Employment and Poverty in the Philippines
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Abstract

This study analyzes labor market performance in the Philippines from the perspective of workers’ welfare. It argues that pervasive in-work poverty is the main challenge facing labor policy. Poverty is primarily due to low earning capacity of the poor and to their limited access to regular and productive jobs. Behind these are the two interrelated root causes of in-work poverty—low education of the poor, and the scarcity of productive job opportunities. The labor market is segmented into “good” and “bad” jobs, with the poor working in the latter. They hold jobs that are informal, temporary or casual, and low-paid. Widespread informality means that the poor neither benefit from the minimum wage policy nor from employment protection legislation. They do not benefit from wage growth either, because their bargaining power is weak. “Good” jobs are so few, especially in rural areas, that even better educated workers are often forced to take unskilled jobs and work as low-paid laborers. The reduction of in-work poverty hinges on removing constraints to gainful employment in both supply side (better education and skills) and demand side (better jobs). It is critical that the young poor have improved access to quality education, and be equipped with skills required in the modern sector of the economy. But in parallel, better jobs need to be created, which can be attained from the growth of the formal and higher value added sector of the economy. The process of structural transformation should be supported by effective labor policy. Labor regulations need to be made simpler and more flexible to facilitate the reallocation of labor from less to more productive activities, and from informal to formal sector. Targeted training programs have the potential to address the problem of low skills among the poor workers, especially the young ones. Such programs should be developed on a pilot basis and expanded if proven to be cost-effective.

Main Concepts Used in the Note

Bad jobs. Jobs are considered “bad” if they are low-paid and informal, and thus are not covered by labor regulations. Jobs can also be bad if they are involuntarily part-time, temporary or casual. As a rule, jobs that are deemed as “bad” are associated with an elevated risk of poverty. “Good” jobs are jobs that pay above the low-pay threshold or are formal, unless they have some characteristics that render them “bad” (e.g. are involuntarily part-time or temporary). As a rule, “good” jobs are associated with low risk of poverty.

1 The Note represents a stand-alone overview of the Philippine Labor Market Review prepared under the World Bank programmatic technical assistance to the Philippines in the social protection and labor area. The report was prepared by a team led Jan Rutkowski and comprising Yuko Okamura, Rosechin Olfindo and Jorge Avalos. Kat Dinglasan provided research assistance. Isabel Ferino edited the text. The team worked under the guidance of Jehan Arulpragasam as the Practice Manager, and Aleksandra Posarac as the Program Leader, in the EAP Social Protection and Labor Global Practice. The report was prepared under the overall direction of Motoo Konishi, Country Director for the Philippines. Peer reviewers were Truman Packard and Erwin Tiongson. Comments were also provided by Rogier van den Brink, Carolina Diaz-Bonilla and Pablo Acosta. The full report will be available in February 2016.

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One does not need to be an economist to conclude that low-quality employment, inequality and poverty are big issues in the Philippines. The problems are obvious even to a casual observer. However, one needs economic analysis to determine the causes of poor labor market outcomes, and to suggest remedies. This Note sets out to analyze labor market performance in the Philippines from the perspective of workers’ welfare. Its main goal is to identify labor market constraints to reducing poverty and sharing prosperity, and to suggest ways to address them. To this end, the Note focuses on three areas. First, it looks at the nature of jobs and employment in the Philippines, and how it has changed during the course of economic growth. Second, it examines the links between labor market outcomes and poverty. Finally, it analyzes the effectiveness of labor market policies and programs, and suggests measures to enhance their performance.

The Note finds that in work poverty is pervasive in the Philippines. On the one hand, it is caused by low labor productivity, which reflects low education and skills of the workforce. On the other, it is caused by lack of productive job opportunities. This may give rise to a vicious circle: workers have little incentives to invest in skills because there are few jobs requiring advanced skills. At the same time, skill-intensive jobs are not being created because workers lack the required skills. The economic growth in the last decade has not improved this situation much. It has created jobs, but it has hardly brought about structural change. The newly created jobs are still “bad” jobs – they are informal and precarious, pay little and often do not lift workers out of poverty. Although younger workers are better educated than older ones, there is still a large fraction of youth, especially those with poor background, who lack education and skills that would allow them to take more productive and better paying jobs. But even better educated workers often end up in low-skilled and “bad” jobs, implying that there is not enough “good” jobs. Strikingly, real wages remained flat despite growth in labor productivity, a stark contrast to strong wage growth in other countries in the region.

Labor market segmentation and large productivity differentials between sectors give rise to earnings inequality and impede the attainment of shared prosperity objective. The urban/rural and formal/informal divides are particularly pronounced. Rural and informal workers earn little, and are at a high risk of poverty.

