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**“Successes” and Adjustment in the
Philippine Labor Market**

by

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Abstract

A high degree of unemployment and underemployment characterizes the Philippine economic development record. In large part, the mainstream labor policies that emphasized high labor welfare standards and high minimum wages over the creation of employment are responsible for this outcome. In spite of this poor record of employment generation, some successes have been achieved in generating jobs and incomes in specific areas of industry and services. Focusing on these successes gives an insight on what works well. *These “successes” in employment and income creation represent a common thread: they try to avoid the jurisdiction of the mainstream labor market policies or they are efforts of firms to adjust to the labor policies within the law to avoid their worst effects on cost and efficiency.* The successes that are discussed in this essay are the following: the overseas contract workers; employment of labor in export processing zones; market for professionals among multinational companies; labor employment in the information technology sector; and domestic outsourcing of labor services and manufacturing. In an open economy, the country benefits from outsourcing by taking jobs away from high wage centers to the country. The same pattern of outsourcing happens when firms in the country forsake the country to transfer of their mainline operations in other countries to take advantage of lower wage costs. The main lesson from this paper is to point towards the need to reform the country’s labor market policies so that they attain a higher degree of flexibility.

Key words: Philippine economy, labor market policies, overseas contract worker, outsourcing and subcontracting.

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I. Introduction

This essay describes the achievements of the labor market in creating employment within the country. One of the major problems of Philippine economic development is the seeming inability of the economy to provide sufficient growth of employment to absorb the all the labor force in gainful occupations. Focusing on successes would offer insight on what works well.

Some of the successes in employment gains are activities arise out of relevance of domestic labor market policies. When the jobs created are mainly within the economy, they are in response to outside market developments that affect a segment of the labor force where most of the labor laws on welfare and wage protection appear to be irrelevant. There are successes that happen which are in the nature of adjustments taken by firms to avoid the high unit labor costs imposed by the labor welfare policies on employers. Where some amount of flexibility and wage competitiveness occurs, Philippine labor as a factor of production makes enormous gains.

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In short, the successes represent aberrations that happen outside the mainstream labor policies. Successful results occur when the policies in the mainstream labor market do not interfere or when the companies try to escape from the impositions imposed by the inflexibility of regulations and policies through an adjustment of their business practices.

The more we understand these successes, the better it is for national policy makers to devise remedies to improve further the performance of the mainstream labor market. It is admitted that one of the most difficult policies to reform is the policy on the domestic labor market. Only a sound understanding of the problems would make it possible to move forward in this case.

This paper hopes to make a presentation of the areas where successful results are happening. To replicate them within the mainstream labor market is the big problem. This would restore flexibility in the labor market and make employment growth faster, bring in new industries, and create for greater economic efficiency, growth of productivity, and improve economic performance.

II. Philippine labor market policy and response

Over the years, the domestic labor market has become over-regulated and high cost [see Sicat (2004a)]. The domestic labor market serves the mainstream of the labor force to help allocate labor services with all the productive activities that take place in the Philippine economy.

The open economy and Philippine wages

The country's resources provide the basis for economic prosperity. Labor – its quality and its abundance – is one of these resources. The country's experience since independence in 1946 in trying to mold economic policy had taken the route of emphasizing improved welfare standards and assuring – by government fiat – that each worker when employed be entitled to a level of minimum wages including welfare and income entitlements. Philippine labor policy had been enthusiastic in embracing advanced social policies commonly found in developed countries.

To have made enormous progress comparable to the many countries of East Asia possible – perhaps even better – the missing complement toward the development of the country's labor resources was a policy to encourage the domestic and foreign capital to take advantage of the labor opportunities. That would have made the country into an economy that participates effectively in the world economy. For many decades, Philippine economic policy restricted various forms of entry by foreign capital and created unnecessary monopolies for domestic capital to take advantage of the economic landscape. That this was a poor set of policies is borne out of the Philippine experience of falling behind in economic development among countries in East Asia.

Some taste of what might have been could have been foretold by the recent experience of sudden growth in exports of manufactures during the 1990s. This arose out of the freeing of foreign capital to participate in the country's export industries. As a result, the Philippines has become a major component of the manufacturing network within Asia and the world for computer and electronics products that power the telecommunications revolution in the world. Compare this experience to the fact that after many decades, the industries promoted under a protectionist mantle during the inward looking import substitution days, there is hardly any major export industry developing out of those industries. It is in this sense that there are successes in development arising outside of the mainstream sectors of the economy. These successes have produced corresponding successes in terms of job creation in the labor market.

In an open economy, international differentials in factor prices are very important. Poor countries like the Philippines have abundant labor. Their wage rates could attract foreign capital if restrictions do not prevent capital from coming in. Restrictions come in many forms: protectionist policies, nationalistic industrial and trade policies, legal restraints on business practices from retail distribution, to land ownership, to investment restrictions, to professional practice. All these restrictions played a role in making the Philippines (relatively) unattractive to foreign capital for many decades despite many efforts to prove that it is a good place for foreign investment. Even today, a lot more efforts need to be done by economic policy, a separate subject matter that is not the concern of this paper. [But see Sicat (2002).]

Wage differentials between countries account for a major factor in determining the flow of capital into other countries. Through the mainstream labor policies adopted by the government, Philippine wages became expensive internationally compared to other countries in East Asia. Philippine wages have become high (in foreign exchange terms) compared to many countries in the course of their development: in relation to Taiwan, South Korea, HongKong and Malaysia(during the 1960s to the 1970s), and with Thailand, Indonesia, China and Vietnam (from the 1970s to the present day).

Against this world, too, policies toward foreign capital have been more liberal over a wide variety of sectors. In the Philippines, there have been so many areas restricted against participation of foreign capital. But in the other countries, the openness to foreign capital signaled also relatively generous policies toward investments by citizens.

Against this world, the wage differentials between the industrial countries compared to the East Asian countries have been very high. During relevant spurts of rapid growth among many East Asian countries, while foreign capital (and with it technology) from industrial countries was moving to East Asia, the country picking went to those countries that had much more open investment policies and where wage rates were relatively cheaper. For many reasons, the first of the industries to move to the developing countries were the labor-intensive industries. As the countries developed expertise and sufficient internal markets, they moved into heavier industries, each time creating a further deepening of the development process.

In the meantime, the Philippine economy was slowly being bypassed. Today, the picture has been somewhat altered. Some major successes in the labor market need to be detailed in order to find some pattern of future moves for reforms. This essay deals with the labor successes. A succeeding paper deals with the necessity of reforms. [See Sicat (2004b)].

Mainstream labor market regulation and fragmentation

A thriving underclass of workers is an outcome of this situation. Poor workers who cannot find jobs in normal occupations find themselves toiling in what is often called an unorganized market. These workers find themselves either working constantly at low incomes or find only sporadic economic opportunities during the year. These laborers face an uncertain economic future. Laborers in the informal market fail to acquire skills that upgrade their income earning capacities. Or the skills that they might already have initially do not get harnessed in a work environment. They eventually go to waste or they stand still. This side of the labor market story produces the problems of poverty that the country acquires.

When there is a high rate of unemployment in the economy, the supply of jobs is wanting. Many participants in the labor market suffer a loss of welfare. Some of those who are employed do not feel that they get relatively adequate incomes. Insufficient demand in the economy does not produce a tightening of the labor market that is critical to the rise of labor incomes. In this situation, those who are excluded from direct employment suffer all the more than in the case of those who complain of low incomes while being employed. The latter find themselves in situations of very unsteady incomes. They are either underemployed or just unemployed.

In a highly regulated market, the jobs are not created because many economic agents avoid getting committed contractually in that market. Here, distinction is useful, between the *mainstream* labor market and other labor markets that arise because of the regulation. To some extent, the highly regulated market contributes to a fragmentation of the labor market. The domestic labor market *is* the mainstream labor market in the economy. Market dualism arises when the mainstream market does not enlarge sufficiently to cover all of the available labor market. When there is large unemployment, the unorganized market becomes large, and work there is contracted out by economic agents at rates of wages that are not covered by the mainstream labor policies.

The biggest losers in the mainstream domestic labor market are the young laborers and unskilled workers. Many find it hard to be employed. Most of these become self-employed persons or family labor in family enterprises, working long hours but earning little incomes. In urban areas, these are the ones who are seen hawking merchandise on foot. Others end up jobless and without any productive activity, for they cannot find work even if they want to. These are often the poor people who migrate from the rural areas

looking for jobs and ending up in the urban areas of squalor. They are unemployed or underemployed and end up poorer over time. They constitute the base of the country's growing immiserization of the already poor.

Labor movements and outsourcing

A labor market that is highly regulated creates incentives for mechanisms that avoid aspects of those regulations. The regulations often impose higher unit costs than would happen without them. By their presence, the regulations themselves provide incentives to economic agents – businesses and laborers – to look for means of escape from the high costs imposed. A form of escape is for the laborer or the business to seek economic activity abroad.

This segment of the labor market looks to the overseas contract market as a way out of the domestic labor market. The qualified worker who finds contract work of fixed duration abroad leaves the domestic labor market. Immigration – or permanent departure from the labor market – is an extreme form of escape. Sometimes, the reasons for immigration could be other than economic.

In general, it is difficult to escape from the mainstream labor market totally. Labor across countries is not mobile. There are many barriers to international labor movements. As a result, the bulk of the labor force is destined to work in the mainstream labor market. The domestic labor laws provide the parameters or the limitations of, as well as entitlements derived from, employment contracts. The mainstream labor market would permit adjustments of labor use through processes and institutional arrangements that are legally possible.

An example is that firms could invest in machinery that displaces labor, making the remainder of the employees more productive. Or these firms could look for flexible work arrangements in which a range of labor services formerly provided internally are contracted out. Such subcontracts include specific activities within the firm that were provided by regular employees, for instance, internal security, janitorial services, a process of manufacturing or service provision. This removes them from their liability under the labor laws.

The new mechanisms described above often get set up to avoid the cost penalties of the highly regulated labor market. Finding these opportunities, new businesses get established to provide the services in a more specialized way. The businesses become the enterprises that mobilize and employ the labor directly. They sell the services and eventually displace the direct labor hires of the firms that make the subcontract. Rather than hire the individual employees, these latter firms purchase the labor services provided by these new companies. The types of services can employ a variety of skills needed – from the very basic to sophisticated service of specialized professionals. In short, activities designed to provide particular services become niche industries for some businesses.

The firms that find the labor costs unnecessarily burdensome look for alternative ways of reducing these costs. The result is the growth of niche markets for some types of firms to undertake subcontracting of labor or processes that result in cheaper labor costs. Some of these new firms, in fact, could result from the reorganization of the economic activities of the primary firms. This is done by spinning off certain activities or units of operating enterprises as independent companies by separating the hiring of labor services to the spun off companies. The result is a greater flexibility in dealing with the employment contracts of the workers separate from the labor force of the primary companies. The more common route however is for new firms to enter these market niches to take advantage of these opportunities and offering their services to the established operations.

