supporting policies on both workers and employers, especially those who find adjustment costly. Regulations protecting labor are likely to increase employers' costs, while actions taken by employers to raise workplace productivity may put some jobs at risk. This suggests that workers' and employers' opposing views regarding labor market regulations spring largely from considerations of cost avoidance, even survival, in the short term.

If so, the question is how policies should be crafted so that workers and employers are persuaded to adopt a longer time horizon in assessing their effects on their respective bottom lines.

MINIMUM WAGES

Under the Republic, minimum wages were established in 1951 for non-agricultural and agricultural workers.

These were adjusted by Congress only twice (1965 and 1970) during the 20-year period preceding martial rule in 1972, after which further adjustments – either in the form of basic wage increases or wage supplements – came more frequently by

presidential decree or wage order almost yearly between 1972 and 1986.

Shortly after the regime change in 1986, the 13th month pay was made mandatory for all workers, while the previous cost-of-living allowances were integrated into the basic minimum wage. With the power to fix wages restored to Congress in 1987, the minimum wage was raised two more times. The last legislated across-the-board increase was in 1989 when RA 6727 hiked the statutory level by 40 percent.

RA 6727 also created the National Wages and Productivity Commission (NWPC) and decentralized the wage fixing process through the creation of the Regional Tripartite Wage and Productivity Boards (RTWPBs) for each of the country's administrative regions. Since 1989, regional wage boards have on average raised wages every year. Currently, there are at least 216 minimum wage levels nationwide, with the highest in the National Capital Region.

Philippine minimum wage laws have been motivated by the objective to provide workers with the “minimum standards of living necessary for the(ir) health, efficiency, and well-being” in keeping with the constitutional mandate to provide labor full protection. In the same vein, the need to catch up with the rising cost of living underlies workers' occasional demands for increases in the minimum wage.

The main argument against minimum wages in the Philippines, however, has been that they tend to discourage investments thereby inhibiting employment growth. A recent finding shows that the country

has the third most expensive labor among Southeast Asian countries after Singapore and Malaysia. Furthermore, small enterprises may not be able to shoulder the additional costs brought about by regular wage increases. This is a significant issue for a country where 99 percent of establishments are either small or micro enterprises and may account for the relatively high rate of non-compliance.

Unfortunately, little empirical evidence has been advanced in order to convincingly argue that minimum wages either benefit the poor or reduce employment. Part of the reason has been the difficulty of accessing wage data across individuals and over time to determine the coverage and impact of minimum wages since their introduction in the 1950s. As a result, the debate has not progressed to the point where it is possible to compare objectively the costs and benefits of this social policy. Still, it may be pointed out that high youth unemployment, though not necessarily an outcome of the minimum wage, becomes more difficult to address if employers are not likely to hire inexperienced, unskilled youth at the prescribed minimum.

Clearly, more empirical work is needed to inform the debate. Against the numbers that can potentially exit poverty after a minimum wage adjustment must be compared the potential losses in employment. The problem is whether a social consensus can be arrived at regarding the weights to attach to seemingly conflicting objectives, let alone the role of a minimum wage. According to the ILO, a minimum wage is meant to be merely a safety net for unorganized workers, who are also usually among the disadvantaged. However, in a country

¹Labor Force Survey, January 2009, National Statistics Office (NSO).

²2006 List of Establishments, Industry and Trade Statistics, NSO.

³Data are as of 2008. Computed as the ratio of union membership in private establishments to wage and salary workers in private establishments. The ratio is unchanged by the inclusion of union membership in the public sector. But even this low union density estimate is generally considered an overestimate by most accounts.

where basic social services are inadequately provided, the minimum wage tends to be viewed as the primary means for addressing the problems of poverty and vulnerability. This creates strong social pressures for upward adjustments in the minimum wage during difficult times and places the burden of combating poverty almost exclusively on this single device.

