

## Bills Prohibiting/Restricting All Forms of Temporary Employment: Why They Are Problematic<sup>1</sup>

### 1. Introduction

- a. Various bills propose to ban/restrict all temporary employment contracts (TECS), all aiming to strengthen workers' job tenure, income security and other entitlements that come with being a permanent employee.
- b. By compelling enterprises to hire all their workers as regular or permanent employees, they hope to strengthen their job tenure along with other related entitlements.
- c. The question is: how would the bills, if approved, impact government's national goal of inclusive growth and zero poverty by 2040, as articulated in the 2017-2022 PDP and Ambisyon 2040?
- d. An informed analysis of this question is needed to ensure that we do not adopt solutions that are ineffective or worse, would unintentionally exacerbate economic exclusion of disadvantaged Filipinos and impede poverty reduction.

### 2. Economic and political context

Before addressing the question head on, we would like first to contextualize our views and clear the air.

Figure 1: The demonization of outsourcing and TECs



- a. First, the PDI caricature in (Figure 1), which reflects a strong anti-contractualization belief among voters, exaggerates when it demonizes all temporary employment contracts.

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- b. This belief is unfortunate because it tends to mislead public opinion and delegitimize contractual mechanisms that serve important roles in the efficient functioning of labor markets.
- c. The demonization of contractualization clouds the ability of the public to separate the grains from the husks.
- d. To this point, Table 1 presents a different view: workers hired by labor contractors/agencies to work as temps for other companies are satisfied with their jobs and receive benefits that informal sector workers can only dream of.

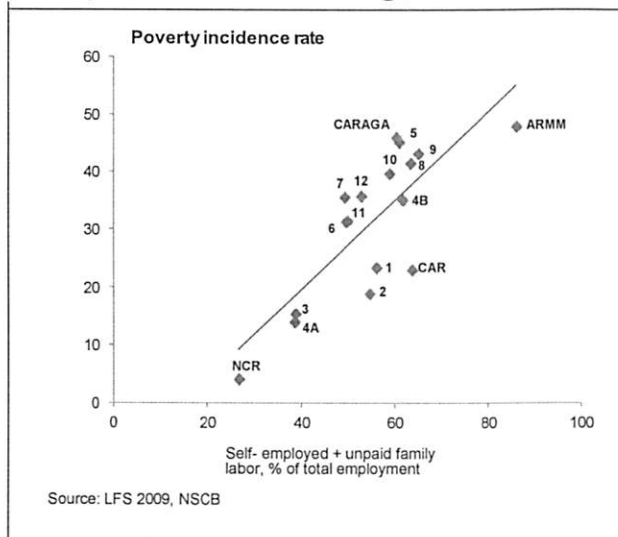
**Table 1. Survey of 5-5-5 Workers, Contractors and Principals in Region XI, X, IV-A and NCR**

Survey questions	Observations	Percent
<b>1. How satisfied are you with your current job?</b>		
Satisfied	90	94.7
Dissatisfied	3	2.1
Neither	2	3.2
Total (valid sample)	95	100
<b>2. Are the following social security and welfare benefits deducted</b>		
SSS	94	95.9
Pag-ibig	91	92.8
PhilHealth	93	94.8
<b>N.B. These benefits are paid for by contractor/agency (92.9%) and</b>		
<b>3. Are you entitled to the following rights and privileges?</b>		
Minimum wage	93	94.8
Overtime pay/holiday premiums	86	87.7
13 <sup>th</sup> month pay	95	96.9
Leave credits	27	36.7
Separation pay	36	36.7
Retirement benefits	12	12.2
Security of tenure	9	9.1
Self-organization, collective bargaining	3	3
Safe and healthful working environment	38	38.7

Source: Ivan Cassidy F. Villena, "Examining the 555 Arrangement in Contractualization: A Study on the Repeated Hiring Practices of Firms in Selected Industries," Institute for Labor Studies, Monograph Series 2014-07

- e. Second, contrary to the depiction of private business enterprises as anti-labor, data show they are actually creating millions of jobs and are in fact the primary generators of employment opportunities that the poor badly need.
- f. Third, it is this job creation function of private enterprises that, if harnessed well to expand formal employment, will enable the Philippines to achieve radical reduction of poverty. [see Figure 2 below for the relationship between poverty and employment]
- g. Fourth, but to harness private businesses effectively, they must be enabled and incentivized rather than harassed and burdened by excessive, costly and unproductive government impositions.