This is the beginning of outsourcing of services. The primary firms hire the firms engaged in these niche operations. With proper attention to detail and to the productivity of the services being offered by these companies, they help to promote overall efficiency in production in the whole economy. In general, the activities that can be available for out-sourcing of services represent a wide range of possibilities. They could involve the employment of laborers in all classes of labor skills – unskilled, semi-skilled, to the highly professional or technical skills.

So long as the outsourcing undertaken by Philippine firms is undertaken within the domestic economy, this process could go on without the loss of actual jobs within the country. The penalty that high labor costs imposes to primary companies is redistributed in terms of new jobs to the subcontractors. A net result of this is that country progresses without loss of jobs except for a redistribution of jobs. This promotes greater efficiency because the net result is a reduction of costs overall. As stated above, the penalty that a highly regulated labor market imposes is in the slower generation of jobs but outsourcing redistributes the jobs and might even permit the growth of employment even if only to a limited extent as cost efficiency is gained.

Outsourcing and the open economy

In the presence of open international borders, there is nothing inevitable about labor employment being just redistributed within the internal economy. In a global or regional economy, outsourcing could cross borders. Countries compete for the contract of manufacturing and the rendering of labor services. The high labor cost economy could be under pressure from the low labor cost economies. In short, in the open economy, outsourcing is a double-edged opportunity. It is a source of potential jobs when competing with developed, labor-tight economies of high-income countries. The segment of the labor force within the mainstream market enjoys enormous competitive edge at the highly skilled labor market where wages are relatively low compared to the developed country levels.

The other face of outsourcing is that it forces the country to face tough competition at the low-wage-end of the labor market. Other countries with lower labor costs have a similar edge in labor costs over the Philippine wages. So long as high tariffs and other regulations make it impossible to import products that are produced at home, this does not pose a problem. But with the opening of lower tariff barriers and accession to international rules of trade under the WTO, these barriers would need to fall. The country stands to lose out to low labor cost countries. A migration of industries could result in a net loss of jobs and also output within the country. So long as the barriers to trade exists, the country could redistribute the jobs arising out of domestic outsourcing of jobs within the mainstream labor market. But once the barriers are lowered, the sluice gates could mean an outward flow of output and of jobs unless the labor market is competitive.

This problem has encouraged the resurgence of protectionism in the Philippines arising from the reactions to job losses. Protectionism is the poor answer to the problem. Protectionism only contributes toward making the Philippine economy retain the inefficiency of the industrial base. The proper state response to this should be a reform of the labor market policies, which is the subject of the subsequent essay accompanying this paper [see Sicat (2004b)].

Defining "success" in the labor market

For purposes of the foregoing discussion, "success" is defined as an adjustment within the mainstream labor market that allows labor to be allocated to its best possible use in the economy. One form of successful adjustment is the one already described above: the ability of economic agents to employ labor in its most effective use, given the policies governing the market. Outsourcing and flexible work arrangements to avoid the higher costs of standard operations of employment within the traditional production operation represent one form of success.

The labor policies have built over the years a highly regulated labor market. Such regulations include welfare provisions for workers, an effort for the government to impose minimum wages and wage supplements, including regulations that limit the freedom of action of employers to hire and disemploy workers. Some of these labor policies are seen as major impositions on employers to recognize a regime of employment that is along the high standards followed in advance countries. To some extent, these appear to be premature and inappropriate applications of labor standards on a labor market that has a high labor market supply where the main problem has become that of job generation. The high welfare standards imposed by law have come in conflict with the more urgent task of creating jobs to absorb the growing labor force. In short, the mainstream labor has become highly regulated and has, as a major characteristic, a high degree of inflexibility.

As a way out of the highly regulated mainstream labor market, flexible work arrangements have helped to bring down the cost of production and help to avoid the labor liabilities that are imposed under the normal employer-employee relations that are recognized under the labor laws. Rather than view these arrangements as negative aspects of the mainstream labor market, flexible and outsourcing arrangements are really successful efforts to adjust within the mainstream labor market. As a result, the labor market is rendered relatively flexible whereas, under the highly regulated setting of the mainstream labor market, many of these firms would have given up their operations to lower cost competitors.

The successes in the domestic labor market took various measures to innovate on various methods to reduce labor costs essentially outside the sphere of the domestic labor market that suffers from heavy regulation. When some of them do happen within the market, it is because they represent an effort to adjust to the heavily regulated market that they manage to eke out the successful activity.

The successes are few but some of these are outstanding. They happen outside the ambit of the highly welfare-oriented mainstream labor market. Take the case of overseas contract workers, the first case of success to be cited below. These are laborers who adjust to the problems at home by seeking alternative employment elsewhere. They do not have to find the same opportunities possible of attainment at home. Sometimes, the labor market segment that succeeds does so because it has unique characteristics that sets it apart from rest of the labor sector. The improvement of labor employment within the export manufacturing sector, most of them located in the industrial processing zones, is the result of special incentives to the companies and also the presence of specific skills among the employed laborers. Such labor is above the range common laborers who receive wages close to the minimum wage where skills are more important.

III. Examples of successes

The successes experienced in the labor market demonstrate the ability of the Filipino worker or of establishments to thrive in competitive situations. Some successes relate to professional capacity within a competitive peer framework. Other successes involve the ability to adjust to regulatory pressures to avoid high costs and inefficiency. They describe innovations in the installation of competing, low cost alternatives to the system of allocation. Other successes depend on the ability of the government to simply enable the process to begin and to sustain it. In other words, the government's place is simply that of enabling rather than guiding or regulating. These will be explained in due time.

The following successes will be discussed: (a) overseas contract workers; (b) exports of manufactured exports using skilled workers in export processing zones; (c) professional Filipino professional expatriates who have done well in their work and who have returned to the country; (d) the information technology service industry serving as offshore sub-contractors for call centers or back room operations of large companies in industrial countries; and (e) flexible work arrangements servicing major domestic and export oriented industries.

(a) The overseas contract workers market

Emigration to places of work demonstrates labor mobility. This is often a movement from low wage jobs at home to high wage jobs available in foreign countries. Most overseas contracts are of fixed duration. Temporary working permits are given with the permit to work for a fixed time period. A small set of these workers has the intention to leave permanently since they have immigration status in the country of destination.

Migration and contract work

Migration is a permanent loss of the laborer to another country while overseas contract work represents a temporary loss of the laborer in the mainstream market. The direction of migration has been dominantly to the United States. This involves oftentimes professionals who bring their entire families to the country of immigration. Some countries like Canada and Australia have had active encouragement of a limited amount of migration that has attracted Filipinos. One problem of migration is that the policies of the countries of immigration are designed to select highly qualified and well educated professionals and technicians to their country. In some respects, this is similar to the process of high-grading mineral ore as in

mining. The best grade of qualified people is goaded to migrate but the bar is effective against those who do not fall under the highly selective immigration criteria.

Sometimes, migration and overseas contract work lose their distinction as a subset of tourists and overseas contract workers get lost in the mainstream labor markets of foreign countries as illegal workers and often stay on and one without detection. Some of these become permanent residents and take root as migrants effectively in their country of abode. There is no official accounting of illegal workers in many countries, but each of these countries – from those in Europe to the United States – complain about the number of illegal workers in their midst. Most of these workers earn productive incomes where they work in these foreign labor markets. They are able to manage their lives in relative comfort compared to what it would be in their home markets.

Filipino overseas contract workers have increased over time. During the 1960s, Filipinos discovered the seamen's market. They trooped to learn the art of merchant marine work quickly to man the sea lanes of the world. Easily available at lower wage rates than those prevailing for established seamen, they managed to displace a lot their British and European counterparts by the force of competition in the labor market for seamen where wage rates play an important role. Filipino seamen are the new merchant mariners of the world. In 1991, there were 125,759 working as seaman overseas. In 2002, there were 209,593 seamen.¹

Contract work migration in land-based jobs began en masse after the 1970s. The Middle Eastern oil producers became rich overnight when they emerged strong economically after the oil exporting countries decided to form a cartel and impose their control of supply of energy, thereby raising the price of crude oil. This action created new incomes for these economies and they needed workers to help them in their investment programs as well as to man their service industries. The Philippine government discovered the opportunities available and it facilitated an overseas workers program.

The program originally began with two components: construction industry and overseas labor contracts. The one that succeeded well was the program of overseas Filipino contract workers as individuals in pursuit of their job. The hiring of contract workers undertaken individually or by groups for various job contractors became the more vibrant labor market activity. The one that did not do well was the program linked to Philippine construction companies.

A comment on the latter is made first. The country encouraged construction companies to win large contracts for the building of public works and facilities. Philippine contractors were encouraged to undertake primary contracting and then bring in Filipino labor and other materials that could be procured from the country. Philippine construction companies were to become a magnet for Filipino workers. As developments would have it, the primary contracting business for Philippine construction companies fizzled out during the late 1970s and 1980s.

The reason for this was the inadequacy of a strong industrial base in support of the engineering and construction industries – a defining characteristic of the relatively non-competitive import substituting domestic industries. There were Philippine companies that undertook jobs in construction and which thrived well for a while. Some of these were engineering firms and construction companies that had successful work at home and ventured abroad. Unlike the Koreans, these companies did not have a strong domestic base of efficient industries that fed materials for use into their construction projects. Another major factor that contributed to their failure was the economic crisis that hit the Philippines during the mid-1980s that put out some of them out of business.

The overseas labor contract workers, however, thrived and multiplied. With government support and given the high demand for labor in the oil exporting economies, Filipino labor, which had a high degree of skill and experience within the Philippine labor market, moved to the Middle East in droves as contract workers. Years before, the labor contracts were for merchant marine crews. But now in addition to

¹ The early Filipino overseas workers were labor immigrants who mainly became fruit pickers in Hawaii and California during the American occupation in the first half of the last century. These were essentially unskilled workers. There were of course Filipinos who also migrated to America who were professionals. These were limited in numbers as there were strict immigration laws for Filipinos then desiring to live in America.

the growth of demand for merchant marine crew to supply the world's shipping lines with Filipino labor, the growth of contract workers in land-based occupations developed a dynamic of their own.

The labor contracts expanded to demands for labor to supply personnel for low-end occupations that were being deserted by labor in the countries of immigration – chambermaids, house help, personal care, factory work, and other forms of service industries. Some of these workers were mobilized through local recruiters. Many labor recruiters from other countries soon developed contacts in the Philippines and their activities were able to enlarge the scale of recruitment of overseas contract workers. Soon, the growth of labor shortage in the manufacturing industries of newly industrialized economies in Asia, in particular, in Taiwan, South Korea, and to a more limited extent ASEAN member countries like Malaysia and Singapore, had led to contract workers for factory work.