FREEDOM OF CONTRACTING

Employers' increasing use of flexible staffing arrangements is a contentious issue in Philippine industrial relations. Specifically, this pertains to the practice of employing workers on a non-regular basis (i.e. as contractuels, casuals, or temporary), whether hired directly or through an employment agency. Workers hired based on these contractual arrangements generally have shorter job tenures and do not enjoy the non-wage benefits granted to regular employees. As these labor contracts conflict with established notions of the employment relationship (widely interpreted as job security), they have encountered resistance from organized labor. From labor's standpoint, employers resort to flexible employment arrangements to circumvent various labor regulations, such as minimum wages, various non-wage benefits and other labor standards, including the right of workers to unionize, that increase labor cost.

Various explanations for firms' use of non-regular employment contracts have been advanced in the literature (Abraham and Taylor [1996], Segal and Sullivan [1997]), all of which point to cost minimization. In order to survive in today's increasingly internationalized business environment, greater agility is required. Thus firms avoid being locked in to production technologies that tie them to inflexible

long-term contracts with their workers, even when product demand is expanding. In this situation, labor standards and job security regulations that make terminations costly increase hiring costs (Lazear [1990]). Firms avoid these costs by resorting to employment contracts that escape coverage of existing labor laws. But as a result, employment has become more precarious and workers' incomes increasingly vulnerable to economic shocks.

The response from organized labor has been to pressure government to regulate labor contracting and thereby restrict employers' ability to terminate workers. At bottom, however, what the various attempts to curb flexible labor contracting are trying (or have tried) to achieve is secure for the worker the terms of employment typically associated with regular employment contracts (e.g. continuous employment, access to wage and non-wage benefits mandated by law and/or collective bargaining agreements, severance payments). The government's response has been to define the scope for lawful labor contracting and explicitly assign the responsibility for providing mandated benefits or complying with labor standards to either the labor contractor or the firm for whom the services are performed.

Contracting and subcontracting are generally allowed under Philippine laws, but are subject to regulation in the interest of employment promotion, recognition of workers' rights to just and humane conditions of work, security of tenure, self-organization and collective bargaining. Hence any contracting of labor services that contravenes these declared objectives is considered an outright violation of law

or public policy. For example, engaging in labor-only contracting (LOC) is expressly proscribed.

By defining the limits of legitimate contracting, the intent of existing regulation is to assure the contractual worker that some party shall assume responsibility for providing him whatever entitlements existing laws have mandated all workers to receive. However, the institutional requirements for determining when contracting violates existing laws or public policy open the door to various creative legal interpretations. This shifts to the already clogged courts the burden of determining whether the conditions for lawful labor contracting have been breached.

Thus, while the objective of some labor groups to have LOC illegalized may have been achieved, it is another thing to say that this will achieve the intended effect, which is the provision of some measure of income security for non-regular workers. In the first place, the determination of whether a contracting arrangement is LOC, or if it violates the rules on legitimate labor contracting, can be a tedious legal process. Due to more limited resources, workers normally are at a disadvantage in long-drawn out court cases.

On the other hand, firms' willingness to invest more in the domestic economy could also be dampened as a result of contracting restrictions, although it is important to point out that existing regulations thus far have allowed firms sufficient flexibility in their hiring and firing decisions.

A policy question in light of what seems to be an inexorable trend towards flexibility in labor markets worldwide is whether there

are other avenues available for contractual (and other non-regular) workers so that they are not disadvantaged by income shocks arising from interruptions in paid work. Recent work (Esguerra, Ogawa and Vodopivec [2002]) on publicly provided income support for the unemployed should be instructive. Such support can take various forms: unemployment insurance, unemployment assistance, severance pay, unemployment insurance savings accounts, and public works.

However, choice of which income support scheme is appropriate for the Philippines and its design will have to consider issues of client selection, work incentives, resource mobilization, institutional viability, administrative capacity, and a large, heterogeneous informal sector. Finally, such scheme should be packaged along with training or re-tooling programs and an effective labor market information system to increase employability and shorten the period of job search.