**Figure 2. Informality rate is highly correlated with poverty incidence rate at the regional level in 2009.**



Note: informal jobs = self-employed +unpaid family labor

- h. Fifth, there is a popular impression that employment protection legislation in the Philippines lags behind other countries and, therefore, needs tightening up with stronger control measures like the outlawing of fixed-term contracts. Table 2, which is an international comparison of labor market environment, suggests otherwise.
- i. Apropos, the call for prohibition of fixed-term employment and other TECs is a move in the opposite direction that PH should be taking to prepare for the labor-displacing Fourth Industrial Revolution that is now under way and is expected to accelerate soon.
- j. The boldness of this advocacy is astounding:
  - It completely ignores the cautionary tale of the European labor regulatory reform that introduced among others the idea of fixed-term employment to effectively address jobless growth (discussed below).
  - It proposes to completely ban fixed-term employment contracts, while China, Japan, Australia, Sweden, Korea, UK, and other successful countries are keeping them legal but improving their regulation.

Table 2. Philippine labor markets (LM): high labor cost, inflexible, inefficient due to restrictive laws

Country	Labor market efficiency score <sup>a</sup>	Rank in labor market efficiency (out of 144)	Selected components (1-7)			Ratio of min. wage to ave. value-added per worker <sup>b</sup>
			Hiring and firing practices	Redundancy costs, weeks of salary	Flexibility in wage determination	
Singapore	5.7	2	5.4	3.0	6.0	
Malaysia	4.8	19	4.9	23.9	5.5	0.23
China	4.6	37	4.6	27.4	4.8	0.33
Vietnam	4.4	49	3.9	24.6	5.1	0.60
Thailand	4.2	66	4.4	36.0	4.3	0.41
Philippines	4.0	91	3.4	27.4	4.8	0.69
Indonesia	3.8	110	4.3	57.8	4.4	0.55

<sup>a</sup> Score of 1 means heavily impeded by regulations, 7 means extremely flexible; <sup>b</sup>— means no minimum wage.

Source: World Bank (2016). Data from *Global Competitiveness Report 2014-2015* (WEF 2014); and World Bank's *Doing Business Report 2015* (World Bank 2014b).

**With those observations, we now focus on whether proposed anti-contractualization ideas will result in more secure jobs and greater income security? And if it does, who will benefit and at whose expense?**

### 3. The role of TECs in a market economy.

To answer those questions coherently, it is important to clearly understand the economic role of TECs and appreciate the wisdom (or lack of it) of severely restricting, not to mention banning, the use of TECs in all its forms. In this regard, our view is that:

- (i) TECs are valuable mechanisms for adapting the level and composition of employers' work force to respond to these conditions:
  - a. Unpredictable business cycles and structural economic shocks
  - b. Seasonal business activities
  - c. Rising opportunities to gain from highly profitable but competitive local and global value chains that require a great deal of flexibility
  - d. Concerns about country risks and uncertainty that could stifle long-term investment and innovations for fear of being locked into costly and losing propositions.

There is little doubt that the present labor code needs reform. Nevertheless, the TECs currently permitted by the labor code provides employers some flexibility (albeit, insufficiently) that enable them to:

- e. Reduce resource wastage from underutilized or unproductive employees during low demand periods and facilitate rapid increase in available workers during peak demand

- f. Make timely reallocation of labor from low productivity sector during low demand periods to other sectors with higher productivity - without having to pay enormously expensive litigation and settlement costs
  - g. Undertake, adapt and adopt innovations that would raise the competitiveness of firms and labor productivity
  - h. Employ scarce talents that prefer to work on assignment basis only (today's evolving trend among Millennials)
  - i. Allow firms and potential partners (local and foreign) to manage risk and uncertainty associated with working in new and changing environment.
- (ii) TECs also act as screening device for ensuring quality worker-job matches (Faccini 2014)
- Risk of mismatches can be high and getting stuck with them can be costly, depending on the nature of jobs (minimize lock-in effects)
  - TECs provide a pathway for workers with poor credentials but with undiscovered competencies to enter the formal labor market and move on to become regular employees.
  - Incidentally, in the Philippines the rate of transition from temporary to regular jobs compares well with that of European countries.

#### 4. The impact of the proposed bill on cost, risk and uncertainty

Based on those various functions of TECs, we argue that the effects of banning and restricting further all forms of TECs on business cost, risk and uncertainty could be harmful to many disadvantaged workers and employers, especially MSMEs. Broadly speaking, we should be careful in including the following measures because of their likely adverse effects:

- a. Measures that make it difficult and costly for the economy to re-allocate labor from less to more productive use for they would raise business cost and lower productivity [like outlawing fixed term contracts].
- b. Measures that raise expected cost of litigation and business uncertainty, given long delays in resolving labor cases and the high degree of legal uncertainty and court's unpredictability in the Philippines.
- c. Measures that increase the prevalence of worker-job mismatches and the cost of implementing timely corrective measures [use of shorter probation time].
- d. Measures that impose fast increases in minimum wages and widening of entitlements beyond labor productivity growth and inflation.
  - Decrease employment, especially of inexperience, less educated and other disadvantaged groups.
  - Reduce employment of small and medium enterprises.

