

Beware of the “End Contractualization!” Battle Cry¹

By Vicente B. Paqueo and Aniceto C. Orbeta

Abstract

In the aftermath of the 2016 election, labor leaders and their political allies pushed for an immediate end to so-called employment “contractualization”, a policy proposal currently popular with voters and politicians. The idea is for the government to tighten and reduce, if not prohibit, the use of temporary employment contracts (TECs) and job outsourcing. This paper analyzes the policy idea and its potential economic consequences by looking at the roles of TECs and job outsourcing in the functioning of efficient labor markets, the experience of European countries regarding TECs, and Philippine employment data. The study finds that while the policy idea is undoubtedly well-intentioned, it can undermine the goal of achieving rapid, inclusive and sustained economic growth. The realization of this outcome depends on the nature of the policy design actually adopted. On this point, the paper suggests a framework that can be useful in formulating a coherent policy on temporary employment and a strategy for dealing with “endo” practices.

The story of three department store salesladies

Directly hired by the firm. When Neri turned 18 years old, she hurriedly applied as a saleslady in a department store in their town. She just dropped off from college on her first year, the oldest in her class because she had to skip two years of high school due to poverty. Meeting the requirements and passing the interview, Neri got the job - her first job at that. Her contract indicates putting her for six months probationary period pending evaluation for possible regularization. This is good enough for her knowing some of her peers were not able to get directly hired by the department store and even had to apply thru different agencies. Neri and her family felt hopeful. However, on the fourth month, Neri was informed that she is now "endo" which means the end of her contract. It was disheartening news to Neri's poor family. What makes it sadder is the fact that the department store has a policy that a salesperson can only directly apply once. If not offered a regular position, the only option is to apply thru an agency. Neri felt bad about this and got frustrated. She did not bother to apply thru agencies anymore and went jobless for a time. Four years after, she is now a mother to a one-year old baby and currently work as a regular employee in an electronics factory. Looking back, Neri knew why she did not get the permanent saleslady position. Being young and somewhat still immature, she had been tardy at work and incurred more than the allowable absences. She now carries the lessons she learned from that experience.

Hired thru a manpower agency. Meanwhile, Nene, unlike Neri, did not have the confidence to directly apply to the department store. She heard that they only consider applicants who has at least reached college. As she is only a graduate from high school, she applied through a manpower agency

¹ We would like to thank Anne Jillian Adona and Jed Santos for their wonderful research assistance. We are also grateful to Ribi Daño-Luna and Sophia Cuevas for their invaluable editorial services.

and was successfully chosen to work as a saleslady. Her contract with the agency indicates an initial period of six months pending evaluation for renewal of contract to another six months. The contract also indicates that a PHP 550 agency fee will be deducted every 15 days from her salary - which the agency releases. The job came at a good time as she is in dire need of income to support her old parents. She always came on time and rarely absent from work. Her performance evaluation came in satisfactory that she was able to renew her contract thrice. Sadly, despite her satisfactory performance and good work ethics, she will never be offered a regular position. As an agency-hired employee, she is bound to her contract with the agency and can only be renewed every six months. Afraid to go jobless, she accepts this condition by the agency. In her mind, her priority is to gain work experience first, no matter how limiting the setup is. After all, she is grateful for the agency in helping her get the job despite her poor credentials and lack of experience.

Hired thru an agency then directly hired by the company. Diding had a rather different experience. She was raised in poverty in Visayas as the eldest of her four siblings. Her father died when she was in high school. Her family transferred to Manila in their aunt's house, where her mother served as a maid. When it became clear that she needs to help her mother in raising her siblings, she applied as a department store saleslady through an agency. It became her first job. Many times she felt like not going to work but had to fight tardiness off. She knew her siblings would go hungry if she loses her job. After two years of repeated renewal of six-month contracts, Diding finally decided to apply directly to the department store in a different branch. Armed with her two-year experience and positive performance evaluation, she got accepted under probation for six months pending evaluation for possible regularization. Consistently, Diding did her best applying her learned skill in building customer rapport and making sales. Her good performance did not go unnoticed. She was offered a regular position but her luck did not stop there. After a couple of years, she got promoted as a department manager in lady's wear where she imparts her skills and wisdom to younger salesladies. For the longest time, her job at the department store became her family's bread and butter. With the help of other siblings, they were able to send their youngest sibling to college. Now married and with her own child, Diding currently works as one of the coordinators of Social Security System (SSS) office of the Philippine embassy in Dubai. A career she never dreamed of attaining which only started with a six-month temporary employment contract.

The above stories depict the familiar experience of many Filipino workers who used temporary employment as a stepping stone screening device for better job opportunities of the disadvantaged. With the current clamor to end contractualization and the call to outlaw temporary employment contracts (TECs), will there still be stories like Neri, Nene and Diding in the future?

Introduction

"End contractualization!" has been the ever-present battle cry of worker groups in the Philippines. For them, this means that decades-old "endo" practices should be made illegal ("endo" is short for end of contract). These practices refer to the use of temporary employment contracts (TECs) whereby a firm hires a temporary worker for a six-month probation, dismisses them after a few (usually five) months, then rehires them and dismisses them again after five months, colloquially known as 5-5-5.

This year, anti-contractualization advocates have succeeded in getting political leaders, including the elected President and Vice-President, to commit to a new law and immediate issuance of regulations that would tighten, if not abolish, the use of TECs and tamp down abuses in outsourcing. Following up on his electoral promise, President Duterte has given his new Department of Labor and Employment (DOLE) Secretary marching orders to end “contractualization”. The President emphasizes that the government, after all, is mandated by the constitution to provide job security to all workers.