To reduce poverty and promote shared prosperity, the Philippines needs to address the twin problems of low skills and low productivity jobs. A mechanism also needs to be put in place to ensure that gains in labor productivity translate into higher wages. Poverty in the Philippines will not be reduced without growth in real wages, especially at the bottom of the wage distribution.

These problems cannot be addressed by means of labor policy alone. To improve labor market outcomes, fundamental reforms are necessary in the areas of education, investment climate, and business environment. The recent Philippine Development Report (World Bank 2013) and the Philippines Skills Report (World Bank 2010) discuss these reforms in detail, while the East Asia Pacific at Work (World Bank 2014) provides a regional perspective. The Philippine Labor Market Review builds on these studies, but concentrates on the role of labor policy in improving workers’ welfare.

The Note focuses on the domestic labor market at the national level. As such, it does not cover important issues of international migration and of regional variation in labor market outcomes in the Philippines. The issue of migration was addressed in World Bank (2013) and will be addressed in the upcoming Association of Southeast Asian Nations (ASEAN) labor migration study. The regional variation in labor market conditions will be covered in the upcoming Mindanao Jobs Report.

The Note is divided into three parts. Part I looks at the nature of jobs and employment in the Philippines and their changes during the course of economic growth. Part II examines the links between labor market outcomes and poverty. Part III discusses the effectiveness of labor market policies and programs.

I. Nature of jobs and employment

Most people work in the Philippines and few are unemployed. Economic growth creates jobs, but hardly improves their quality. It largely reproduces the existing traditional employment structure, with a high share of low-skilled and informal jobs. Real wages do not grow, despite growth in labor productivity. Wage inequality is high, with a large share of the workforce in low-paid employment. On a positive note, young workers move to more productive activities. They are better educated than the older generation, although the share of poorly educated, low-skilled youth is still relatively high. Moreover, many youth are idle, i.e. are neither in employment nor in education.

Economic growth has created enough jobs to absorb the increase in the working age population but has failed to improve jobs quality.

Economic growth during the last decade created enough jobs to absorb the growing labor force. Employment grew at roughly the same rate as the population of working age. New entrants to the labor market were finding employment, and there was no increase in unemployment. Contrary to what was claimed in some earlier studies, economic growth was not jobless (Figure 1a).

Economic growth did not bring about wage growth. Although labor productivity was growing at a relatively high pace, real wages remained stagnant in the last decade. Economic growth created jobs, but failed to improve their

1 The Philippine Development Report (PDR) and the Philippine Labor Market Review (PLMR) differ in terms of focus and scope. The PLMR addresses the main question on how to reduce in-work poverty, whereas the PDR addresses how to create more and better jobs (although different, both questions are obviously related). Accordingly, the PLMR focuses on worker protection and labor policy, whereas the PDR focuses on jobs and development policy. The PLMR covers issues related to labor market performance, whereas the PDR covers a wider range of issues related to Philippines economic development.

2 Changes in the average wage mask substantial diversity in wage dynamics by industry and occupation. In many occupations and industries, wages were rising while in others they were falling. Highly skilled workers such as engineers (computer, electrical, mechanical, chemical, etc.) and accountants saw considerable real salary increases during the period 2006-2014. In contrast, unskilled and low-skilled workers, such as freight handlers, saw their wages fall. The picture is mixed for middle-skilled occupations. For example, motor vehicle mechanics and heavy truck drivers experienced large wage hikes. At the same time, production clerks, salesperson, tailors, etc. saw some decline in their real wages. (Source: Structure of Earnings Survey, various years).
Many jobs require little skills, with laborers being the largest occupational group. One in three workers is a laborer and has a job that requires no skills (farmers are a separate category). Even outside agriculture and in urban areas, unskilled workers account for nearly one-fourth of total employment. The prevalence of low-skilled employment reflects both the scarcity of skilled jobs, and the relatively low educational attainment of the workforce. As many as 44 percent of workers have less than secondary education, which is substantially higher in rural areas (57 percent), but is high even in urban areas (30 percent).

There is a shortage of skilled jobs. Educated workers are often forced by necessity to take unskilled jobs, and work as laborers. About 30 percent of workers with secondary education hold unskilled jobs, and 35 percent of laborers have at least a secondary education. This suggests that the scarcity of “good” jobs is not caused by insufficient supply of middle-skilled labor. Instead, there seem to be not enough “good” jobs because the demand for middle-skilled labor is weak in the Philippines.