[Cite Paqueo, Orbeta, and Lanzona and Canales studies on minimum wage effects to illustrate effect increased labor costs on employment].

**5. Probable effects on economic outcomes**

- a. In the short-run there would probably be little negative effect on incumbent permanent employees, as predominantly most of them have security of tenure, violations of which can be costly.
- b. Some temps are probably needed (at least in the short-run) to keep the business running at some desired level. They would likely become regular employees.
- c. Other temps, however, would become informal sector workers or unemployed or labor force dropouts due to higher costs associated with regularizing workers.
  - Note: South Korea's reform of its labor regulations, which did not ban but only impose a couple of conditions on fixed-term employment in 2007, is instructive. It led two years later to the following results: 37% of fixed term workers were converted into regular employees; almost the same number of such workers lost their jobs.
- f. In the long-run, these adverse effects would be magnified for this reason: the higher cost of formal sector employment would induce firms to switch to cheaper less labor-intensive production/service delivery processes.
- g. This substitution effect will become larger over time, as the accelerating Fourth Industrial Revolution brings forth increasingly cheaper labor-substituting technologies and innovations.  
[such as AI-enabled robots, 3-D printing and biosynthesis for manufacturing]

**6. Summing up: Proposed curtailment of TECS, including banning of fixed-term employment contract, is anti-poor and anti-growth.**

- a. The proposed measures would benefit some of today's temps [those with superior credentials for regular jobs].
- b. The benefit, however, would be at the expense of present day TEC employees becoming informal sector workers.
- c. Moreover, it would be at the cost of relatively fewer formal sector job opportunities for laborers with informal jobs and the jobless.
- d. Those adversely affected would disproportionately come from groups that are disadvantaged in regard to economic background, experience, education and competencies (cognitive and non-cognitive).
- e. The various effects would likely mean a rise in exclusion rates; and as the share of informal sector workers in total employment increases, poverty rate would remain high.
- f. The radical curtailment of TECs makes the functioning of labor markets less efficient and reduces their capacity to encourage and support the creation of gainful formal sector job.
- g. Those adverse labor market effects make PH less attractive as an investment destination, further weakening GDP growth and formal job creation.
- h. On top of these effects, the prohibition and tighter control of TECs of all forms would create greater incentives for rent-seeking behavior
  - Leading predictably to more widespread corruption that would threaten the credibility and success of President Duterte's drive to eradicate corruption.

7. **Postscript: Look for alternative solutions consistent with President Duterte's PDP and Ambisyon 2040 goals**
- a. Our negative view of the bills does not mean that we are against reforming the labor code.
  - b. On the contrary, we believe that the labor code needs to be re-engineered to effectively address strategic challenges facing the nation.
  - c. But the re-engineering must be based on an integrated, forward-looking and informed view of the current and evolving challenges.
  - d. Currently, the central challenge is maintaining a high GDP growth that would generate rapid expansion of productive jobs and shift workers from low productivity informal employment to poverty-reducing formal sector jobs .

The challenge of the future is achieving the same goal but under a radically different conditions arising from Fourth Industrial Revolution, which will usher in cheaper labor displacing technologies and opportunities for abundance.

- e. Highly disruptive, new wave of innovations are expected to destroy 35 to 70 percent of old jobs while creating new job opportunities, depending on the type of industry and occupation.
- f. The new situation will require new competencies, constant skill upgrading, re-skilling and more frequent job changes over one's lifetime.
- g. The re-engineering must also be informed by relevant lessons from the past. To this point, Europe's historical experience indicates that excessive restrictions on labor markets led to jobless growth.
  - By liberalizing labor regulations, including use of fixed-term employment contracts, unemployment rate fell.
  - This experience should caution us against rushing to adopt excessive heavy handed curtailment of TECs
- h. Rounding out our discussion, an informed re-engineering of the labor code should consider:
  - Clarifying the objective and focus of the labor code reform to ensure that top priority challenges are given top consideration;
  - Revising labor code provisions that tend to have exclusionary and harmful consequences to the poor and disadvantaged as well as MSMEs;
  - Developing a 21<sup>st</sup> century labor code freed from tired old ideas that in the past have not been very helpful to the poor still stuck in informal employment.
  - For Philippine enterprises and workers, particularly those in the informal sector, to survive and thrive under FIRE, the labor code should be reformed to address the following critical issues:
    - The expected massive job displacements of workers and their need to frequently move from one job to another (necessitating an improved social protection system to support workers in between jobs and facilitate their lifelong education and skills formation);
    - The need to rethink the meaningfulness of the old concept of job tenure based on the 20<sup>th</sup> century idea of permanent employment; and
    - Increased urgency of lowering the cost, time and hassle of litigation and improving the quality and predictability of settling labor cases to enable timely adaptation by workers and employers to new opportunities.