What ending “contractualization” means and to what extent the use of TECs will be curtailed varies across different actors in the political-economic spectrum. What specific TEC and outsourcing practices will be outlawed remain unclear. Despite this lack of clarity, the common rhetoric against TECs has been burning and sweeping. Except for the recent World Bank Philippine labor market review,² and commentaries by renowned Filipino economists,³ there has been little awareness and economic discussion on the potential risks of the above policy proposals. To inform the labor policy reform debate, we examine empirical evidences for and against TECs, articulating potential consequences for inclusive economic growth, especially to the stakeholder the proposal is supposed to protect: the Filipino workers. Like the impact of rapidly rising legal minimum wages (see Paqueo, Orbeta and Lanzona chapter 2 of this volume), some proposed regulatory changes could inadvertently hurt the growth and survival⁴ of small enterprises (see Lanzona and Paqueo chapter 3 of this volume). This could prevent them from providing job opportunities to people with poor credentials. Such unintentional consequences could happen, should political leaders fail to recognize TECs' role in the efficient functioning of labor markets. Specifically, we look at Europe's efforts to address “eurosclerosis” - an economic illness where a country persistently experience high unemployment during periods of economic growth.⁵ We also look at the buffer stock, filter and outsourcing efficiency hypotheses to explain TEC's role in employment and unemployment.

While we do not pretend to present definitive conclusions about the “anti-contractualization” proposals, we believe that a more informed view of the policy proposal is needed. This is to allow time to find more efficient and less counter-productive alternatives to the proposed curtailment of TEC use. Based on our preliminary reading of immediately available information, we present a cautionary note.

The economic context

The Philippines, now one of Asia's brightest investment spots, has finally learned to grow its GDP with diversified income sources from remarkable Business Process Outsourcing (BPO) growth and Overseas Filipino Workers (OFWs) remittances. Such accomplishments are founded on sound macroeconomic policies, efficiency-enhancing trade and institutional reforms, and the rise of national productivity (World Bank 2016 and 2014). However, the country's poverty rate (Figure 1) remains stubbornly high with high income inequality. Moreover, inclusive growth remains a dream due to lack of

² World Bank (2016). Republic of the Philippines Labor Market Review. Employment and Poverty Report No. AU58661. January 22, 2016. Washington D.C.

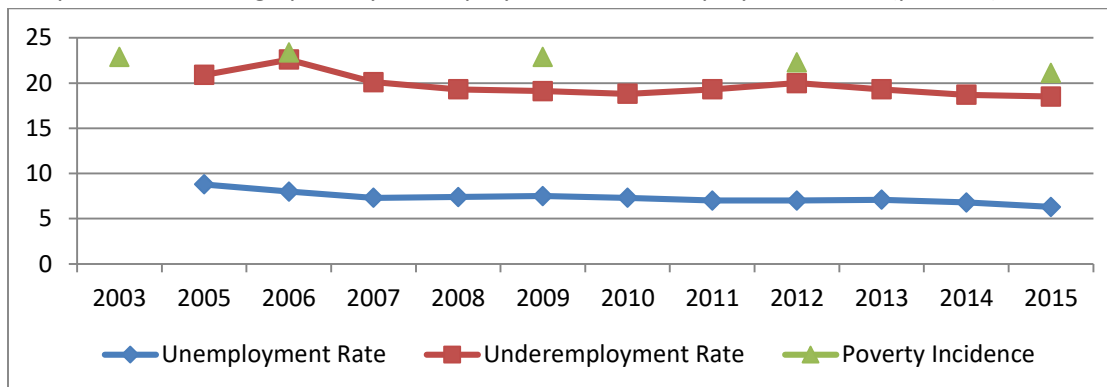
³ Gerardo Sicat (first National Economic Planning Secretary), Dr. John Nye (Frederic Bastiat Professor of Political Economy in George Mason University), and Dr. Vicente Paqueo (retired World Bank economist and expert in economics and human development) lay out the negative effects of constrictive labor policies.

⁴ Data indicate that the survival probability of small enterprises is less than 50 percent.

⁵ “Eurosclerosis” is “a term introduced by German economist Herbert Giersch referring to economic stagnation that can result from a government's overregulation and overly generous social benefits policies” (Investopedia.com).

decent jobs where there is high youth open unemployment rate (15.30 percent among 21-29 year olds). **This poses a challenge for the government to create an enabling environment for the youth to find the right job match before it evolves into costly social problems of political unrest, even criminality, and drugs.** We argue that TEC curtailment with aggressive push for higher minimum wages and costly worker dismissals could hurt young workers.

Figure 1. The persistence of high poverty, unemployment, underemployment rates (percent): 2003-2015



Source: Philippine Statistics Authority (PSA) Official Poverty Statistics, Labor Force Survey (LFS)

Profile of Filipino workers and the nature of their jobs

It is clear from the data in Table 1 that Filipino workers are predominantly regular workers constituting 70 percent of all workers. Interestingly, the share of regular employees was steady at 75 percent prior to 2014. In terms of wage rate presented in Table 2, we find that: 1) relatively, regular workers have higher wages; 2) there is a decline in real wage rate between 2001 to 2014; and 3) there is a rise in real earnings from Php 260 (2010) to Php 266 (2014) during the term of President Benigno Aquino III.

Table 1. Distribution of employment by nature of job: *rising share of temporary workers*

Nature of job	2000	2005	2010	2014
Temporary	18.4	20.8	21.9	24.0
Regular	74.5	74.8	74.2	69.6
Others	7.1	4.4	3.9	6.4

Source of basic data: Labor Force Survey (LFS) October 2014 Series. Consumer Price Index (CPI) deflator is used.