Young workers move to better jobs. Young workers are better educated and are more likely to be employed outside agriculture and in the wage-and-salary sector (Figure 2). But they hardly migrate to urban areas; the share of urban employment among younger age cohorts is only marginally higher than among older ones. Although not dramatic, the changes in the employment structure are noticeable. Young workers are more likely to be employed in the services and industry, and to hold wage and salary jobs than older workers. For example, the share of wage-and-salary employment among the 20 to 29 age cohort is 20 percentage points higher than among the 40-49 cohort. Young workers are more likely to hold both highly-skilled (professional) and low-skilled jobs, than older workers.

Changes in employment structure contribute to poverty reduction. Workers employed outside agriculture and in the wage-and-salary employment earn more, and run a lower risk of poverty than the agricultural workers and the self-employed. What is perplexing, however, is the negligible increase in the share of urban employment among young workers, which limits the potential gains in poverty reduction because urban jobs are better than rural jobs.

Bad jobs are widespread, but young workers move to better jobs

Employment structure remains traditional, and the modern sector of the economy is still relatively small. The service sector is the largest employer (about half of total employment), followed by agriculture (one-third of total employment), while industry plays a relatively minor role (World Bank 2013). The size of the wage-and-salary sector is still modest. Wage and salary workers represent about 60 percent of total employment, whereas the self-employed and unpaid family members account for the remaining 40 percent. The relatively high share of non-wage employment is another symptom of a traditional employment structure, since economic development is associated with a growth in the share of formal wage and salary employment.

Informality looms large. Around three-quarters of all jobs, and two-thirds of urban jobs are informal. Among wage workers, 6 out of 10 are hired informally. About 50 percent of informal workers are wage workers, 40 percent are self-employed, and 10 percent are unpaid family members. Informal wage workers lack employment contracts and social insurance, and are not protected against unfair dismissal. All else being equal, their wages are significantly lower. Informal non-agricultural jobs require lower skills than formal ones, and are disproportionately held by less-educated workers.
There is room to improve utilization of labor resources in the Philippines

On the face of it, labor resources are almost fully utilized in the Philippines. Employment rate, as defined by the ratio of employment to working age population, provides a summary measure of the utilization of labor resources. The 60% employment rate (Table 1) is average by international standards, but is lower than most ASEAN countries, where employment rate is above world average. The modest employment rate is primarily due to the low labor force participation rate among youth and women. Only one in two women is economically active in the Philippines. There is a 27 percentage point difference between the labor force participation rate of women and men.

Among the employed, one in five persons is underemployed. The underemployed would like to work more to increase their earnings. Close to 60 percent work less than full-time, largely because they do not have access to regular full-time jobs. The underemployment rate is relatively low. The standard ILO underemployment rate, which includes only the jobless who are actively looking for work, is less than 3 percent. The underemployment rate is around 6-7 percent (Table 1) using a broad measure of unemployment, which includes persons available for work, but not actively looking for work. In addition to underemployment and unemployment, outmigration of Filipino workers and substantial overseas employment indicate that labor resources are not utilized to their full potential domestically (World Bank 2013).

![Figure 3. Younger workers are better educated but education agenda is unfinished](image)

Persistently high wage inequality and high incidence of low-pay

Wage inequality is moderately high in the Philippines by international standards. While wage inequality is higher in the Philippines than in most developed European countries, it is in the middle of the developing economies range. High earners (top decile) earn about 7 times more than low earners (bottom decile). In the most equal countries, this ratio is less than four, and exceeds 10 in the most unequal countries. The relative earning status of low-paid workers is modest. The bottom decile worker earns about 40 percent of the median wage. This is much less than in low inequality countries, where the bottom decile worker earns over 60 percent of the median wage. However, it is more than in inequality countries, where the bottom decile worker earns around 20 percent of the median wage.

Wage distribution changed little in the last 15 years. Economic growth did not improve the relative status of low-paid workers and hardly reduced the incidence of low-pay. If anything, wage inequality slightly increased, which resulted from an increase in relative wages of the top 10 percent of wage earners rather than from a decrease in wages of the bottom 10 percent of wage earners.

The incidence of low-pay is high. As many as 30 percent of all wage workers earn less than two-thirds of the median wage, which is a standard low-wage threshold. In countries where wage inequality is lower than the Philippines, the incidence of low pay is within the 10 to 20 percent range. The high incidence of low-pay translates into the high incidence of in-work poverty.

Low-pay and informality go hand-in-hand

The incidence of low-pay is particularly high in the informal sector. In the informal sector, majority of workers (56 percent) are low-paid, with only a minority (7 percent) in the formal sector. Low-paid employment is almost tantamount to informal employment. About 90 percent of all low-paid jobs are informal. 1 The incidence of low-paid employment is thus an upshot of widespread informality.