Statistical picture

The distribution of educational attainment of various overseas contract workers speak well of the variety of skills that were available. More than 29 percent of OFWs have finished high school education and 46.8 percent have had post-secondary education. Around 33 percent of these have college degrees. There is a much higher percentage of post-secondary degree holders among males (55 percent of total male OFWs) compared to females (38.4 percent).

Eventually, Filipino overseas contract workers would be distributed across many parts of the world. But the Middle East and countries in Asia employ about 85 percent of the land-based workers. As conditions in labor demand stabilized in the Middle East and as other nationals also entered the field to provide competition, Filipino contract workers went also to other countries. Some of these countries were nearer to home, others went to far off lands, such as Africa and Europe. Filipinos found work in all continents and in far off islands. (See table on OFW destination and educational attainment, Statistical Appendix.)

A popular view of overseas contract work

A popular commentary [see Diamond (2003)] recently appeared in the internet describing the phenomenon of overseas contract Filipino workers. Entitled, "The Philippines: One nation, overseas," the article captured the essence of the country's positive experience in the overseas contract labor market:

"The Philippines has discovered the future of work.... In 2001, more than 800,000 people headed out on a commute that makes Rye-Grand Central [GS note: This is the urban commuter railroad line from New York City] seem like a milk run to the corner store. They went to Italy, Saudi Arabia, Canada, Singapore, and Uzbekistan. They went to Mongolia and Equatorial Guinea. Filipinos toil as domestic helpers, engineers, nurses, bricklayers, teachers, farmers, seafarers, stenographers, hairdressers, crane operators, cooks, and entertainers. Having discovered its prowess as an outsourcer of labor, the Philippines is now pursuing the opportunity with fervor.... [T]he Philippine [government] revels in the export of its people.... Filipino global commuters constitute one of the biggest sources of stability for the economy of a country perennially known as the Sick Man of Asia. ...Flexible, industrious, and frequently skilled, Filipinos are finding their way into unexpected niche [labor] markets..."

The phenomenal success of the overseas contract labor market for Filipinos has invited a lot of commentary at home among leaders, policy makers and analysts. For instance, President Fidel Ramos called the OFW as the new Filipino hero. Current leaders have followed this importance given to the OFW. It is now in the consciousness of many Filipino young people to think of working abroad as a higher objective rather than seeking work at home.

The remittances from Filipino workers have emerged as one of the largest sources of earnings in the economy. They have also played a major role in providing financial buttress to the problems of keeping the economy afloat with dollars by easing the burden of amortizing external debt and extending the capacity of the economy to pay for current imports. Remittances are an important part of income and the balance of payments. The central bank reports that in 2002, for instance, these amounted to 10.8 percent of real GDP and 15.6 percent of current accounts receipts.

Characteristics of the OFW market: the good outcomes, the bad outcomes, and the practical

What are the characteristics of the overseas contract work? First, it is a market that is fully mobile. It depends on a complement of resources provided only by the foreign countries where the OFW finds work. It is a clearcut case of being fully complemented by *100 percent foreign capital*. The success of the overseas contract worker depends fully on being employed in enterprises owned entirely by foreigners. In only a few limited circumstances are the workers employed by a Filipino enterprise.

The OFW laborer works in situations of complete dependence on foreign employers, without protection of the Philippine law, and under the jurisdiction of foreign labor rules. Therefore, should trouble or misunderstandings arise, the Filipino worker would be at some great disadvantage. He is at the mercy of the caprice of foreign employers and foreign laws. He is a guest worker with few privileges. There have been cases of the Filipino worker suffering from abuse and arbitrary judgments.

Overseas workers are more at risk of exploitation and other kinds of problems in the country of work than they would be at the home front. The work contracts of OFWs could be at the mercy of developments outside the control of the Philippine government. These workers can hardly depend on legal protection from abuse by their employers or by infraction of government rules and regulations. Despite the efforts and claims of the government on the protection of overseas Filipino workers, there is a high degree of cynicism on the effectiveness of such help. A few of these workers get stranded and they seek protection from the embassy for help.

The success of the OFW experience has come at a cost to the worker's income and to his family life. It is possible to extend this remark to psychological and sociological issues. But we confine the commentary only on the economic cost of participation in the overseas labor market. There are out of pocket expenses that are shouldered directly by the worker, most of these costs are charged up-front, with risk of their total loss if they happened to get involved with bad recruiters or had experienced a poor fit with the work. A successful overseas recruit could recover these up-front transaction costs through an installment payment deduction plan. Since these up-front costs need to be retired, the net take home pay is reduced.

Many workers get into debt just to be able to get into the roster of potential applicants, creating a potential for financial disaster for the family in case they are not hired. Even when they do get hired, they often bear part of the cost of travel to the destination. (Even when transport cost is supposed to be netted out as an expense, it does represent a reduction of net take home pay because, if transport cost were not a problem, they could likely get higher pay.) The other important aspect of economic cost could be contingencies related to the employment that could arise once the worker goes abroad. These could be unforeseen and work-related (even though some of these workers would be covered by insurance from the work place). Nevertheless, the net reduction on their earnings of the contract workers is substantial and could reach an average of 30 percent of gross earnings.

Another cost could be to the community. This has to be analyzed further for there are community benefits that happen because of the remittances that improve housing and living standards of those directly supported by remittance incomes. (Moreover, the impact of foreign exchange receipts from worker remittances represents a boost to the country's balance of payments position.) As to the cost of the exodus of skills, sometimes the cost is related to the impact on community life of those who migrate with their skills, often leaving the community to fend on their own.

When the OFW migration affects teams of family members and relations who are from among the well to do workers, their exodus creates local economic dislocation. In some situations, reports of lands derived from land reform programs had been sold off to pay for the initial investments of the workers for transport and other expenses just to become an OFW contract worker or, just migrant worker even without permit. So far the evidence on this is not yet available except that there are now anecdotal evidence of cases that need to be further evaluated.

In general, the overseas labor market works under competitive rules. Filipino laborers participate in competition with other workers who offer competing services. Here, they offer their services at wages

that are reasonable and competitive with the other labor market participants. The relative success with which the Philippines has entered these markets for labor lies in the fact that they offer their services at wages that are relatively cheaper than the prevailing wages of these labor-importing countries. The need of these countries for foreign labor is premised on the high wages that arise because of the tight labor situation. By offering to bring in foreign workers, the governments are able in effect able to undertake economic activity to take place as well as to depress the high wages for labor. This is the situation that the Philippine government has learned to exploit by encouraging the overseas contract market.

The government has played a very positive role in the expansion of the overseas contract labor market. The government helped to identify sources of labor employment and encouraged the recruitment of Filipinos. It played a developmental role in the promotion of employment. Such a role was in mark contrast to the efforts of the government to institute labor policies on the home front that were later to create a great amount of bureaucracy and inflexibility within the domestic labor market.

(b) Labor in the export processing zone areas

The export processing zones have succeeded in generating new export opportunities. A consequence of this success is the increase of employment opportunities that has tapped semi-skilled and skilled labor. In fact, the export processing zones represent a bright spot in domestic industrial development.

The export processing zone concept was implemented early in the 1970s. These zones liberalized the role of foreign direct investments in that they could avail of incentives if they engaged primarily in exports of products manufactured in the zones. The procedures for importing raw materials at world market price were made easy for export zone locators to enable them to use these materials to assemble and manufacture products.

In general, the main advantage offered was the relatively abundant labor that is available in the country. The export zone locators mainly required skill-intensive assembly work. The impressive growth of exports of manufactures of electronics and semiconductors was a consequence of two important developments. First were the improved procedures for encouraging foreign investments and the streamlining of the procedures for the import of raw materials and products used by the export assemblers. Second was the liberalization of the tariff rates on computer and associated products. These reduced the pressures for tightening tariff rates on products that were required for importation in high volume to enable the export companies to feed their assembly operations.

The seeds of success here were planted at the close of the 1970s (when Texas Instruments and Intel decided to set up semiconductor assembly operations in the country). These investments were further strengthened by a large inflow of many other electronics firms during the 1990s. These new export industries established by foreign direct investment succeeded to make an imprint for the Philippines as an exporter of semiconductors, disk drives, assembly in telecommunications and computer equipment, and other subsidiary industrial activities connected to the electronics revolution.

The success of exports from the manufacturing sector helped to change the nature of the policy debate in industrialization in the Philippines. Preoccupation with import substitution policies led to the neglect of the opportunities open to the country then of the boom in low cost exports of garments, textiles, shoes, and other labor-intensive traded products. Focus on the production of these products enabled the rapid growth of Taiwan, South Korea and Hong Kong during the 1960s and 1970s and, later on, that of a host of other Southeast Asian countries to industrial prosperity. Unfortunately, these were the same products that could not be produced at low cost because the Philippines loaded its labor policies with cost-enhancing measures that priced it out of the market.

Industrial policies focused on promoting import substituting industries rather than outward looking industries. It was simply the high protectionist barriers at home that distorted the balance, for the government was proclaiming the need to promote exports too. This strategy of industrialization helped to dissipate the country's advantage from the export earnings of agricultural and primary exports because these import substituting industries also consumed a lot of imports without ever gaining export earnings

because of their high cost. It helped to mute some of the demand for wage adjustments because many of the firms in these areas have job opportunities for workers could afford to deal with a unit cost above the minimum wages mandated in the past. The skills they needed were some notches above those of unskilled labor.

Despite the recent success of activities in the export processing zones, these zones of industrial activity were severely threatened by labor problems that arose during the early post-Marcos transition. Labor unrest swept some of the establishments and led to departures and cancellations of expansion plans and of those that intended to set up new plants. Some of the manufacturing that was dependent on inexpensive labor for their survival, especially those related to garments and other operations, found survival difficult. Eventually, many of these had to close down their operations and others to find alternative means of survival.

The growth of manufacturing for exports demonstrates the large potentials for export generation and for labor employment that the Philippine economy is capable of. It demonstrates the missed opportunities that the country has foregone because of a preoccupation with protection of industry and regulation of the labor market. Those that depended on electronics and semiconductor operations were able to discover their niche operations, especially after the government fixed the problems of labor unrest. This was when further expansion of their operations took place.

The new export industries come from manufacturing activity that was set outside of the mainstream import substituting market that is subject to a high level of protection. The mainstream industrial market has become a burden rather than a boon on the economy in many ways. The established industries have massed their political clout to arrest the liberalization efforts at every point. They continue to depend on support and protection from the government. And instead of being propelled by competitive enterprises that arise from the domestic entrepreneurial class, the new export industries have come mainly from foreign direct investments that got attracted into the country to set up export operations.