Table 2. Average daily earnings of wage and salary workers (in 2006 prices)

Recent rise after decline but still below 2001 level

Nature of jobs	2001	2005	2010	2014
All	Php 290.3	Php 268.6	Php 259.7	Php 265.6
Regular employees	Php 329.4	Php 298.6	Php 289.9	Php 300.8
Temporary employees	Php 201.48	Php 188.63	Php 181.56	Php 194.91

Source of basic data: Labor Force Survey (LFS) October 2014 Series. Consumer Price Index (CPI) deflator is used.

Regularization, endo and related laws

The political context. Why is there a strong political demand to end contractualization and outlaw all forms of TECs? There is a popular perception that while firms profited from rapid economic growth, workers do not share benefits and are left behind. By ending contractualization, advocates believe that the laborer's economic situation would improve. **TECs are portrayed as a cause of workers' hardships and exploitation.** The above narrative is succinctly captured in a cartoon below (Figure 2).

Figure 2. Contractualization blamed for the hardships of Filipino workers



Source: Philippine Daily Inquirer (May 2, 2016) (permission being asked from the cartoonist)

Last election, all Presidential candidates committed to end contractualization. President Duterte is now under pressure to deliver on his commitment. There is no doubt that “endo” practices violate the law. The anti-contractualization rhetoric, however, goes beyond the condemnation of those practices.

Labor regulatory environment. The Labor Code of the Philippines (LCP) enacted in 1974, follows constitutional mandate to protect the poor against unfair labor practices, strengthen their bargaining power and promote their standard of living.

Table 3. Definition of TECs relative to LCP’s classification of employees

<p>Regular employees: those performing necessary or desirable activities in the usual trade or business of the employers excluding project or seasonal employees. Plus,</p> <ol style="list-style-type: none"> 1. casual who has rendered at least one year of service; 2. employee who is allowed to work after a probationary period; and 3. a probationary employee uninformed about the qualification standards for regular employment at the time of his engagement. 	<p>TECs = casual plus probationary employees</p> <ol style="list-style-type: none"> 1. <u>Probationary employees:</u> those working with employers under a <ol style="list-style-type: none"> 1. written apprenticeship agreements with specified employment duration; and 2. specified standards under which he will qualify as a regular employee and specified standards about which the workers have been informed at the time of his engagement. 2. <u>Casuals:</u> total employees less probationary and regular employees
---	--

There are two fundamental reasons why workers want to be regular employees. First, regular workers are entitled to certain benefits that temporary employees are not. Second, regular workers can be dismissed only for lawful or authorized cause and with observance of due process. This means in practice, that it is very difficult and costly for firms to dismiss regular workers (security of tenure).

As part of Philippine employment protection laws (EPLs), employers must offer permanent employment to casuals and other temps after six months of engagement; otherwise, the employers must lay them off. (LCP Articles 279, 280, 281, 286 and 287).⁶ This is the so-called regularization law or rule. Some employers resort to endo to avoid adverse consequences on their business. Temporary workers can be legally hired directly by principals or thru manpower service contractors (agencies) provided certain conditions are met.⁷ Through direct hiring, endo is committed when firms repeatedly hire workers with experience and training without incurring certain costs every time temps finish their six month temporary employment limit. Through contractors, firms practice "endo" by repeatedly using the same temps without having to regularize them. Labor leaders oppose this, citing they violate rights to secure decent jobs. Firms take advantage of this, for it allows them to have an edge in business competition. Such circumventions of labor regulations can be interpreted as firms' coping mechanisms for avoiding the cost of regulatory compliance and the risk of getting locked in an unprofitable situation when the business environment changes.

Philippine labor market (in)efficiency. In order to appreciate the potential consequences of imposing further restrictions on TECs, it is important to know the labor market (LM) context and its significance. Table 4 shows that the country's overall labor market efficiency (LME) score is 4.0 on a scale of 1-7, one being heavily impeded and 7 being extremely flexible. In contrast, Singapore's LME score is 5.7. Except for Indonesia, other ASEAN labor markets also appear to be more efficient than the Philippines. Out of 144 countries, the Philippines ranks 91 on this LME scale. The Philippines also has relatively low scores in (i) hiring and firing (3.4 on a scale of 1-7), (ii) redundancy costs (weeks of salary), and (iii) flexibility in wage determination (4.8 on a scale of 1-7). The Philippines appears costly relative to labor average productivity: 0.69 compared to Singapore's 0.23, Malaysia's 0.37 and China's 0.33.

Table 4. LM characterization: high labor cost, inflexible, inefficient due to restrictive laws

Country	Labor market efficiency score ^a	Rank in labor market efficiency (out of 144)	Selected components (1-7)			Ratio of min. wage to ave. value-added per worker/ ^b
			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

^a Score of 1 means heavily impeded by regulations, 7 means extremely flexible; ^b– means no minimum wage.

⁶ See detailed discussion of LCP provisions in chapter 2 of this volume on legal minimum wage.

⁷ Prohibition of principal employers from contracting out includes: (i) activities directly related to the employer's principal business (Article 106, para. 4, LCP); (ii) regular functions that are usually necessary or desirable in usual business or trade of the employer (Article 286, para. 1, LCP); and (iii) jobs to "labor-only" contractors (Article 106, LCP, in relation to DO 18-A, S 2011).