The high incidence of low-pay among informal workers is closely related to the characteristics of informal jobs. Informal wage jobs are concentrated in rural areas in the services sector, and in low-skilled occupations. Over 50 percent of all low-paid jobs are in the services sector, and 36 percent of service and sales workers have low paid jobs. The incidence of low-pay among skilled manual workers is three times lower.

The incidence of low-pay is significantly higher among women than men. As many as 37 percent of women are in low-paid employment compared with 25 percent of men. This large difference may be due to women being more likely employed in low wage industries and occupations. Almost 80 percent of women are employed in the service sector compared with less than 50 percent of men, who are more often employed in the better paying industry sector. However, discrimination seems to play a role. All else being equal, women earn less than men.

Wage inequality is driven by labor market segmentation. The low-paying lower tier of the labor market is informal and casual, and mostly rural. The well-paying upper tier is formal, secure, and mostly urban. Workers in the lower tier are poorly educated and hold low-skilled jobs, while those in the upper tier have at least secondary education and hold middle- and high-skilled jobs. Wage differentials between labor market segments are large, with average formal workers earning more than twice than informal workers. Urban workers earn 50 percent more than their rural counterpart. Workers with tertiary education earn 3.4 times more than those with primary education, and skilled manual workers earn 70 percent more than laborers. Results of regression analysis indicate that urban/rural residence, formality status, education, and skills level (proxied by occupation) are the four most important factors that independently contribute to wage inequality.

II. Labor Market Determinants of Poverty

People are poor in the Philippines because they earn little, not because they do not work. Having a job does not provide a pathway out of poverty, and in-work poverty is pervasive in the Philippines. It is the quality of a job that

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1 The reverse is not true. Many informal jobs are relatively well-paid. For example, one in four informal jobs pays more than the median wage.
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matters. Workers employed in low-productivity jobs run a higher risk of poverty than the unemployed. Such “bad” jobs are common. They tend to be informal and casual, and do not pull workers out of poverty. The prevalence of low-productivity jobs means that the earning capacity of many households is low, which is the primary cause of poverty in the Philippines. Contrary to a common myth, poverty is not a result of idleness. Members of poor households are not jobless; they do work, but they hold casual, low-paying jobs. Hence, the reduction of poverty in the Philippines hinges on increasing the earning capacity of the poor by investing in their education and by improving their access to productive jobs.

Worker characteristics and poverty

In-work poverty is pervasive in the Philippines. The working poor are characterized by having low educational attainment, residing in rural areas, and having informal jobs that are often temporary, casual, or part-time. The majority of the working poor work as laborers in unskilled occupations. In-work poverty is not limited to rural areas; it also occurs in urban areas and outside agriculture. The key factor behind urban poverty is informality, where the vast majority of low-paying jobs are. Informal workers, both wage workers and the self-employed, face an elevated risk of poverty.

High incidence of in-work poverty

Labor force status has little impact on the risk of poverty in the Philippines. The employed are as likely to be poor as the economically inactive, and paradoxically, more likely to be poor than the unemployed (Figure 4a). Because low-paying jobs are plenty, having a job does not protect one from poverty. Two-thirds of the working-age poor are employed, while the unemployed account for a tiny fraction of the working-age poor.

Unemployment does not mean poverty. The unemployed are often well-educated young persons from better-off families, who look for jobs that meet their professional aspirations. This does not mean that unemployment is not a social problem in the Philippines. It is a problem because it lowers the returns to investment in human capital, and implies underutilization of the well-educated labor force. It also entices some of the well educated workers to seek job opportunities abroad rather than in their home country.

Figure 4. Employment does not lower the risk of poverty, and the quality of employment matters

Rural workers and agricultural laborers represent majority of working poor

In-work poverty is mostly, although not exclusively, a rural and agricultural phenomenon. Rural workers, who account for the bulk of the working poor, run a much higher risk of poverty than urban ones. The average rural workers are almost four times more likely to be in the bottom income quintile than their urban counterparts. As a result, 84 percent of all working poor live in the rural areas. The same is true for agricultural workers, who are much more likely to be poor than their counterparts employed in industry or services.

Contrary to common perception, industrial workers are somewhat more likely to be poor than service workers. The difference in poverty risk between industrial workers and service workers is rather small (3 percentage points), but still significant. Service jobs are not necessarily worse than manufacturing jobs, and not all manufacturing jobs are “good”. The industry and service sectors are heterogeneous in the Philippines as elsewhere, providing both “good” and “bad” jobs.