INDUSTRIAL RELATIONS

The regulation of labor-capital relations is a key element in the promotion of industrial peace. To this end, existing laws provide guarantees to labor's rights to organize, bargain collectively, and engage in industrial action (e.g. strikes) to advance its interests. There is a prevailing sentiment that these rights are mere paper rights, however, in light of the low union density and the limited scope of collective bargaining referred to above. In addition, the trade union movement is weakened by division within its own ranks.

Whatever the reasons for the general weakness of organized labor, its consequences do not augur well for inclusive growth. Unions can contribute

to better workplace governance by helping enforce labor standards. They also advance redistributive goals by bargaining on behalf of workers for a bigger share of firms' surplus. Where they or their equivalent(s) are absent or weak, there is no countervailing institution to the power of employers over workers in the workplace. Workers then have to rely on the intervention of a third party, often with the assistance of lawyers, to compensate for their disadvantage in direct dealings with employers. The result is an excessive reliance on the courts and quasi-judicial bodies for resolving issues involving labor-management relations, as what is observed.

The process of resolving labor disputes in the Philippines is exasperatingly slow. This situation has tended to fuel allegations, albeit largely unsubstantiated, of corruption (decisions for sale) in the system. Clearly, the issue is how to wean the current system of dispute settlement away from costly adjudication and move it toward prevention. The strengthening of institutional capabilities is certainly a move in the right direction. The deployment of personnel who are well-trained in conciliation, mediation and adjudication should be able to help reduce the backlog of unresolved cases. However, there is also a need to examine existing rules and procedures governing dispute settlement as these may be generating incentives that are a potential source of the problem. There may also be good reasons to re-examine the existing system of providing separation pay for displaced workers.

Most cases at the NLRC (80 percent) involve terminations or dismissals with money claims. These suggest that part of the explanation for the large number of industrial relations disputes may lie in

the inadequacy of the current system of providing workers who are displaced with retrenchment benefits or severance pay. Where financial awards are contingent on the reasons for termination, the process is frequently attended by delays and costly litigation. A well-designed system that guarantees separation benefits may help reduce the incidence of disputes even as it satisfies the safety net consideration.

WHAT DO OTHER STUDIES SHOW?

There is a renewed importance of minimum wages in both developed and developing countries brought about “by an increase in the number of vulnerable workers, particularly those in part-time, temporary or casual employment, and more jobs with low pay”, and the widening income inequality (ILO [2009]). The effects of minimum wages, whether beneficial or detrimental, depend on the level at which they are set, and their enforcement. Countries with higher minimum wages also have lower income inequality in the

bottom half of their labor market, while the impact on employment is mixed.

Likewise, the relationship between employment protection and aggregate employment or unemployment has been observed to be weak. Studies differ in their results. In its 1994 Jobs Study, the OECD attributed the higher job creation in the US relative to Europe to the greater flexibility of its labor market and proposed it as a strategy for Europe. But under the weight of evidence, it conceded in its Employment Outlook of 2004 that employment protection does not clearly lead to higher unemployment, although it is associated with lower employment rates. Employment protection may also change the distribution of employment, favoring some groups more than others. For example, where there is stricter protection of regular jobs, higher levels of temporary and other non-standard contracts have been observed. The stability of employment also has a positive effect on

productivity, whether through training or innovation.

In developing countries where data bases are weak and enforcement of regulations is problematic, strong evidence of the impact of regulation on employment is harder to come by. While some labor reforms are clearly needed, labor policies are not the primary cause of unemployment and persistent underemployment (ADB [2006]).

Achieving balance between flexibility and security is possible through different combinations of employment protection, and income and social protection policies. Without corresponding measures to enforce labor standards, mitigate income losses arising from job separations, promote opportunities for worker training and re-skilling, and facilitate re-employment, the benefits from having a more flexible labor market cannot be maximized.

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