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

These data show that the Philippines, compared to other countries, suffers from a competitive disadvantage when it comes to cost and flexibility of labor use. The current labor market (LM) is characterized by inefficiency due to costly and inflexible regulatory environment. This is unfavorable to economic efficiency, competitiveness, and jobs-generating growth. Moreover, it arguably generates unintended consequences against disadvantaged and vulnerable workers and families. Our concern is that government anti-contractualization policy could exacerbate the above adverse effects, depending on the kind of interventions adopted. Therefore, awareness of this context is important for an informed public discussion of the anti-contractualization issue.

Towards a more informed response to the anti-contractualization advocacy

The call to outlaw TECs is partly due to lack of appreciation of its important role in labor market efficiency. For government and voters to have a more informed responses to the anti-contractualization demands, it is critical to have a good understanding of the economic value of temporary employment contracts (TECs). In terms of evidence, we look at the experience of European countries with TEC liberalization given their years of experience with restrictive temporary employment regulations.⁸ Further, we highlight three hypotheses on the roles of TECs in explaining observed employment and unemployment behavior: buffer stock, screening/filter, and outsourcing efficiency hypotheses.

Hypotheses on the roles of TECs. TECs are mechanisms for efficiently and opportunely allocating labor resources to jobs where and when the economic value of their contributions are highest. This view can be gleaned from the various roles that TECs play in labor market functioning. A well-known role is the employers' use of temps as "buffer stock". There are many angles to this hypothesis. First, TECs allow firms to make timely adaptation of the level and composition of their work force to changing demands due to business cycles and unexpected shocks. Second, employers can use temps to efficiently meet seasonal labor requirements. Third, TECs provide a mechanism allowing enterprises like construction firms to hire temps for project-based employment.

Through the above TECs, firms avoid unnecessary expenses in between projects, seasons, and economic cycles. In terms of the real economy effects, TECs allow employers to avoid maintaining underutilized or unproductive employees during low demand periods; and they facilitate rapid increase in available workers during peak demand (e.g. harvest season, Christmas season). TECs also allow timely reallocation of labor from low productivity sectors during low demand periods to other sectors with higher productivity.

To complement the buffer hypothesis, Faccini (2014) proposes the screening/filter hypothesis to explain how liberalization tend to simultaneously reduce unemployment rate and raise the transition rate of workers from temporary to permanent employment over time. According to Faccini, TECs can be

⁸ A caveat: one should be careful about unqualified application of develop countries' labor standards and experience to a developing country like the Philippines. In this case, however, Europe's adoption and then liberalization of highly restrictive regulation of TECs arguably provide a cautionary tale for the Philippines. Many of the labor standards governing TECs in the country mimic those of European and other developed countries. A labor surplus economy that continues to struggle with slow job creation despite rapid GDP growth, the Philippines is more likely to be adversely affected in terms of employment by imposition of more TEC restrictions -- or favorably by their liberalization.

viewed as devices for ensuring quality worker-job matches. He observes that unreliability of information provided by credentials and paper/pencil tests poses risks to employers. He notes the risk of mismatches can be high and getting stuck with mismatched workers can be costly, depending on the complexity and difficulty of the jobs involved. TECs provide a stepping stone or pathway for workers with poor credentials becoming regular employees, which is good for inclusivity.

There are several implications we can draw from Faccini's analytical framework. First, TECs allow timely reallocation of labor to best-fit use of human resources and thus, minimize costly lock-in effects. Second, curtailment of TECs could lead to reduced employment rate and increased unemployment rate. Third, more restricted use of TECs would decrease the transition of workers rate from temporary to permanent jobs. Moreover, from Faccini's hypothesis we can infer that curtailment of TECs could lead to less opportunity for disadvantaged / vulnerable workers to become permanent employees. Therefore, it can be argued that TEC curtailment makes labor market not only inefficient but also less inclusive.

"Eurosclerosis" and reform of TECs in Europe. In the late-1970s and in the mid-1980s, Europe was suffering from so-called "eurosclerosis" – a term originally coined to describe European countries "experiencing high rates of unemployment and lagging job creation during periods of economic growth".⁹ The culprits were overly generous labor benefits (e.g. unemployment insurance) and overregulation of labor markets (e.g. restrictive rules governing employment contracts). It was believed that the surge and persistence of high unemployment rates after the mid-1970s in Europe was due to labor market rigidities. By 1997, most of Europe had relaxed TEC regulations. As a result, the share of temporary workers in Europe rose from less than 6 percent in 1983 to nearly 15 percent in 2007 (Faccini 2014)¹⁰. To date, liberalization of temporary employment contracts is seen as a major instrument for bringing down high unemployment rates. Using panel data on 18 European countries from 1985 to 2008, Faccini reports a significantly negative relationship between long term unemployment rate and employment protection legislation (EPL) indices. He estimated this relationship, using multiple fixed effects regression analysis (see Annex 1).

The experience of temps in the Philippines

Workers' own assessment. A 2014 survey data¹¹ (Table 5) suggest that 95 percent of workers employed by "endo" contractors appear satisfied with their current jobs. Additional information reveals that the workers covered by Social Security System (SSS), Pagibig and PhilHealth are quite high at 95.7, 92.8 and 94.8 percent respectively. A high proportion also enjoy minimum wages, overtime pay/holiday premiums and 13th month pay.¹² It is, therefore, not surprising that a high proportion of interviewed

⁹ See footnote 5.

¹⁰ Renato Faccini (2014), "Reassessing Labour Market Reforms: Temporary Contracts as a Screening Device," *The Economic Journal*, March 2014. pp. 167-200.