Non-wage workers are predominant among the working poor. The self-employed and unpaid family workers represent 52 percent of the bottom income quintile (Figure 5). The self-employed also run a higher risk of poverty than the wage workers, in both urban and rural areas. The rural workers are predominant among the poor wage workers. Almost 40 percent of rural wage workers fall into the bottom income quintile, compared with less than 10 percent of urban ones. This characteristic of in-work poverty has important implications for the minimum wage policy.

Figure 5. Wage workers in rural areas are the single largest group among the working poor

Poor education and lack of skills are key factors behind in-work poverty

Workers with higher educational attainment and more skills have a substantially lower risk of poverty than their less educated and less skilled peers. Figure 6 illustrates the pattern of the poverty risk falling with improvements in education and skills, in both urban and rural areas. This suggests a clear policy implication that investment in access to quality education is the most effective way to combat in-work poverty.

Completing secondary education is critical. Workers with less than secondary education face a high risk of poverty and are preponderant among the working poor. Altogether, they represent nearly 80 percent of the working poor. The completion of secondary education dramatically lowers the risk of poverty. Less than 10 percent of workers with secondary education are in the bottom income quintile, compared with nearly 25 percent of workers with primary education (Figure 6a).
Low
Middle
High
Very high
The incidence of in-work poverty is lower among female workers than male workers. Men comprise two-thirds of the working poor. The risk of poverty faced by a female worker is 5 percentage points lower than that of a male worker.

Household characteristics and poverty

Four factors determine a household’s per capita income. First, the number of earners within the household relative to the number of household members of working age. Second, the number of hours the earners usually work. These two factors combined are referred to as work intensity, and measure the amount of labor that the household supplies to the market. The number of earners is referred to as an extensive, and the number of hours worked as an intensive margin of work intensity. Third, the household’s earning capacity, which is the amount of labor income that the employed household members are able to earn. Finally, the household’s demographic composition or the number of household members who are of working age relative to household size. In the ensuing analysis we look the relative importance of these factors, focusing on the impact of work intensity and earning capacity, ignoring that of the demographic factor.

Philippine households are poor as they are disadvantaged by all four factors that determine per capita income. First, in poor households fewer household members of working age are employed than in richer ones. Second, those who are employed, work shorter hours. Third, they earn less. Finally, there are more dependents in poor than in non-poor households.

Low earning capacity rather than joblessness is the primary cause of poverty

Differences in earning capacity play the most important role. The impact of differences in earning capacity is greater than that of work intensity. First, the differences in earning capacity between the poor and non-poor are larger compared to their differences in work intensity (Figure 8a). Second, all else equal, increases in earning capacity more sharply reduce the risk of poverty than increases in work intensity (increases either in the number of earners within the household or in the hours worked). The earning capacity of poor households is much lower than that of non-poor. On average, earnings of workers from the bottom quintile households are half of those of their counterparts from the middle income quintile. These are substantial differences, much larger than the difference in work intensity.

An increase in households’ earning capacity leads to a sharp reduction in the risk of poverty. If a household moves from the first to the second earning capacity group, the risk of poverty drops by 18 percentage points. However, the increase in earning capacity needs to be considerable to have noticeable reduction in the risk of poverty. To move from the first to the second earning capacity group, the employed household members would need to double their earnings. For many poor households such increase is hardly possible given the limited job opportunities that are available to them.

Poor households are seldom jobless. In poor households most family members of working age are usually employed. Poverty is associated with joblessness in only a fraction of poor households. However, the proportion of jobless households is somewhat higher among the poor than among the non-poor. For example, among the poorest households, 11 percent only have one earner per four household members of working age. This is 4 percentage points more than households in the middle income quintile (Figure 8b). But the number of poor households, where few of their members work, is still rather small. Joblessness is not the primary factor behind poverty in the Philippines.

The risk of poverty is only modestly reduced with more earners within a household. The relationship between poverty and the number of earners in the household is rather weak. For example, if the number of household members employed increases from 2 to 3, the likelihood of poverty drops just by a few percentage points. High work intensity does not necessarily protect households from poverty.

Workers in poor families work shorter hours than their counterparts in richer families. On average, workers in the bottom quintile work almost 4 hours per week less than those in the second quintile, and 7 hours less than those in

In-work poverty and informality are closely linked

As expected, in-work poverty is closely linked with low wages. Workers who earn less than two-thirds of the median wage face a significantly higher risk of poverty than those who are above the low-pay threshold (Figure 7a). These are not surprising results, but imply that reduction of in-work poverty in the Philippines hinges on growth in real wages, or on reduction in wage inequality, or both. Unfortunately, none of these conditions was met in the 2000s.