The major companies engaged in semiconductors began to enter the country, led by American companies like Texas Instruments, Intel, and Fairchild Electronics, set up operations during the late 1970s and early 1980s. Soon Japanese, Taiwanese, Korean, Singaporean companies began to expand their operations. Today, there is a wide variety of companies in the electronics field, and the original investors like Texas Instruments and Intel have expanded their operations from the early ventures that they started with. Fullness of the growth of semi-conductor exports and electronics based industries began to be clear by the 1990s. During the period of that decade, exports based on manufactures rose to account for ___ percent of total exports.

Filipino labor is adaptable and learns as fast as anywhere else, sometimes with better track record than is found in other countries according to testimonials of employers that have had investment operations in other countries. Productivity is driven through experience within the work units and with the efforts of the companies to continue improving capital equipment. Training and continued retraining are especially an integral part of the electronics companies, especially of the high tech companies that are engaged in semiconductor assembly, testing and design.

Among these foreign owned companies, the prevalence of foreign staff working in the country is very minimal. There are sensitive posts such as those of general manager and treasurer, which are often occupied by expatriates. But in general, the employees from managers and key administrative staffs to the lowest laborers are Filipinos. In short, except for technical support and management, the likelihood of the Filipino employees taking charge of the operations is very high. This is not a surprising development because of the high level of competency of the Filipino workman. The problem is to find work for them, to find the challenge of work that is afforded by long term employment contracts of viable companies. (This issue is further discussed under the market for professionals among multinational, in the section following below.)

But the firms that export their products operate in the competitive world of production. The need for the country to deal with competitiveness rests upon, first and foremost, on wage rates and on productivity of the firm. Productivity follows with inducements for those locating in the country to expand

their industrial operation by investing more in machines to make their workers more productive. When company decision-makers face the issue of whether to expand or to intensify production activity, they take into account many factors. They relate to the pressures that they face arising from fluctuations in product demand and to those related to cost of production. The issue of competitive edge is tied up with the price that they pay for labor as one of the major factors of production. In one sense, the companies are essentially footloose in their anchor on the Philippine operation, especially when the activity is largely that of assembly. In such cases, the price of labor is very relevant.

Of course, the total unit cost of manufacturing includes labor only as one component. However, labor could be a significant element of that cost. This is the reason why the presence of a large supply of labor is an advantage, especially if it is still in a relative sense low cost than in other places. The advantage of abundant labor is partly blunted by the effects of labor laws that made the unit cost of labor more expensive.

Many export zone locators have realized cheaper infrastructure and attentive support in administrative processing that has helped to offset part of the relatively high unit cost of labor when they set up operations. The skilled labor supply advantage still dominated their calculations on labor cost, which translated as relatively inexpensive labor. However, some of these companies had factored in their high expectations that energy costs and broader infrastructure improvements would soon be available to help cut other costs. Such an advantage would likely be challenged by the relative slowness by which cheaper energy costs and infrastructure services are being provided. These companies have also adapted to the needs of the market to reduce labor costs by undertaking flexible work arrangements, to be discussed later below.

Part of the costs involves those related to labor organization, to the prevalence of dispute settlements and also to the possibility of labor problems occurring. Here, the experience of the last few years has been instructive. In part due to the element of competition, labor union work that was disruptive in the experience of many companies appears to be no longer a major problem. Depending on the nature of the industry, some elements of absenteeism has been found, but this has not been in the case of the large employment companies that are based labor-intensive work. In the case of the garments and wood working plants – perhaps by the nature of their work and the background of the workers – absenteeism has been identified as a problem that needs to be attended to. Predictability of work force supply affects the amount of output finished within given days.

The volatility of market demand has affected performance. During the recent economic crisis following the downturn in the electronics and semiconductor industries, for instance, major companies have had to retrench in response to demand for the product. But this affected the manufacturing operations in a number of directions. It meant, for some, a rearrangement of production costs to where they could be obtained most cheaply. With cost cutting, some of these adjustments led to the closure of activities from factories in the Philippines to factories in other countries. In others, it was the transfer of some types of operations to the Philippines and the closure of corresponding branches. The hold on relatively low labor costs in the electronics and semiconductor assembly has led to greater specialization of those activities with higher end skills, and the transfer of purely labor-assembly operations to factories of the same companies in China, for instance.

Some of the adjustments in the assembly of computers and of electronics equipment have happened where the Philippine operation was the net loser. In some, it is a stalemate because of the various reallocations that expanded some lines and reduced activities in other lines. In the case of one major computer company, the desk top computer assembly moved to China, but laptop computer assembly remained and expanded even in the Philippines.

The reality is that the companies operating in the country operate in highly competitive markets. These companies increase the competitive nature of the Philippine position in the world economy. When the companies succeed in their operations within the country, they become good y come in quantnature of the position of the country in attracting investments, and being alert to the issue of cost and productivity inducements is a major issue. This is the important factor that policy makers have to contend with in seeing to it the Philippine labor gets to have a large share of the employment pie.

(c) Market for professionals among the multinationals

The market for high level professionals among multinational companies needs to be mentioned as one of the successes of the labor market. It is a limited success because the amount of foreign direct investments in the Philippines is relatively limited compared to other countries. But it should be mentioned however that Filipino managerial talent is spread beyond the Philippine based companies. If Philippine economic development had been as spectacular as the growth of some East Asian neighbors, the magnitude of the success could have been higher. Even then, many Filipinos work in multinational companies located in other countries.

Some part of the successful examples of Filipino managerial labor is found in the international field. But like the mainstream domestic labor market, the demand for Filipino professionals could have been much higher if only this market has done very well for the Philippine economy. The entry of foreign direct investments into the country is definitely linked to the growth of Filipino professionals employed in these companies. In fact, many of the foreign direct investment companies that located in the country were encouraged by the import substitution policies. They too mainly produced for the domestic market.

However, they were a source of employment by laborers and professional Filipinos. During the 1960s the idea of "equal pay for equal work" pervaded discussions related to the policies of attracting foreign direct investments. The government again adopted this principle in the labor laws and provided teeth for bureaucrats in the labor department to provide a basis for intervention in the affairs of business relating to pay and personnel.

The market for professionals and for managers is a fiercely competitive market. The larger and more publicly owned the company is, the more transparent and professional are the standards of choice for the officials of the company. These companies pay top salaries for excellent managers. Top level companies develop the managerial class separately from the rank and file, for the same reason that governments try to develop a high level career service within the government often separately from the development of policies for the rank and file.

Yet again, Philippine labor laws introduced equal pay for equal work as a principle of work. It is a rule that could lead to hobbled and dissatisfied institutions and workers.² Although in general these principles could be useful in the determination of relative pay, to put them in the forefront of the culture of

² The case of the International School is a labor dispute that reached the Supreme Court. It is between the teacher's union and the school administration. It represents a classic case in labor dispute demonstrating the difference in the perceptions of the two contesting parties. The teacher's union sued the school administration on the principle that teachers hired from abroad were paid salaries much higher than those who were hired locally. The local teachers hires of the school are very well paid (well paid even compared to university professors in some of the country's best known universities). But they demanded that they be given "equal pay for equal work." They won their case in the Supreme Court. The ruling was to get the teachers compensated at the same rates at which the foreign-hires are paid. Actually, the situation of the teachers and the foreign hired teachers were not on the same footing. The foreign hired teachers were fixed term appointments. They also required hardship pay conditions, because they have to be uprooted from their place of work. The local teachers are regular appointments, with all the security guaranteed by tenured appointment. Also, the foreign hires are made in part to retain the international character of the school's enrollment. They are hired in markets where the salaries of teachers are so much higher than those in the Philippines for the same teachers and they are hired at those competitive rates. A consequence of the court decision is that no new hires from local teachers are now being made. The School administration discovered that it was cheaper to hire fixed term teachers from abroad given the judgment of the court in this case. In addition to the problems brought about by this issue, the problem itself has larger implications on the lives of the expatriates families with children of school age who work for foreign companies in the country. It presents a negative issue representing policy on the attraction of foreign direct investments. In other countries that the Philippines compete with, the governments encourage the setting up of schools for foreigners in order to help ease the problem of expatriate families with young children insofar as the education of their children is concerned.

hiring professionals in the managerial position could produce staid and unimaginative managers whose concern is more about relative position rather than performance on the job.

Filipino professionals perform well in companies owned by foreign multinationals. They do not need protection from the government to extract higher pay from the company because, in time, their talents if they are that good, would be recognized and they would get improvements in emoluments. And if they are dissatisfied with their pay, the route towards the open market for jobs is always available as an option. Rather than objective equal pay for equal work principles, the more important one for the choice of high officials is often outlined best described by the principle of opportunity cost – what it would take to hire a productive manager in another employment or occupation.

It is expected that a foreign company would wish to appoint the head manager and the treasurer of the company and even appoint key technicians from their own national or foreign rosters. Small and medium scale foreign investments often have this type of arrangements. They tend to be tighter with their choice of own nationals as against host country professionals.

Filipino managers have been known to head major country positions of foreign corporations or subsidiaries. Sometime ago, I paid a visit to the Philippine plant of Texas Instruments in Baguio to talk with the head of the company in the Philippines – a Filipino manager. I noticed the official plantilla of the domestic subsidiary. It is composed of more than 20 key officers with their pictures posted on a wall.³ These managers all looked like Filipinos. With one exception who was company comptroller. This is a company with one of the highest annual payrolls in the country.

At one time the head of the Intel operation was a Filipino. Managers and technicians are chosen from a wide pool and if a Filipino is qualified he would be chosen especially when the operation is within the country. Most professionals and technicians in foreign multinationals get good on the job and formal training within in the plant and also are sent to other plants of the company in the world for term assignments or for further training.⁴ Filipino managers have been heads of the IBM Philippines in the same manner that there are high technology companies also with Filipino nationals. Shell Philippines and Nestle Philippines are other examples. The chance of meeting top of the line technicians in multinational companies is very high. They get their supply of employees from the home country and in general seek managerial expertise to carry through executive functions. If initially, the foreign company takes a cautious approach, in time, the competence of the Filipino manager shows itself and he would get recognized.

Many foreign corporations operating in the Philippines have appointed Filipinos to head their operations. The possibility of Filipino managers rising in foreign multinational corporations is far higher than in the case of large family owned corporations and conglomerates in the Philippines.

The common practice of family corporations to appoint their own people in otherwise viable companies have often led to disasters. The poor performance of many Philippine owned enterprises could be affected by nepotism. Perhaps an extreme example is the case of one of the best engineering firms in the country, Atlantic, Gulf and Pacific. The ailing firm collapsed further after the aging but successful owner of the company who had acquired the old company from earlier owners of yesteryears appointed his sons to manage it.

There many examples of many industrial firms in the country that had risen in prominence during the heyday of import substituting industrialization years. Many of the firms performed strongly initially because of political connections and the immediate benefits derived from the monopoly positions that they acquired in the domestic market. As succeeding generations began to take over, when political connections became less dominant as a trait in the firm's prominence, the managers from the family became less able to raise the economic performance of the firms. Hence, these firms eventually receded into a state of poor economic performance.