¹¹ Villena (2014) surveyed a total of 112 respondents composed of 11 contracting agencies, 3 principals, and 98 agency-hired workers. Simple Random Sampling was used to draw samples from a list of contracting agencies registered under DO 18-A in Regions NCR, IV-A, X and XI. For the agency-hired workers and principals, snowball sampling was used. In terms of distribution, 53 respondents were from Region XI, 33 from Region X, 15 from Region 15 and 6 from NCR. No principal/firm was surveyed from NCR.

¹² Recent accounts from present and former saleslady personnel of a known department store confirm that they receive SSS, Pagibig, and Philhealth benefits aside from access to medical benefits.

workers expressed satisfaction with their current jobs despite the fact that only a small proportion of them are entitled to leave credits, separation pay, security of tenure and other benefits. There is, however, still room for improving the work conditions of endo workers when it comes to security of tenure. As a caveat on this survey, we note the need to validate those conclusions with nationally represented data.

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

Survey questions	Observations	Percent
1. How satisfied are you with your current job?		
Satisfied	90	94.7
Dissatisfied	3	2.1
Neither	2	3.2
Total (valid sample)	95	100
2. Are the following social security and welfare benefits deducted		
SSS	94	95.9
Pag-ibig	91	92.8
PhilHealth	93	94.8
N.B. These benefits are paid for by contractor/agency (92.9%) and		
3. Are you entitled to the following rights and privileges?		
Minimum wage	93	94.8
Overtime pay/holiday premiums	86	87.7
13 th 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

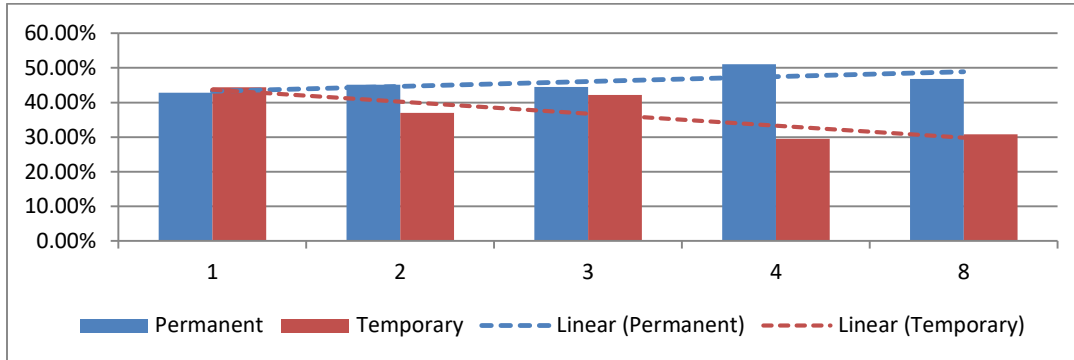
Source: Ivan Cassidy F. Villena, "Examining the 555 Arrangement in Contractualization: A Study on the Repeated Hiring Practices of Firms in Selected Industries," Institute for Labor Studies, Monograph Series 2014-07

We also find, using the Philippine Labor Force Survey (LFS) data that the transition rate of workers from temporary to permanent employment is substantial. In the Philippines, 40-55 percent of temporary workers during the 2003-2010 period transitioned to permanent employment status after a few quarters (Panel LFS data). To compare, temps in Europe (year 1996) who were transitioning to permanent jobs one year later ranges from 56.1 percent in UK to 20.8 percent in France. It appears that the Philippine transition rate is at the higher end of the European experience.

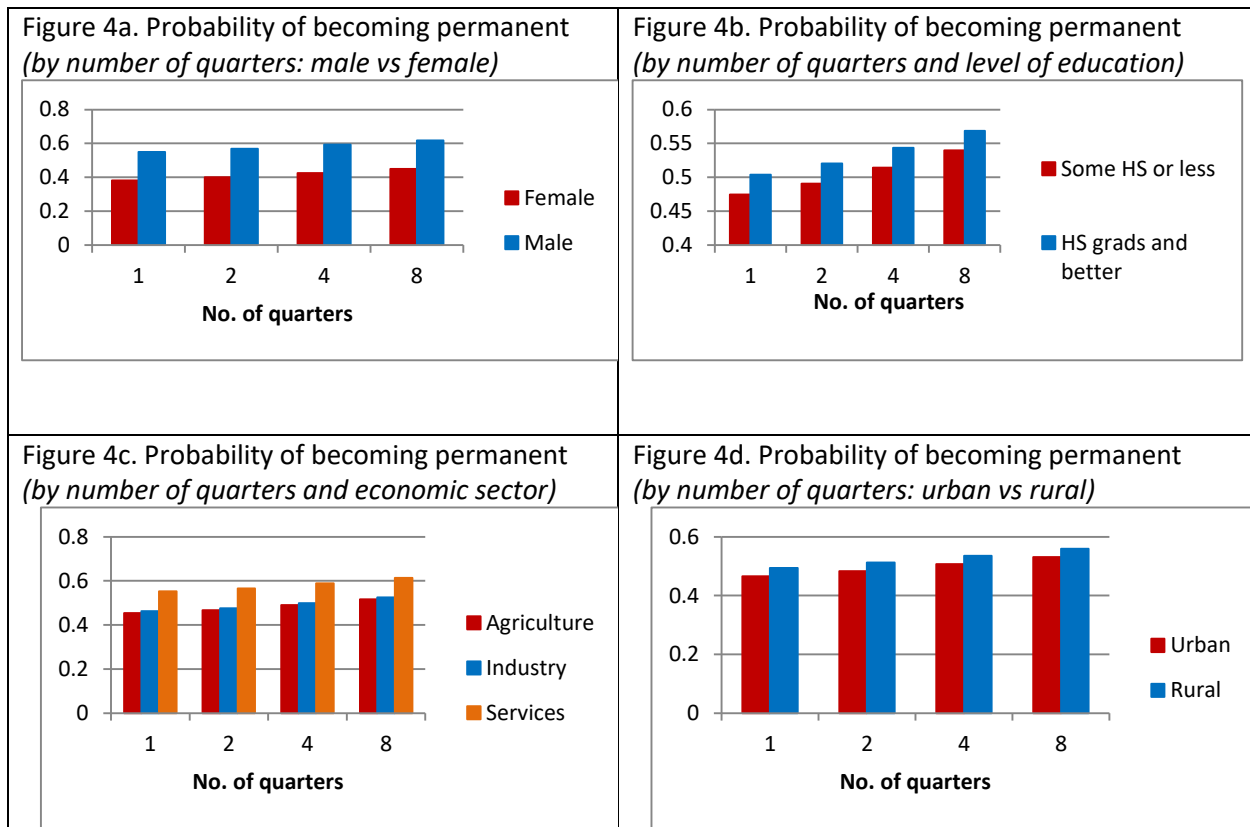
Based on the LFS data, more than 50 percent of first-time temps do not make it to regular job and had to be fired after 2 quarters of work as temps. Workers who fail to transition to regular job after 6 months of temp work come from disadvantaged groups with poor credentials. This includes the young, the women and workers without high school diploma and others. It takes between 4-8 quarters for 50 percent of temps to become permanent (Figure 3). College graduates (Figure 4b), male and service sector workers (Figure 4a and 4c) have faster rates of transition. Interestingly, when education and other factors are controlled for, urban-rural residence does matter significantly (Figure 4d). The implication of differences in temps' ability to transition to regular jobs is that the 6-month period appears too short for workers with poor credentials to learn on the job and for a firm to see their hidden