With low paid jobs concentrated in the informal sector, in-work poverty is closely related to informality. Over 90 percent of all low-paid jobs are informal, and as a result, informal workers are disproportionately represented in the bottom 20 percent. The high incidence of in-work poverty is thus just a mirror image of pervasive informality. However, while the majority of the working poor are informal workers, informal employment does not necessarily lead to poverty. Many informal workers earn above the low-pay threshold and avoid poverty (Figure 7b).

Poorer households work shorter hours than their counterparts in richer families. On average, workers in the bottom quintile work almost 4 hours per week less than those in the second quintile, and 7 hours less than those in
the middle, third quintile. These are substantial differences in hours worked, which translate into lower total earnings of poor households.

The poor work shorter hours because of lack of opportunities to work full-time. Among the poor the percentage of workers who would like to work more is significantly higher than among the non-poor. For instance, 33 percent of bottom quintile workers would like to work longer hours, compared with 10 percent in the top quintile. The poor work shorter hours not because they choose so, but because they have no other option. There is a shortage of regular—full-time and permanent—jobs accessible to vulnerable workers.

Minimum wage has limited potential to reduce in-work poverty in the Philippine

The minimum wage is determined through collective bargaining between formal sector employers, which tend to represent large firms, and trade unions, which represent formal sector workers. The reference wage for the negotiations is the average wage of trades unions for the negotiations is the average wage of formal workers, who are defined as full-time workers with permanent employment contracts. As a result, the statutory minimum wage in the Philippines does not represent wage conditions in the informal sector.

Workers who benefit from the minimum wage are not necessarily poor. Nearly 50 percent of low-paid workers come from relatively well-off families (top 60 percent), and less than 30 percent from the poorest families. Accordingly, minimum wage increases benefit many non-poor workers. At the same time, the high minimum wage may limit the earnings capacity of workers who would like to work more because of lack of opportunities for additional work.

Low earning capacity is often accompanied by short work hours. Household members who earn little also work shorter hours. For instance, members of households with the lowest earning capacity work 13 hours less on average than households with the highest earning capacity. The combination of low earning capacity and shorter working hours pushes households even deeper into poverty. The poor cannot offset their low earning capacity by working more because of lack of opportunities for additional work.

Minimum wage has limited potential to reduce in-work poverty. The minimum wage is a policy tool intended to address in-work poverty, and the Government of the Philippines is actively using it for this purpose. However, the potential of the minimum wage policy to reduce in-work poverty is limited for two reasons. First, a large proportion of the working poor are not wage earners. Second, those working poor who are wage earners are usually employed informally. Hence, the majority of the working poor are not covered by the minimum wage policy.

Workers covered by the minimum wage policy represent a minority among the working poor. Majority of the working poor are informal or non-wage workers who are not covered by the minimum wage policy. Wage workers, who are the target of the minimum wage policy, represent only about half of the working poor (Figure 5), while the other half includes the self-employed and unpaid family workers. Over 90 percent of low-paid workers are employed informally, and thus are not covered by the minimum wage policy. As a result, less than 2 percent (sic!) of the working poor benefit from the minimum wage policy. The minimum wage policy does little to address in-work poverty in the Philippines.

Actual coverage of labor regulations is limited

The actual coverage of employment protection legislation is limited because of the relatively small size of wage employment, and widespread informality. Wage and salary employment represents only 60 percent of total employment in the Philippines, and only about 40 percent of wage and salary workers are employed formally.  

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Accordingly, employment protection legislation effectively covers only about one-quarter of the workforce. There is thus a considerable discrepancy between de jure and de facto coverage of labor regulations (Figure 9).

Informality limits the actual coverage of the minimum wage policy. Among employees of private firms, less than half (45 percent) are employed in firms that are formal. Among those who are employed in formal firms, about 25 percent are paid less than the minimum wage. Accordingly, only about one-third of workers in private firms benefit from the minimum wage policy.

**Figure 9. Informality and non-compliance limit the coverage of worker protection**

<table>
<thead>
<tr>
<th>De jure coverage</th>
<th>All Employed Workers (100%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wage workers (60%)</td>
<td>Non-wage workers (40%)</td>
</tr>
<tr>
<td>Workers in formal firms (50%)</td>
<td>Workers in informal firms (50%)</td>
</tr>
<tr>
<td>De facto coverage</td>
<td>24% of total employment, 40% of wage workers</td>
</tr>
</tbody>
</table>

Sources: Informal Sector Survey 2008; Bank staff calculations.