³ I suspect that there were some other Asians in that plantilla, but it was dominantly a company managed by Filipino managers.

⁴ I have noted the training aspects and part of my conversation with Mr. Vieira, President of Texas Instruments Philippines in my notes reported in one paper, see Sicat (2002).

Many Filipino corporations have begun to hire professional managers. The Ayala Corporation is an example of a family company that has begun to hire more professional managers to develop their various business companies even though the family scions still take command. Many Filipino companies and conglomerates, including some of those run by Filipino Chinese taipans in business, are partly hampered by the ties of kin, culture, and networks of old. But the most successful of these companies send their children and the family supply of managers to the top business schools. Other companies have introduced professional Filipino managers when the next generation are less inclined to succeed in the business.

This is one of the reasons why increasing the amount of foreign direct investments has major impact on the growth of the entrepreneurial class in the country. That Filipino professionals often express preference to work for foreign multinationals indicates that they have great opportunities for advancement in these companies. The horizon of their work and responsibilities expands. Often, they are brought into situations where they are also sent to other countries to undertake part of their duties. These rotation in duties broadens their experience and increase their value as professionals further.

The Sunday edition of the classified ads of the *Manila Bulletin*, the most widely used channel for labor recruitment, has many pages of advertising that call for skills, mainly directed at different kinds of professionals and managerial positions. The advertisers are established companies that specialize in search for talent, often serving as job placement bureaus for multinational and established domestic companies. There is also a large element of this advertising that is for foreign companies located in other countries. These want ads make it clear that the market for skills is vibrant.

One outstanding example in the Philippines is the contribution of Citibank to the development of the financial system and of banking in particular. The book celebrating Citibank's centenary celebration in the Philippines [see Orendain (2002), pp. 174-191] describes the program of training that it had to develop managers for itself. Eventually, many of these trainees left Citibank to follow their own stars in other lines of work, including work in other financial companies. Most of these former employees in fact have remained in banking. Many of them went to the private sector and some have contributed significantly to the management of public sector institutions and government programs. The examples include a list of many names,⁵ but Rafael Buenaventura, the present governor of the central bank, was an outstanding Citibank manager. He was fielded to posts in other countries before and after his headship of the Philippine Citibank branch. The experience of work in a competitive multinational with world wide reach is often a major education to a country's supply of professionals, enriching the supply pool far more than formal university education.

(d) Labor opportunities in the information technology (IT) revolution

Background to the IT revolution in the Philippines

The growth of the IT outsourcing market was given a jumpstart with the telecommunications reforms undertaken during the early 1990s. A surge of technological possibilities was induced, first, by the liberalization of the telecommunications industry with the franchising of competing providers of voice and data services to other franchises in the country, allowing some degree of franchise area overlap.

This affected the buildup of capacity in telecommunications infrastructure. The competing companies built their support infrastructure. Two national fiber optic cable networks were built to complement submarine cables in place. In addition, this infrastructure is further backed up by access to

⁵ The table on page 188 includes names of prominent Filipino managers such as: Placido Mapa, Jr., Antonio Ozaeta, Edward Go, Xavier Loinaz, Vitaliano Nanagas, Jr. These men were part of an executive training program that was organized by Citibank for a period extending between 1961 to 1986. However, there have been and continue to be many professional career people who have had experience working for Citibank (and for that matter other banks and also other well-known foreign companies) whose experience working in these foreign companies helped to train them in leadership positions when they took up professional jobs at home. Exposure to work in a competitive environment, within an environment of business where productivity and hard work are rewarded handily help these individuals in other positions of leadership in other businesses.

satellite communications. The regulatory framework has assured connectivity for heavy duty IT communications. In addition to the presence of these independent sources of telecommunications, the government has designated IT industrial parks to encourage companies to find a ready place where to set up physical infrastructure for their operations. Today, there is a redundancy in this capacity. This assures further capacity for expansion of business in this industry.

Unlike the case of Malaysia, which is cash-rich and which built a cyber-city in Kuala Lumpur to attract IT companies to locate in the country, the Philippine government during the period was cash-starved and could not afford a government-led program. This was probably a fortuitous circumstance. For it led the government to build its program mainly around private sector initiative.

The building up of the facilities for telecommunications was market-driven program. It was part of the anticipated telecommunications boom and the competitive struggle among the telecommunications companies that were positioned in the market through the franchises that the government granted. With market overlap as an element of the telecommunications franchising of various telecommunications services and the presence of connectivity, the companies rushed to provide their infrastructure through an aggressive investment program. In this way, the optic cable network infrastructure and other telecommunications facilities were built.

The government played a key role. It provided the essential moral, regulatory and facilitative support. Perhaps this was the better model, as it was less risky on the part of the government, and it depended mainly on private sector initiative. Actually, the government had little choice for it had no resources to bet to create the investments. But the government was creative in pushing for the solutions to make the industry move forward.

There is an active interest in the private sector, goaded by the mechanism of IT parks that were innovatively introduced as part of the portfolio of industrial export zones supported by the incentives-giving agencies of the government – the Philippine Export Zone Authority (PEZA). Later, the Board of Investments (BOI) recognized the grant of incentives for IT companies that exploit opportunities to earn export revenues.

The Philippine government facilitated all the multi-sectoral groups to come together and to provide a program that was driven by the private sector and by the growth of the market. It was easier to get the program moving forward when the excess capacity was built. It was ready made for the next stage. In this situation, the major actors undertook to respond to the demands of the market. In fact, the market-driven approach appeared to work very well.

The various components in the private sector – the property developers, the telecommunications company building the required over-investment, the IT companies that could tap into the business, and the educational sector got together to provide solutions that helped to expand the industry.

The IT outsourcing industry

IT outsourcing industry is a major consequence of the revolution in services and in telecommunications. With data and voice exchange being made available at low cost across the world by the revolution in telecommunications services, the geographic location of services would no longer be held in hock at specific locations near the large commercial and industrial activities where service is undertaken. If a country had the advantage in labor and other resources to provide competitive service, all that would be needed is a reliable telecommunications delivery network.

The communications technology revolution made possible the subcontract of services that used to be conducted in the back rooms of established corporations to any location anywhere in the world where labor skills and costs are available at much lower costs. It is not simply a matter of cost reduction. It involves a rearrangement of business processes that permits a higher level of productivity because of changing proportions of management resources with labor skills, which are both highly scarce and valued. [See Hagel (2004)].

The current endowment of manpower skills in the country has made possible some comparative advantage in offering part of the large array of business processes outsourcing that has accompanied the technological revolution in IT. The business processes that are now being outsourced to specialist

enterprises include the following: human resource, financial and accounting services, inventory/ logistics management and customer relationships.

Some of these specialized business processes that are being outsourced are as follows. Business administration activities that are being outsourced include the undertaking of tax processing, claims processing, and documentation management. An example in the human resources administration includes employee record management, undertaking of payrolls, administering of personnel benefits, educational benefits, and recruitment.

An example in finance and accounting services include financial reconciliation, management of accounts payable, management of receivables, risk management, and general accounting. The supply chain management involves the management of inventory, warehouse and transportation management. An example in customer relationships management involves the taking of orders, online sales, helpdesk management, and essentially customer services, including answering of complaints.

Major companies have found it essential to undertake sub-contracting of these activities as a means of cutting down costs and improving the productivity of their product and service deliveries. They include those that require continuous interaction with customers and potential clients. Some of these activities are labor intensive – they require a warm body to answer the telephone for inquiries, complaints, orders of merchandise, or filling up of forms. They include monitoring of costs and of revenues. So they relate to accounting services. They include the transcriptions of reports, such as those made by doctors in the normal course of their work on medical patients.

The Philippine domestic labor market has a unique opportunity to make a successful transition towards an industry with high growth potential – the information technology (IT) industry. This is an area where Philippine government lead and supportive programs has put it on the edge of a successful bid for a future place in the area.

In addition to the availability of the infrastructure facilities, there is a current pool of 290,000 IT-skilled Filipino professionals (2003). The country possesses a pool of qualified labor composed of university graduates. An example is the preponderance of accounting school graduates, engineers, and IT workers. There are 70,000 graduates in information technology and computer related sciences. This labor pool is available at low cost compared to the cost of the same services in the industrial countries. Another advantage of the learning systems is that the accounting systems in the Philippines are modeled after the US accounting models. So, there are few conceptual difficulties.

The available supply of information technology skills might be of varying levels of quality at the beginning, but as a headstart, there is a pool of highly qualified and skilled professionals. As that pool of labor gets employed and the cream of the labor supply is exhausted, there is enough lead time for the educational sector to upgrade underlying skill requirements. Moreover, one consequence of progress in the industry would be to induce to the educational sector to redirect its supply of professionals towards raising quality as well as numbers of technologically adept labor.

In the present context, the global perspective on the current amount of business in business processes outsourcing is huge. The business is above US\$110 billion in value (circa 2002), but it is projected to grow toward US \$200 billion within the decade. Of these, a large part of the business still remains in developed countries. In terms of overall share of the global, 55 percent is located in the US; 22 percent in Western Europe; Asia Pacific only 7 percent. In short, the Asia Pacific market is hardly tapped, and the Philippines could become a major source of the outsourcing business in the region.

Within the context of this expanding set of opportunities in information technology, the government program has decided to move in terms of five program thrusts: (1) contact customer relationship centers, or call centers; (2) business process outsourcing/ shared financial services; (3) application/ software development outsourcing; (4) animation; and (5) medical transcription. The the best promoters of the program are those that are already situated in IT parks, encouraging new locators to set up business in the country. The PEZA and the BOI have an incentives package that are designed specifically to deal with companies that provide services to outsource back office operations.

Call centers

A major growth activity in the domestic labor market in the Philippines in recent years has been the installation of call centers of companies located in the United States. These call centers have located in IT industrial parks in Metropolitan Manila (Eastwood, Makati, Alabang), in Cebu, in Clark and Subic business zones, with prospects for more being built.

From almost little during 2001, the call center industry has grown quickly. The number of call center seats grew from nil to around 20,000 seats by 2004. A seat in the industry refers to a work station that permits one worker to work on a call terminal. Since a worker normally has 8 hours of work in a given seat, each seat has a potential to employ three employees. However, there are limitations for the use of a seat. Theoretically, each seat could operate on a twenty four hour sequence, but most of these are busy only for about half this period, taking into account that the continental United States is in three time zones spread over a twelve hour working period.

The growth of employment of IT call centers has been very rapid nevertheless. These workers are spread mainly in Metro Manila and in the Clark Export Zone in Pampanga. But these are spreading to other parts of the country. Most of the call centers are located in what are called IT parks or in designated companies who receive incentives for IT activities.