character and competencies. Data suggests that **the current regularization rule is an inflexible one-size-fits-all rule**. The current rule makes it more difficult and costly for disadvantaged workers to be regulars. These findings suggest that allowing more flexibility in the regularization rule could be more inclusive and efficient -- more welfare-enhancing.¹³

Figure 3. Percent of temps becoming regulars after a given number of quarters working as temps



Source: Panel Labor Force Survey (LFS)



Source: Authors' calculation, using probit regression model estimated; Based on LFS Panel

¹³ Some have pointed out the 6-month regularization law is in line with Organization for Economic Co-operation and Development (OECD) norms. This is irrelevant to the point we are making in this paragraph. The OECD data refer to the average worker and not to laborers with poor credentials and background. But even if we compare averages, one can argue that the average Filipino worker might need more time to learn on-the-job and show his competencies, because his level and quality of education and training are less than his OECD counterpart.

Understanding endo and the challenge of ending it

Why do some employers resort to endo? This is a strategically important question for the analysis of government's policy and strategy for ending endo. In our view, endo is a mechanism for coping with the business costs and difficulties associated with labor regulations. For many employers, their decision to regularize a worker or practice endo depends on their calculation of the costs and benefits from endo practices.

Figure 4 presents a simplified model depicting this view in broad terms. The model assumes that an employer would tend to practice endo, if by doing so he would enjoy net savings for his enterprise. Net savings here is defined as the additional costs avoided for not regularizing a worker (gross benefit) less the expected cost of getting penalized for not complying with the law (penalty cost). Our hypothesis is that the larger the net savings the higher the probability that an employer would practice endo.

Examples of factors that drive gross benefit include the cost to the firm of contributions to social security, Pag-ibig, and PhilHealth; overtime pay and other entitlements; and several payment and costs associated with the regular workers' right to security of tenure. On the other hand, the expected penalty cost would be determined among others by the probability of getting caught for non-compliance, the value of the penalties imposed, as well as the reputational cost to the enterprise.

So, other things equal, we expect endo practice to be more prevalent when minimum wages are higher, since cost of social security, PhilHealth, Pagibig and other entitlements rise with level of workers' salary. We also expect that the prevalence of endo would fall with reductions in the cost of dismissal of permanent workers, risk of litigation and cost of dispute resolution. We further predict that endo would be less prevalent when the penalty cost of non-compliance increases with more frequent and stricter DOLE inspections, larger fines, and bigger back pay awards.

In theory, there are a variety of ways for reducing the prevalence of endo practice. They range from tightening enforcement of existing labor regulations to passing legislation for plugging loopholes that employers are allegedly abusing to circumvent the regularization law.

The dilemma is that, on the one hand, limiting government action to tightening enforcement might not be enough to eliminate endo practice, as promised by President Duterte. On the other hand, aggressive threats of government harassment, huge penalties, business closures as well as prohibition of all forms of TECs to close "loopholes" could lead to unintended adverse consequences like reduction in job opportunities and inclusive growth.

In view of this concern, the Department of Trade and Industry (DTI) has proposed an alternative strategy labelled as a win-win approach to ending endo (see Table 6). The proposal is supposed to be a win-win for both employers and workers. All wage and salary workers would have regular jobs and would enjoy all the benefits of a permanent employee. Employers (principals) could hire workers directly as regular employees. Manpower service agencies could also hire workers as regulars and then supply them to principals on a temporary basis. The fly in the ointment is that the additional cost of such a scheme to the employers could be high. One employer's estimate puts the increase in firms' costs in the range of 30-40 percent, which is much larger than DTI's estimate of less than 10 percent. But even with DTI's lower estimate, the adverse employment impact of DTI's proposal could still be significant. To counter the impact, the government can rationalize the labor code to reduce the cost, risk and uncertainty of worker dismissal.