Strict labor regulations are likely to contribute to labor market segmentation

While informality confines the effective coverage of labor regulations, strict labor regulations contribute to informality.¹ This is because strict regulation raises the cost of formal labor relative to informal. As such, it discourages employers from hiring workers formally. This effect is particularly strong in the case of low-productivity workers. There is thus a trade-off between the strictness of labor regulations and their actual coverage. By reducing the strictness of labor regulations, the Government could encourage formal employment, and thus expand the actual scope of employment protection and the minimum wage policy.

Strict employment protection legislation leads employers to increasingly use temporary employment contracts. As such, it contributes to duality within the formal sector. According to LFS, about 40 percent of employees in private establishments had non-regular employment in 2013. Similarly, a survey conducted among large formal establishments in 2012, shows that about 35 percent of employees were hired either on a non-regular basis, or as independent subcontractors. This is 7 percentage points higher than four years earlier.

Minimum wage cuts deep into the wage distribution and thus fails to serve as an effective wage floor. Figure 10 illustrates the effects of minimum wage in the Philippines by showing the location of the minimum wage, the median wage and the poverty threshold in the wage distribution. Set at its current level of about 80 percent of the median wage, the minimum wage leaves outside its coverage about 33 percent of workers because their productivity (approximated by their wages) is less than the minimum wage.² Setting the minimum wage at the level of the poverty threshold (about 70 percent of the median wage), would increase the effective coverage of the policy by 8 percentage points without compromising the poverty reduction objective. The minimum wage better aligned with worker productivity might result in better compliance and a higher proportion of wage workers actually benefitting from the regulation.

¹ Labor regulations are only one factor behind informality in the Philippines, and not necessarily the most important one. It is the whole business environment (of which labor regulations are part) plus the culture of informality that influence firms’ decisions whether or not to formalize.

² In a competitive labor market, workers are paid wages equal to their marginal product. However, if employers have some monopsony power they can set a wage below the marginal product of labor so that workers are exploited. Even if workers in the Philippines are paid less than their marginal product, Figure 10 shows that the fraction of workers whose productivity is below the minimum wage would still be large.

High minimum wage may exclude low-productivity workers from formal employment. The minimum wage is not a major problem for formal firms, which tend to be larger and employ more skilled workers. In the formal sector the minimum wage accounts for about 60 percent of the sector’s average wage, which is high, but not dramatically high. However, it is a major problem for informal firms, which tend to be small and employ less-skilled workers. In the informal sector the minimum wage accounts for about 115 percent of the sector’s average wage. This means that the cost of formalization for such firms could be prohibitively high, because they would have to pay their workers substantially more than they are paying as informal firms. This is relevant given that as many as 70 percent of informal wage workers are paid less than the minimum wage.

**Figure 10. Minimum wage cuts deep into the wage distribution**

Sources: Bank staff calculations based on the Labor Force Survey 2013 and the minimum wage rates.

Not: About 33 percent of workers employed in private establishments earn less than the minimum wage, and about 25 percent earn less than the poverty threshold.

There is scope to enhance workers’ welfare by reducing the distortionary effects of labor regulations

Making regular employment contracts more flexible could reduce segmentation. The increasing incidence of temporary employment contracts indicates that regular contracts are no longer a satisfactory option for many employers. One option to consider could be a Single Employment Contract (also referred to as Equal Opportunity Contract), which is currently gaining popularity in Europe, as a means to eliminate the duality between open-ended and temporary employment. The idea is that all contracts are open-ended, but the administrative procedures governing dismissals are relaxed, and employment protection is instead provided via severance pay that increases with job tenure.

Aligning the minimum wage with worker productivity can improve the chances of less-skilled workers being hired formally. Setting the minimum wage is a delicate balancing act. On the one hand, the minimum wage is meant to preclude exploitation of workers by employers, and to prevent in-work poverty. On the other, it should be linked to worker productivity and should not discourage employers from hiring workers formally. Set at its current level, the minimum wage in the Philippines favors the first objective, but compromises the second. The policy needs to be rebalanced in order not to exclude low-productivity workers from formal employment. Finding a satisfactory solution requires an empirically informed dialogue among main stakeholders, in which the interests of small employers and informal workers are adequately represented. Initiating such dialogue is thus critical, in accordance with the recommendation of the Philippine Development Report (World Bank 2013).

**Labor policies have a limited role in expanding the coverage of worker protection**

Improving the enforcement of labor regulations can expand coverage, but only marginally. The coverage of labor regulations is low primarily due to the low share of employment in formal firms. In addition, formal firms do employ workers informally—informal workers account for up to 25 percent of their workforce. Even with perfect enforcement and full compliance, the coverage of labor regulations would increase only by 6 percentage points to reach the still modest 30 percent.