The IT parks are designated the industrial estates that enjoy tax and investment incentives under the Philippine Export Processing Zone Authority. The first successful IT park venture is the Eastwood City venture located along the C-5 route from Makati to Quezon City. America-On-Line has a call center in the Clark area which grew to 1,200 employees quickly. A company, Cyber City, is located in the zone. It manages call centers for multiple client companies.

An immediate side effect of the success of the IT park concept is that it provides a magnet for other development activities. The expenditure multiplier arising from new wage incomes is an obvious outcome. It makes the community of new income earners have more disposable income to spend on goods and services within the local economy. Thus, secondary activities around the IT parks have changed the property market landscape. The entertainment and commercial areas have sparked life and activity around it. There is no greater evidence of the multiplier effects of good jobs produced in an economy being translated into new incomes and opportunities for the rest of the economy and the labor force.

Almost overnight – during the turn to the 2000s– the Eastwood IT park became an established commercial and high tech center. The commercial buildings boomed with new office tenants having cadres of employed young professionals, working especially at night, creating a buzzing commercial center and a lively restaurant and entertainment atmosphere within the immediate vicinity. Citibank and the IBM are housed in buildings are identified to their operations. They house many of the work force that make these buildings beehives at night (when America's day begins).

The scene is replicated in less dazzling style in Makati, in Alabang and other commercial areas where call centers are allowed to establish. For instance, call centers are housed in some of the tall buildings in the Makati business district. Cebu already has some call centers, and it would seem that this city would become the call center magnet for companies in the Visayan region.

The Clark Export Zones affects directly the local economies of Angeles City and Mabalacat in Pampanga. The same holds true for the Subic Bay Export Zone. The future holds bright for such local economies as these new industries – coupled with growth of the zone in other industries as well – begin to dictate the pace of growth in employment.

This activity also has a direct impact on the nature of training programs that are being offered in various new institutions and learning companies that use application software. For many, the process of training is many times far beyond typing the QWERTY keyboards of computers or doing word processing.

Because of the importance of voice and data in the call center, proficiency in the English language is required for those working in the call centers. This is an advantage for Filipino labor skills. The educational system is ahead of most countries in the Asian region in the use of English. The basic language is in place. But proficiency can be an acquired experience through further learning. In fact, one of the major activities of the call centers is to set up intensive training for those who already have a good speaking

command in English to increase their level of confidence, their understanding of the spoken word in normal conversation. The training is dominantly to fully understand the American accent because most of the call centers are serves the United States. In other types of business processes, the training would go beyond mere speaking of English but it would be predicated on knowledge of technical business processes.

This type of requirement can only have a major feedback on the level of educational training as well as on the quality and depth of the educational programs in the country. As more business processes are included in the area of outsourcing taken in by companies operating in the Philippines, there could be a profound impact on the educational institutions. They would have to respond to the employment opportunities that are opening up. They would interact with the companies that are taking advantage of the opportunities in the Philippines and which are the main users of the skilled labor force in the outsourcing business.

The highly regulated labor market and the IT sector

In the IT field, the regulations and income protection measures instituted under Philippine labor laws are essentially irrelevant. The minimum wages required, including the special benefits that often figure as wage benefits, when added together are far below the wage offerings of the IT firms for professionals. The relevant wage comparisons are the very high wages of the same skills in the developed countries on the one hand and those available in the Philippines. The wages for university graduates trained in the proper skills in the country are sufficiently attractive.

Philippine wages for these skills are also highly competitive and are in abundant supply compared to other countries among other East Asian country counterparts. The cost of mid- and junior-level IT professionals in Hong Kong are already at least four times than those in Manila. Those in Singapore around three times more compared to Philippine wages. The skills are abundant in Manila and the conditions of the technological backup are already available. The only country where some major competitive situation arises is with India, which has a preponderance of supply of similar skills in IT. And, in time, even the IT skills in countries like China, which has an abundant supply of university graduates, would likely become competitive too.

As already explained, labor absorption for the Philippine economy has become a problem for many unskilled workers because of minimum wage laws and other welfare standards in the mainstream labor market. Even while this problem of employment generation occurs for unskilled workers, the case of skilled workers is different. With their additional years of training, the compensation package for the work is far above the of the mandated minimum wage.

The skilled labor force that fits within the IT industry would become rapidly absorbed with the growth of the IT sector. Further, the opportunities of raising the domestic supply of skills could be enhanced through further manpower training that could yield enormous benefits. The other side of this story, however, is that skilled university graduates are only a small percent of the labor force. The problems of the mainstream labor market remains large in view of the difficulty of getting labor-intensive activities being unable to expand fast enough the absorption of the unskilled supply of labor.

The IT sector helps to generate new employment (however relatively small in comparison with the whole size of the labor force) and of incomes. Young university graduates that had not benefited from the poor economic performance of the country over the last few decades have found a new basis for earning good incomes because of the growth of the IT outsourcing industry. Those possessing the appropriate language and technical skills are hired at wages that are far above those around the average wage at entry (minimum wage) level in the labor force.

Many of these IT jobs start at 10,000 pesos per month at the training entry level (and that is more than twice the going minimum wage). Those employed in the call centers receive a higher income than this starting pay, in the order of 15,000 pesos per month. Wages are adjusted from the initial entry level in relation to the productivity of the worker since the IT industry is sensitive to job performance and employee impact on the company's services. Unlike in the case of problems emanating from the inflexibility of labor laws in the mainstream market, when wage rates are much higher, there is recognition of the principle of labor flexibility in employment.

The starting salary of workers will eventually move in terms of higher multiples of the standard minimum wage today. The prospect is that the supply of skills would eventually be exhausted as soon as the industry expands sufficiently to mop up the available labor skills. Then, further rises in wages would depend on how fast the wage level has achieved closeness to parity with wages that are paid in other countries providing the same service. At that point, the quality of service at the market wage becomes the principal determinant of competitiveness.

Backroom IT operations: beyond the call center

While the call centers have been more obvious as the initial success areas in the country, there is more to the business process outsourcing activities. The help desk centers of companies dealing with their clients has been initially the obvious winners. There is a gradual leap beyond the call center activity for many types of back office operations.

To show how the activity is progressively moving toward deeper business processes, some examples are cited below.

Examples

eTelecare is a company located in the Eastwood IT park. For the last two years, its growth rate per quarter has been at 40% quarterly growth rate. In 2000Q4, the company had 25 employees. By 2002Q4, the company's employment grew to 1,500 employees. In 2003Q4, the company employees 3,000 employees. The company is still in a recruiting binge, and its facilities in the Eastwood IT park are getting occupied quickly. It is planning to set up parallel call centers in Cebu as the next step. Some companies have already located call centers in Cebu, and they are not even the pioneers there.

eTelecare serves a number of blue-chip US clients. This includes a leading computer company (Dell) and a prominent financial services company, which are both with world class reputations. On average, eTelecare delivers the handling service with 25 percent less time to handle incoming calls than it took clients' own call centers or previous outsources. And the customer has delivered, based on feedback surveys of clients, higher levels of customer satisfaction. Of course, the main point about the outsourcing is that it is also so much cheaper compared to the client firm to do it.

The company has planned to provide sixteen different offerings or programs for their call centers. These offerings indicate programs of growing complexity. Today, the services offered include the following: customer care & billing services; stored value cards sales, authorizations and customer service; inbound and outbound sales to business and customers; traveler's check ordering, encashment, refunds and fraud detection; technology support for dial-up ISP (internet service provider); level 1 and level 2 technical helpdesk & dispatch for consumers and corporate customers; mutual funds transfer & brokerage services (requires series 6 & brokerage services premised on Series 6 & series 7 NASDAQ securities licensing).

The full complement of services provided by the IBM Philippines is not only on call centers but on a wide range of services that depends on the speed and power of the computer and telecommunications revolution. IBM Philippines has developed a call center of its own. But recently it won a major contract with Procter & Gamble that would provide the entire back room operations for the Asia Pacific Region in the Philippines. Procter & Gamble's back office operations involves about 1,000 employees.

Another example is illustrated by the AIG-American General took a decision to locate its offshore back office operation in the Philippines [see Chotrani (2003)]. The cost of backroom operations for large service companies like this financial empire – the second largest life insurer in the United States – is a substantial part of their activity that it could subcontract elsewhere. In a tight contest to determine whether to locate in India or the Philippines, the AIG-AG decided to select the Philippines over India. The Philippine operations are to be managed by AIG's affiliate in the Philippines, its local partner, the Philamlife AIG, Inc. which has a 50-year history in a successful insurance operation in the Philippines.

In appraising why the Philippine proposal won over India's, the following factors apparently became critical. In terms of quality of labor, the Philippines fared better because its people are more familiar with American jargon and culture. Western expatriates are more familiar with the living style in the Philippines, and it is conducive to their specific needs. Past operations in training have exposed the evaluators from the outsourcing company on training activities already in place in the Philippines. They

had sufficient familiarity with the performance of the local employees. Tax incentives also played a role. The final clincher in this decision was apparently the fifty years of past history of business association between the local partner, a local subsidiary, of the AIG, the American company.

In this backroom operation, the critical need of AIG was to support a range of office insurance operations. This included data entry, mail management, post-sales servicing of clients, indexing of documents, licensing and contracting. The business rationale for outsourcing was to provide a cost effective solution for the increasing volume and complexity of their insurance operations. This would reduce operational expenses considerably while maintaining the service and quality standards at which they are given. Naturally, the outsourcing will be incrementally enlarged as the operations show success. The chances of success based on the track record of previous experience and training are considered high.

The same feature article also discussed the transfer of the centralized Asia Pacific IT operations of a major drug company and health care operations provider in 10 countries of the region, the Interpharma (Asia-Pacific) Ltd. The operations were moved from Hong Kong to the Philippines because of immediate cost savings and other benefits had become apparent for the long term for the company.

This operation supports the company's extensive IT systems and applications development. Such activity includes an internet-based platform and an on-line sales and inventory system which are available to its clients in the pharmaceutical and health care companies that it serves in the region. The company was induced to transfer to the Philippines because of the overall assessment that the country's IT program was very competitive in cost.

There were no direct inducements arising from the program of tax holidays and other come-ons. The company made the decision to come to the Philippines because it felt that the government's program was pushing IT education in the schools and that that assured a good future for the supply of technicians.

These are not only the outstanding examples of IT outsourcing. There are companies that provide transcriptions of text and data for medical and other office records. The growth of any new but specialized activities could be outsourced to companies.

The animation industry is part of comics arts, and it is in high demand in television, print and movie industries. Supply of Filipino talent in this industry has been evident for some years now. One animation company has been in operation in the Eastwood IT park which supplies major animation works for a Japanese company with a wide network of services. In fact, there is a lot of artistic and animation talent that is based in the Philippines. Many Filipino animators are known to have been engaged in work for US companies. *Finding Nemo*, a recent hit movie, involved prominent participation in the drawing pool of many Filipinos. The same is true of hit movies that involved participation of Disney, Dreamworks, or Pixar, well known names in the animation work. Fads and fashions dictate the demand for animation. It is a relatively volatile industry as a result.