Figure 4. Why do some employers resort to endo practices?

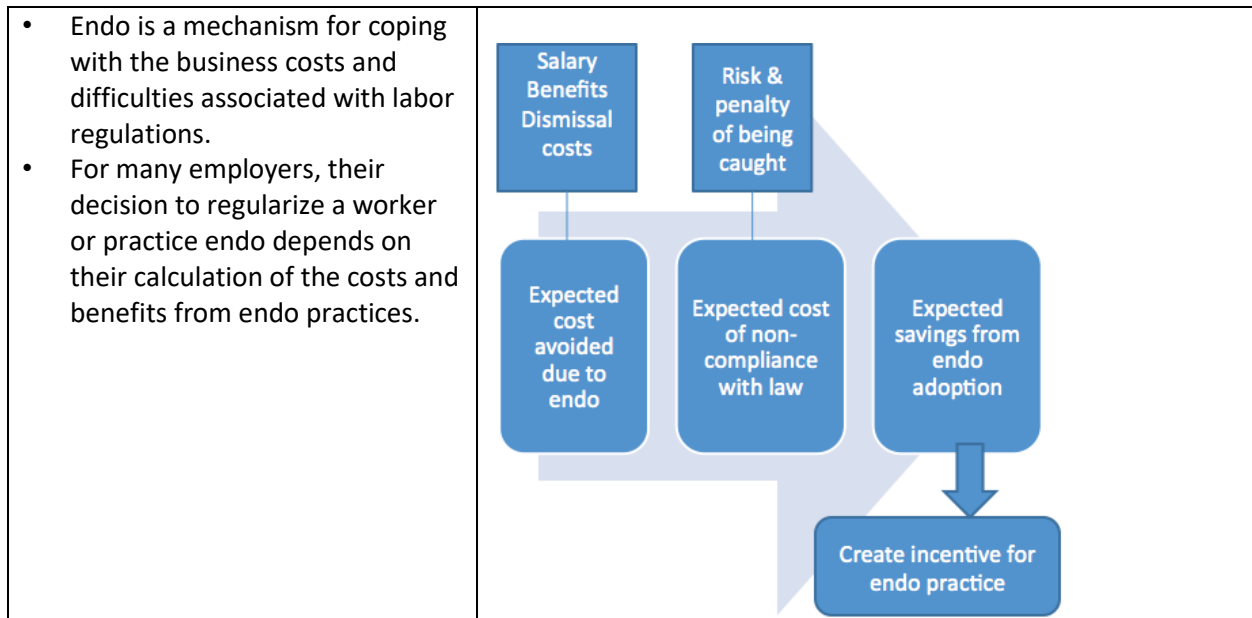


Figure 5. Proposed policy analysis framework for controlling "endo" practices and their impact on economic outcomes

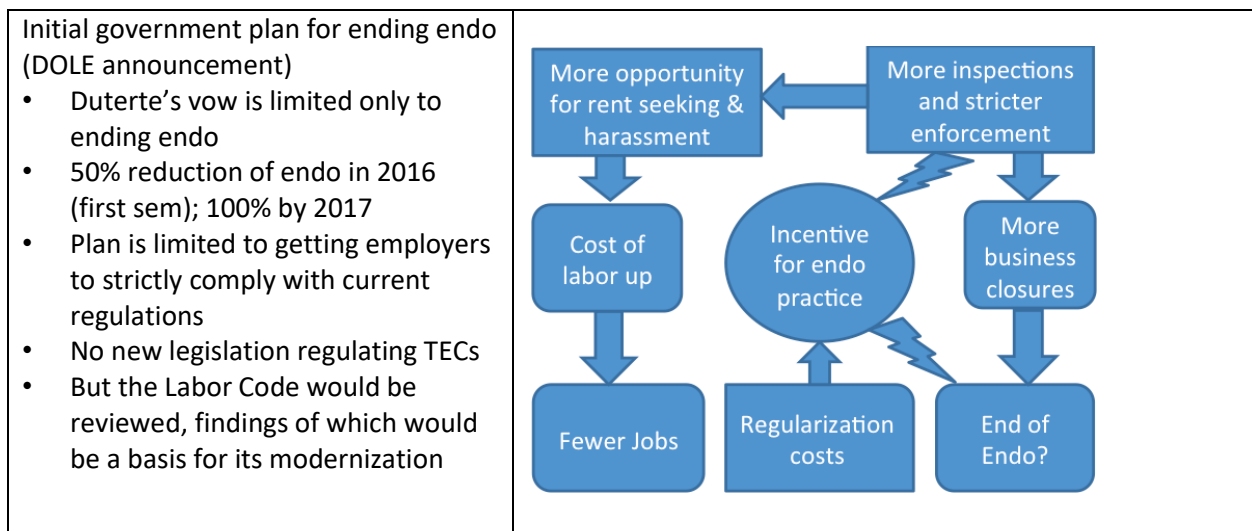


Table 6. How else can endo be ended without impeding expansion of employment demand?