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¹ Labor regulations are only one factor behind informality in the Philippines, and not necessarily the most important one. It is the whole business environment (of which labor regulations are part) plus the culture of informality that influence firms’ decisions whether or not to formalize.

² In a competitive labor market, workers are paid wages equal to their marginal product. However, if employers have some monopsony power they can set a wage below the marginal product of labor so that workers are exploited. Even if workers in the Philippines are paid less than their marginal product, Figure 10 shows that the fraction of workers whose productivity is below the minimum wage would still be large.
There is more to be gained from formalization of employment. Informality among businesses is a larger constraint to expanding worker protection than non-compliance among formal firms. There is potential to expand the coverage of worker protection by encouraging informal firms to formalize their businesses. While there is some scope to reduce the cost of formal employment by making labor regulations more flexible, labor reforms can play only a secondary role in promoting formalization. The primary role in promoting formalization is to be played by investment climate reforms reducing the costs and enhancing the benefits of doing business in the formal sector.

More gains in the coverage of worker protection will be achieved with the increase in the share of wage employment. Because labor regulations are designed for wage and salary work, significant expansion of worker protection coverage can be achieved if the non-covered workers (self-employed and contributing family workers) move to wage employment. Such reallocation of labor hinges on the expansion of the modern sectors of the economy.

Employment programs

The two largest groups of programs being implemented in the Philippines are direct job creation and training programs, which are broadly targeted at vulnerable workers and the youth. The size of direct job creation programs is substantially larger than that of training programs.10 The programs benefit mainly the better skilled among the vulnerable workers, leaving out the most disadvantaged, who lack the basic skills. However, the low-skilled workers are often covered by other government programs targeting the poor, which also aim to improve the employability of the beneficiaries.

Programs are fragmented and information on their performance is scant. It is difficult to assess the performance of employment programs in the Philippines due to the paucity of data. Different programs are administered by different government agencies, and coordination among agencies is limited, which leads to program fragmentation.11 Monitoring and evaluation of program performance is underdeveloped, which limits evidence on their actual coverage, targeting efficiency, cost-effectiveness, and impact.

Instituting program monitoring and evaluation and using the results to allocate resources to programs that are best performing could enhance their impact. There is scope for improving the impact of employment programs by enhancing coordination among implementing agencies, and by developing a monitoring and evaluation system. The results of monitoring and evaluation should guide the policy and allocation of resources. One possible policy direction would be to focus resources on cost-effective training programs, which equip the beneficiaries with employability skills demanded in the labor market, and as such have the potential to enhance their long-term employment prospects. This is particularly relevant given that poor skills of vulnerable workers are the main obstacle to their taking more productive jobs.

Conclusions

Widespread in-work poverty is the main challenge facing labor policy in the Philippines. The working poor are poorly educated and have informal jobs that offer no workers protection. Most of them live in rural areas, where productive job opportunities are few. This points to two interrelated root causes of in-work poverty—low education among vulnerable workers, and scarcity of “good” jobs. Addressing these two constraints requires reforms on both the supply side (education and skills) and demand side (jobs) of the labor market. These reforms have four objectives:

- Reallocation of labor from less to more productive activities, which involves labor moving from agriculture to services and industry.
- Improvement of the effectiveness of the existing labor policies.

The first three objectives lie beyond the realm of labor policy. Specific interventions to advance these objectives are extensively discussed in (World Bank 2013, and 2010). As regards the fourth objective, measures to improve the effectiveness of labor policy include:

- Simplification of the Labor Code, including making regular employment contracts more flexible. This could reduce segmentation by lowering the costs of hiring workers formally. The introduction of Single Employment Contract could reduce duality within the formal sector by making all contracts open-ended.
- Revision of the minimum wage policy to factor in productivity of informal workers. The minimum wage better aligned with productivity of all workers would strengthen incentives for employers to hire low-productivity workers formally, and would thus increase the effective coverage of the policy. Such revision should be based on empirically informed dialogue among all stakeholders, including those representing the interests of small employers and informal workers.
- Overhaul of employment programs to enhance their cost-effectiveness and impact. This includes programs consolidation to decrease fragmentation; better coordination among government agencies; improving targeting so as to better cover vulnerable workers; strengthening and instituting program monitoring and evaluation, and using evaluation results to improve program performance and expand programs that are have the largest impact. This also includes strengthening the capacity of the Public Employment Service Office to deliver effective job search assistance and counseling services.

References

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