Design work and software represents another area where IT work shows some promising results. The scale of the work still needs to improve, but the build up towards a larger industry is yielding good outcomes. A few of these companies that have recently located in the Eastwood IT park indicates the possibilities. Research and design of power supply is a major activity of ASTEC, a subsidiary of Emerson, one of the largest electronics companies in the US.

The research plant uses mainly a high level pool of engineers designing various power supply equipment for all things that are powered by the semiconductor circuit. The company employs about 300 engineers, and its designs when taken to the product stage would either be produced in its manufacturing plant in Cavite which as around 3,000 workers or it sends it for assembly and manufacture in China. The critical equation in the determination of where the manufacture finally goes is the cost of labor in the manufacturing end. The critical balance is that an improvement of competitiveness of Philippine labor could increase the chance of the manufacturing to be undertaken in the country.

In similar fashion, other companies have been setting operations that take advantage of research and product design. For instance, TOS is a CAD engineering firm that provides designs for high performance windows, curtain walls and skylights. Filipino designers have to pass the rigid standards of the ASTM (American Society for Testing and Materials) International certification process. TOS has shown that it is one of the most efficient design center in Asia. So it is likely it will expand its business.

Locators are companies from Taiwan, Japan, and the United States. This area of work is skill intensive. The growth of IT parks which are privately owned is likely to stimulate a further expansion of deeper types of subcontract work and original manufacturing and assembly that is based on higher levels of skills that the Philippine labor force can provide.

(e) Domestic labor market outsourcing and flexible work arrangements

Domestic outsourcing of activities is a similar phenomenon observed in the developed countries along a global scale. There is a difference in the reasons that propel outsourcing, however. In the case of the industrial countries, the main reason for outsourcing is the pressure on wages because of the scarcity of labor and the resulting high cost of wages. This process leads to a transfer of jobs to other regions or countries for people in high wage occupations.

In the Philippine case, the main cause of outsourcing is also a desire to reduce labor unit costs. But it stems not from the fact that there is a scarcity of labor. In fact, labor abounds because of a high level of unemployment and underemployment. The reasons are due to the labor policies that made regular employment within the firm very high cost (relative to market possibilities in the country). This is the outcome of the welfare oriented mainstream labor policies. This is also due to the inflexibility of labor hiring due to regulations and other requirements of labor policies.

The high unit cost of labor – of regular employment within a firm – has caused companies to trim payrolls and to devise methods to reduce the cost of labor. Some of this is due to the pressure of international competition as companies find opportunities to relocate to low cost manufacturing and service centers. The other is the simple route of finding the best way to reduce the cost of labor while producing the same goods. The opportunities for doing this are made available by innovative reorganization of production within the firm.

The adjustment efforts of the companies lead to the subcontracting of activities or operations that could be undertaken more cheaply or much more efficiently by outside contractors. The cost of maintaining personnel on a regular basis is supplanted by cheaper and superior alternatives of providing the same amount of service. Outsourcing and other flexible working arrangements provide the mechanism for hiring of labor to indirectly.

For companies operating in the domestic mainstream market, outsourcing is a "success" story involving the adjustment of the company to reduce costs of production in the face of high or rising unit cost of labor. When firms encounter costs that are avoidable, they invent new ways of organizing the enterprise so as to control a high expense item to enable the firm to survive.

The complex of labor regulations has given rise to new companies specializing in rendering special services to various companies. First in this line of companies is the consulting field on labor issues. The more complex the labor regulations, the better it is for the business to have specialists who deal with them. Another important side effect is the adjustment that companies undertake to cut costs. This led the way toward companies that specialize in offering specialized tasks through subcontracting arrangements. Often, this meant effectively to transfer the labor hiring issue for certain tasks and skills from the company to another company. This phenomenon is outsourcing, and sometimes, it is referred to as contingent employment among labor regulators.

Outsourcing or subcontracting represents an innovative response to enable a firm to deal with labor and other production inputs in order to produce its mainline activities or services. Sometimes, it is also an approach to decentralize the management so that it could also reduce the cost centers of the firm from rising unnecessarily. The subcontractors provide specialized services that otherwise would have to be provided from within the firm: janitorial, security, food catering, messenger, telephone operating, and transport services. With the growth in complexity of the business, even humdrum types of activities in the administrative end – secretarial, form filling and answering services, and even large paper work associated with back office operations – have become the targets for outsourcing contracts with other companies.

Subcontracting of manufacturing operations and equipment maintenance is another direction that came out of this practice. Outsourcing of certain activities that could be consolidated as a single operation

has effectively become a mechanism for cost reduction among large companies. This is partly the reason that the labor regulators are looking at these operations for potential infractions of labor laws rather than for the developmental challenges and innovative arrangements that they introduce to reduce costs.

Initially, companies were set up simply as labor contractors. These companies arose from the desire of established companies to spin away certain operations that required labor through another company of their own making. With regulators on their heels, these specialized companies decided to expand their clientele base, on the basis of their niche activity. But as experience and specialization brought in further rewards (including the inevitable confrontation with the labor regulators who had viewed some of these operations as skirting or avoiding the labor laws), they diversified offered their services to a wider range of companies requiring the same services.

The requirement to hire laborers on contract after six months of continuous employment has given rise to contingent employment arrangements. Such contracts are enforced for a short term arrangement. Extensions are given only to those who might be integrated within the firm as regular employees. The contingent employment contract is not an isolated problem in the Philippines, but the high unit cost of labor in the country through the mesh of labor regulations and welfare legislation has created incentives for companies to speed the adoption of cost-saving arrangements that sidetrack these provisions of labor laws. The welfare oriented efforts to raise labor incomes only induced companies to seek various ways of reducing the cost of labor. Outsourcing of services was a natural outcome.

Outsourcing has reduced a lot of the problems that companies often faced in the implementation of labor laws. This is often the case when the labor market is tight and firms try to find new means of reducing high labor costs. Regular employment often brings in new complications in labor laws and regulations. To avoid the added costs of employment, companies try to find new ways of passing the costs to other suppliers. On the part of the subcontractors, specialization enables them to perform particular tasks better and more cheaply too. The result is the growth of the labor sub-contracting industry.

The growth of labor subcontractors and new companies that undertake factory work sub-contracting is a response to these challenges of high unit cost of labor. The outsourcing companies have mastered the regulations in the workplace. They hire workers more cheaply since they do not have to regularize employment, but work on the availability of product demand. Not being forced to regularize their employment, unlike the traditional manufacturing company, they also find innovative means of cutting costs.

The piece rate innovations might have had their origins from the cottage industries law. The reach of the labor laws is limited when extended to cottage industries. They can maneuver their wage costs with greater flexibility. Piece rate work in the garments industry has resulted from the closures of garment factories that found that they could not compete with cheaper sources of garment labor, such as China, Vietnam, Bangladesh and other places. But the workers who have been fired have developed organizations – through cooperatives – to accept subcontract of bulk manufacturing on the basis of piece rate.

Cooperatives are composed of members who work for their own self-interest and the labor laws do not apply to the cooperatives insofar as labor contracting is concerned when those engaged in the contract are the members of the cooperatives themselves. Specialized labor subcontracting companies that are cooperatives in character are not many, but they are growing in numbers and individual size as a mechanism for replacing the old basis of in-plant manufacturing operations. The company that spins off the activity hires the cooperative to provide the labor services and other services connected with the spun productive activity. The cooperative receives some fee for administrative work and, of course, the wage and other expenses related to the members of the cooperative that work for the subcontract.

In this connection, the workers were able to return to their old jobs, albeit at lower prices wages than their former employment. Many garment firms that were radicalized by their union connections closed their operations. Instead, they engaged in subcontract of the garment making to other groups of contractors. Many former employees of these factories work banded together to form cooperatives so that they could subcontract some of the garment making at piece rates.

Piece rate basis of manufacturing is one of these outcomes. This has been a long standing practice in cottage industries. The system has been extended to larger contracts for work. Piece rate practice has become common in labor intensive operations, such as the example of garments just discussed. Survival in the market place often has led to drastic measures of cost cutting. The requirements of labor laws that workers who work for six months be integrated in the regular work force – with all the implications about the high wages to be paid and numerous other benefits – has encouraged companies to choose subcontract as the more efficient route.

The experience of sub-contracting extends to other industries as well. A manufacturing company can reorganize itself simply into a distributing company, and subcontracts its manufacturing operations to other specialized outsourcers. Many companies faced with strikes and other kinds of labor disruptions have used this method as a means of escaping the labor problems more permanently.

In this way, the unit cost of regular employment is avoided. San Miguel Corporation, the country's largest food company, has undertaken major reorganization of its manufacturing operations to reduce labor costs. Sub-contracting of operations requiring labor is common in the retailing industry. This is how the big retailers are able to keep their labor force payrolls trimmed, through the constant rehiring of new workers before the six month deadline is reached.

Another avenue for flexible work arrangements involve apprenticeships, the use of fresh graduates as initiates, but mainly before the six month period of employment is finished. In fact, contracts of employment for new recruits are often only for this short period. The idea behind this is to be transparently clear that the employee would only be an employee for a fixed term period. In most of these efforts to deal with flexible work arrangements, the offending provision is the law that provides integration of the worker after six months of operation. If it were not in place, a lot more contracts for employment would be longer and a lot of workers would feel a greater sense of financial security at least for a longer period.

Labor groups, industrial relations experts and government regulators see contingent labor employment contracts as mechanisms for the avoidance of labor laws and regulations [see in particular, Amante (2000), McKay (2000), Gat Inciong (2004)]. Economists and management experts see these as mechanisms that the firm undertakes in order to reduce costs to create greater efficiencies in operations. Thus, subcontracting could be a means toward cost cutting and greater efficiency if it leads to these outcomes as it should. In fact, the challenge of globalization that is pressing all national labor markets today is related to the subcontracting of labor and other activities that has been made more efficient by cheaper communication and transportation and the mobility of labor, through limited contingent contracts of employment. Globalization poses the need for a more competitive labor market. [See, for instance, Ofreneo (2000).

Companies with huge payrolls have a high overhead expense for dealing with labor-management issues. But contingent labor arrangements have the merit of reducing this overhead and also the variable costs attendant to the hiring of laborers. The benefits are earned in both directions of cost cutting. In the long run, the company's search for efficiency benefits from not having to be enmeshed with the intricate requirements of labor laws on the hiring and removal of some parts of the work force. Practices of flexible wage arrangements have become attractive to all companies that seek to reduce labor costs, including the burden of having to accept a short probationary period before workers are integrated into the normal payroll.