<p>DTI’s proposed “win-win solution”</p> <p>To allow a firm to hire the services of workers without the obligation of regularizing or firing them after 6 months of work,</p> <ul style="list-style-type: none"> • Provided they are supplied by qualified manpower service agencies (contractors) • Provided further those workers are employed as regular employees of above contractors and said workers receive mandated benefits. 	<p>Observations</p> <ul style="list-style-type: none"> • Scheme would give job security to the laborers while addressing the needs of contractors’ principals for employment flexibility • The main issue is the additional costs to be passed on to the principals by manpower suppliers (about 30 to 40 percent marked ups?)
---	---

	<ul style="list-style-type: none"> • This increased labor cost would lower job creation.
--	---

Conclusions and Reflections

There is little doubt that the “endo” practice is illegal. Therefore, to uphold the majesty of the law, the government is obligated to end the practice. This fact, however, should not prevent citizens from questioning the wisdom of the current worker regularization law and from examining the need for its amendment. More crucially, the outrage against illegal “endo” practices should not blind politicians and voters to the potential adverse consequences of further curtailment or prohibition of temporary employment and job outsourcing.

The government needs to carefully weigh the effects of ending endo and of curtailing other TECs. It appears that the need for immediately ending endo is overblown and could significantly impede achievement of inclusive growth. On this point, one can question the wisdom of the government committing its political and financial capital to ending endo within a year. Instead, shouldn’t the creation of better job opportunities for informal workers be given higher priority by the government? They are more numerous and have more urgent needs compared to endo workers who already enjoy social security, minimum wages and other benefits that informal workers can only dream of.

Endo and other TECs play valuable roles in keeping the Philippine economy efficient, competitive and inclusive. Ending endo would adversely affect inclusive economic growth, depending on the aggressiveness and nature of government response to the anti-contractualization demands. This adverse impact would be intensified by imposition of more restrictions on other forms of TECs or, worse, by the passage of pending congressional bills prohibiting all forms of TECs. Those bills run counter to the lessons of Europe regarding liberalization of EPLs as a way to overcome the phenomenon of growth with little job creation.

The pending bills would also undermine the country’s ability to prepare and re-position its regulatory and policy environment for the impending Fourth Industrial Revolution - the would-be new normal which will bring about massive destruction of current jobs and the creation of new ones. Contrary to people’s mindset at present, what is needed, looking forward, is to liberalize the use of TECs and find ways of providing better-paying jobs and income security under the would-be new normal. It is in light of the above observations that the government should address the anti-contractualization issue.

References:

- Abrera, M. 2016, May 2. *Contractualization*. [Editorial Cartoon] Philippine Daily Inquirer. Retrieved June 28, 2016: <http://opinion.inquirer.net/94540/editorial-cartoon-may-2-2016>
- Cahuc, P., Charlot, O. and Malherbet, F. 2012. 'Explaining the spread of temporary jobs and its impact on labour turnover', Working Paper No. 8864, CEPR.
- Cao, S., Shao, E. and Silos, P. 2011. 'Fixed-term and permanent employment contracts: theory and evidence', Working Paper No. 2011-21, Bank of Canada.
- Daway, S. and Fabella, R. 2015. 'Development progeria: the role of institutions and the exchange rate', *The Philippine Review of Economics*, vol. LII, No. 2 (December), pp. 84-99.
- De Dios, E. and Dinglasan, K. 2015. 'Just how good is unemployment a measure of welfare? A Note', *The Philippine Review of Economics*, vol. LII, No. 2 (December), pp. 234-245.
- Department Order 18-A. 2011. Issued by the Secretary of Department of Labor and Employment (DOLE).
- Faccini, R. 2014. 'Reassessing Labor Market Reforms: Temporary Contracts as a Screening Device', *The Economic Journal*, vol. 124 (March), pp. 167-200.
- Investopedia. (n.d.). *Eurosclerosis*. Retrieved July 12, 2016, from Investopedia: <http://www.investopedia.com/terms/e/eurosclerosis.asp>
- Jimenez, J. 2016. PowerPoint presentation '*The Great Debate: Contractualization and Casualization*' at the 9th Philippine HR Summit: *The Dynamics of Business and People Growth*, Crown Plaza Galleria, Ortigas Center, Pasig
- Labor Code of the Philippines. 1974. Article 106; 234, 253 A and 264; 279, 280, 281 and 287; and 127.
- Philippine Statistical Authority. 2014. *Labor Force Survey (LFS) October 2014 series*. Official Poverty Statistics.
- Pries, M. and Rogerson, R. 2005. 'Hiring policies, labour market institutions, and labour market flows', *Journal of Political Economy*, vol. 113(4), pp. 811-39.
- Villena, I. 2014. 'Examining the 555 Arrangement in Contractualization: A Study on the Repeated Hiring Practices of Firms in Selected Industries', Institute for Labor Studies, Department of Labor and Employment, Monograph Series 2014-07. Manila.
- World Bank. 2016. *Global Competitiveness Report 2014-2015*. World Economic Forum 2014.
- World Bank. 2016a. *Republic of the Philippines Labor Market Review: Employment and Poverty*, Washington, D.C

Annex 1. Higher EPLs raise unemployment rate: fixed effects model, using European panel data and gen. least squares

Independent variables	Dependent =	UNEM
U_{it-1}	0.872***	
EPL temporary contracts _{it}	0.436***	(0.129)
EPL regular contracts _{it}	0.908*	(0.497)
Union density _{it}	0.367	(0.285)
Benefit replacement ratio _{it}	0.083	(0.159)
Benefit duration _{it}	-0.212*	(0.120)
Centralisation _{it}	0.362**	(0.163)
Co-ordination _{it}	-0.116	(0.219)
Labour demand shocks _{it}	-0.385***	(0.078)
TFP shocks _{it}	-0.069*	(0.040)
Time dummies, country dummies		
Hausman test	.001	S.E.

Notes. *, ** and *** denote statistical significance at the 10%, 5% and 1% levels respectively.
Source: Faccini (2014), Economic Journal