Any adjustment that produces lower costs attract all other businesses to follow. Such practices are found not only among domestic companies that are trying to escape from the burden of high labor costs. It is found in the practice of companies located in the export processing zones, among established companies, including multinationals. So long as regulations encourage the practice, the way towards achieving innovative adjustment of company operations would involve these flexible working arrangements.

Domestic outsourcing has an international implication in an open economy

A number of companies among foreign direct investors in the Philippines transferred their manufacturing operations to other countries where labor cost is cheaper. So long as trade restrictions apply that prevent importation of cheaper goods, it is possible for the country's labor market to make the internal

outsourcing adjustments without any jobs and output leaving the country. But as trade liberalization makes it possible to import goods cheaply, economic units within the country can turn to other production sites that offer cheaper unit costs for their activity. Trade and industrial liberalization allows the country's consumers and producers to have cheaper materials but it could initially hurt when jobs are transferred in part because of high labor costs. There are, in short, benefits and costs to outsourcing.

During the 1990s, in preparation for the ASEAN free trade market, several multinational corporations – all were flagships among multinationals already located in the Philippines – simply closed down their factory operations in the Philippines and decided to get their supplies of goods for sale in the country through imports. They relocated their factories to other ASEAN countries, such as Thailand, Vietnam, and Indonesia, where labor cost is cheaper and where the problems of dealing with excessive labor welfare regulations were less intricate than in the Philippines. In these decisions, many factors were of course involved. But labor policies have played a central role in some of these decisions.

With all the many advantages that Philippine labor has over those other countries – in terms of skills, education, and ability to learn productively – these companies nevertheless moved their operations out of the Philippines to these countries. These companies were associated with the manufacture of personal care and household products– cosmetics, toothpaste, paper, pharmaceuticals, and electric bulbs. Of course, many reorganized new companies producing substitute products have arisen. These are companies with reorganized work force arrangements, mainly based on temporary employment of workers.

IV. Concluding remarks: characteristics of "successes"

The "successes" discussed have a lot of things in common. The reform of policy implied by these successes is discussed elsewhere. [See Sicat (2004b).]

1. The major successes represent an *exit* of the laborer from the domestic labor market. Workers who enter in overseas labor contract practically execute an escape, partial or total, from the Philippine mainstream labor market. If opportunities at home were more adequate, a major percentage of those who accept overseas work might choose to stay at home to work despite the presence of wage differentials. In short, the domestic labor market has not been able to provide sufficient economic opportunities for Filipino laborers to consider staying at home as an alternative.

2. Some successes relate to situations in which the compensation package within the industry surpasses the threshold of minimum wage payments that are essentially the concern of the labor laws. Successes have been characterized by the growth of labor employment. Workers in electronics and semiconductor companies require higher levels of skill and by that token are paid higher wages. If paid at the required minimum wage entry level, the corresponding contribution that they bring to the firm is sufficient to make their employment economic. The wage level in the market for IT professionals is even significantly higher than the threshold level for skilled workers in the export processing zones. So, IT professionals get much higher wages than skilled factory workers. Their wage rates and benefits are far above those reserved for the minimum wage employee. Some of these surges in employment have been remarkable and they have contributed to the prosperity of those employed. At least they have provided steady employment to the workers.

3. The market supply for professionals demonstrates limited success in the domestic market. Had there been a large influx of foreign direct investments to the Philippines as in other countries that have flourished with foreign capital, that success of Filipino professionals would have been on a grand scale. The pattern of that promised result would have benefited from the relatively good supply of professionals produced by the higher educational system and by the highly competitive market for professionals in which it has thrived. Laws on minimum wage and other worker benefits are of no consequence to this market. Filipino professionals often find professional and management positions in foreign direct investment companies that locate in the Philippines. Many success cases of professional growth of managerial talent employed in foreign direct investment companies indicate the competitive nature of market among professionals in seeking employment among the foreign investment community. From the viewpoint of the foreign companies, they could literally undertake cherry-picking among the young professionals in view of lack of tightness of the supply. The degree of success of Filipino managers and technical personnel in employment in multinational companies is of far wider evidence among companies that have a regional

presence in Asia. Filipino managers are found in various types of employment in the region and even in farther international locations. This suggests that an expansion of direct foreign investments in the country could only lead to a much higher level of demand for Filipino professionals in addition to the impact that this would have on the growth of employment for workers in these companies.

4. Some successes that are described involved the innovative efforts of operating enterprises to work within the mainstream domestic labor market. These represent the adjustment of employers to higher labor cost by undertaking legally feasible cost cutting measures. Challenged management always finds ways to cut costs. Labor costs are pre-eminent in being artificially made higher by welfare laws and regulatory openings are always the subject of search and testing. As long as the alternatives are open – including of course shutting down the operation, which is the worst option from the viewpoint of the country – any good management would take advantage of the opportunity. The adjustments that they undertake are designed to avoid high labor payrolls. Outsourcing of high cost operations implies that the economy would make cost savings for the company. Most of the examples of outsourcing and flexible work arrangements are of this type. Companies in the export processing zones that use semi-skilled and unskilled workers that are under pressure of international competition from other countries often end up also using flexible work arrangements. This is the case among the labor-intensive enterprises, especially those in garments and even in the electronics assembly industry.

5. *All the successes discussed above depended heavily on the employment of foreign capital.* Overseas contract workers work in establishments and households owned entirely by foreigners. This is the case of 100% foreign capital contributing to the economic activity. In the case of IT companies, the entry of foreign capital is very critical because the companies are often in joint ventures with foreign companies or subsidiaries of existing foreign companies. The foreign businesses that undertake outsourcing investment in countries like the Philippines to reduce their IT operational costs in the home country provide a complement of foreign capital to enable them to employ Filipino employees. The inevitable question that arises from this conclusion is why the country had devised so many restrictive policies in the past to reduce the participation of foreign capital in some industries.

6. Many domestic companies have used the outsourcing route to avoid the direct hiring of labor. This adjustment is an appropriate adjustment considering the high cost of hiring. It is often successful in reducing cost of operations. The regulators condemn subcontracting as illegal efforts to avoid the enforcement of the labor laws. However, most of the outsourcing involves alternative production or contracting methods and there is nothing illegal about them. They represent legitimate efforts to reduce labor costs and to retain the power to hire the appropriate level of employees to accomplish the economic objectives of the enterprise. Many companies that could not adjust to the high cost of operations had to exit from the market.

7. Companies often try to look for solutions that allow them to continue doing business. Exit is not often the best alternative. So, subcontracting would represent one of the best possible methods of reducing costs and raising productivity. The closure of the high cost operations does not necessarily mean a net loss of jobs. However, the subcontractors normally are able to cut down on unit cost of labor through the transfer of the labor contract to other companies or providers. Lost jobs are eventually replaced by new hires who get paid lower wages. When the cost penalty represents a high burden on the domestic enterprises, the recourse is to reduce operational costs. Rather than accept that inefficiency and loss of any competitive edge, the enterprise makes the adjustment.

8. The subcontracting route however cuts both ways in an open economy. The country tries to attract businesses for outsourcing back office operations and also invite manufacturing investments to set up for export processing. When domestic costs are above the manufacturing costs or the cost of services of other countries, there is a net inducement for the firms in the country to seek out subcontracts of requirements from the other low cost providers, which could be located in other countries. The lesson of this is very clear. Labor market policies at home should be made more flexible so long as jobs are wanting. Reforms along the lines of making the labor market adjust to market realities are as needed today as they had been needed in the past. By pretending that high welfare and wages mandated by fiat would help the labor sector, the policies only caused a gap between the employed labor force and the many who could not find employment under the wages and benefits that the law proclaims to improve the condition of labor.

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Statistical Appendix

Table 1. The Overseas Filipino Worker (OFW)

(In thousands)

Year	Total OFWs	Of which Land-based		Total %	Deployment of Land-Based Workers				
		% of OFWs	Number		Middle East	Asia	Europe	Americas	Africa
1990	446.1	75.1%	334.9	100.0%	65.1%	27.1%	2.0%	2.9%	0.4%
1991	615.0	79.6%	489.3	100.0%	61.9%	27.1%	2.7%	2.7%	0.4%
1992	686.5	80.1%	549.7	100.0%	62.0%	24.5%	2.7%	2.2%	0.5%
1993	696.6	79.1%	550.9	100.0%	55.0%	30.5%	2.4%	2.2%	0.4%
1994	719.6	78.5%	565.2	100.0%	50.7%	34.3%	2.0%	2.2%	0.6%
1995	654.0	74.7%	488.6	100.0%	48.0%	34.1%	2.1%	2.8%	0.7%
1996	660.1	73.4%	484.7	100.0%	45.6%	36.0%	2.4%	1.7%	0.5%
1997	747.7	74.8%	559.2	100.0%	39.5%	42.0%	2.3%	1.3%	0.6%
1998	831.6	76.8%	638.3	100.0%	43.8%	48.1%	4.1%	1.4%	0.9%
1999	837.0	76.5%	640.3	100.0%	44.8%	46.8%	4.8%	1.4%	0.8%
2000	841.6	76.4%	643.3	100.0%	44.0%	45.4%	6.1%	1.2%	0.7%
2001	866.6	76.3%	661.6	100.0%	45.0%	43.1%	6.5%	1.6%	0.7%

Note: OFWs are classified as sea-based (maritime workers) and land-based. All the Non-Land-based workers are considered sea-based workers. To get sea-based workers, deduct number of land-based workers from total OFWs.

Source: National Statistical Coordination Board, 2002 Philippine Statistical Yearbook, Tables 11.9 and 11.10.

Table 2. Overseas Workers, By Education and by Sex, 2000

Age Group	Both Sexes	Male	Female
Philippines	992,397	498,843	493,554
No grade completed	16,521	6,739	9,782
Preschool	1,295	416	879
Elementary	190,530	76,701	113,829
High School	290,171	126,000	164,171
Post secondary	145,608	95,929	49,679
College undergraduate	187,878	103,090	84,788
Academic degree holder	121,836	70,408	51,428
Post baccalaureate	8,692	5,018	3,674
Not stated	29,866	14,542	15,324
Age Group	Both Sexes	Male	Female
Percentage Distribution			
Philippines	100.0%	100.0%	100.0%
No grade completed	1.7%	1.4%	2.0%
Preschool	0.1%	0.1%	0.2%
Elementary	19.2%	15.4%	23.1%
High School	29.2%	25.3%	33.3%
Post secondary	14.7%	19.2%	10.1%
College undergraduate	18.9%	20.7%	17.2%
Academic degree holder	12.3%	14.1%	10.4%
Post baccalaureate	0.9%	1.0%	0.7%
Not stated	3.0%	2.9%	3.1%
Post-secondary to Post baccalaureate	46.8%	55.0%	38.4%

Source: National Statistics Office; also 2003 Statistical Yearbook