

## **Implications of an EU FTA to the Philippine Labor Market**

Leonardo A. Lanzona, Jr.  
Ateneo de Manila University

### **Abstract**

The Philippine is currently negotiating a free trade agreement (FTA) with the European Union (EU). This paper is expected to shed light on these negotiations in terms of the possible effects of the FTA on the employment in particular. Conceptually, the effects of FTA on the labor market may come from two sources. The first is the intensification of free trade which can either be an opportunity or a threat to the workers, depending on whether the trading of goods and services are complementary or substitutable to the goods and services produced in the country. The second source is the proposed set of core labor standards which the EU can impose given the previous FTAs it has forged with other countries. These standards can result in making the country less competitive. Analyzing the experience of the country with its previous FTAs with the ASEAN and Japan, the paper found that FTAs are as whole to have a positive impact on employment. While there may be unemployment caused by the entry of more imports from other countries, the effect of the trade commitments found in FTAs is essentially to mitigate such negative effects. It is then proposed that the country should negotiate within the same rules and standards that are set in their previous FTAs and that appropriate taxes and subsidies should be imposed in order to counteract the negative effects of further trade and labor standards.

**Keywords:** Philippine labor market, core labor standards, ASEAN Free Trade Agreement (AFTA), Philippine Japan Economic Partnership Agreement (PJEPA), employment

## **Implications of an EU FTA to the Philippine Labor Market**

Leonardo A. Lanzona, Jr.

### **Introduction**

The Philippines is preparing to engage with the European Union to iron out a bilateral free trade agreement (FTA). One of the contentious issues concerning the FTA is the set of standards or rules that countries often engaged in. Since the 1990's, the demand for a minimum social foundation for the development of trade - one that guarantees certain safeguards against social dumping - has resulted in the signing of an increasing number of FTAs which incorporate a labor dimension, either in the agreement itself or in a parallel agreement. Not only do such labor clauses list minimum commitments for the protection of human rights at work and refer to specific international labor standards adopted by the ILO, but they also provide for conflict resolution systems as well as funds and parallel labor cooperation/consultation. Indeed, a growing number of bilateral free trade agreements - particularly those signed by Canada, the United States and the European Union - contain social and labor provisions along those lines.

The EU FTAs in particular is committed to ensuring that the jobs created by open trade reflect minimum international standards of decent and dignified work and help foster long-term sustainable development and competitiveness (OECD, 2000). The EU's own experience shows that high labor standards that promote quality working conditions support economic development and increase competitiveness. The EU is firmly committed to promoting core labor standards and decent work for all in its trade policy, and routinely includes cooperation initiatives and incentives to better working conditions in the trade agreements it negotiates.

The impact of the EU FTA on the labor market is two-fold. The first is through the change in economic structure resulting from the unification of markets with the partner countries and the second from the expected demand for harmonization of social standards with these countries. One reason for the insistence of core labor standards such as non-discrimination in employment, worker rights and equal opportunities for men and women is because these are guaranteed by EU law. Freedom of association and collective bargaining are enshrined in the

European Charter of Fundamental Rights. Although the EU does not expect developing countries to match its own high labor standards, it does not tolerate labor practices in its trading partners that fall below international norms.

The effort to bring labor issues into an FTA is widely seen by developing countries as a means to undermine their comparative advantage of lower wage trading partners, and could undermine their ability to raise standards through economic development, particularly if it hampers their ability to trade. The proposed standards can be too high for them to meet at their level of development. These low standard nations argue that bringing labor standards into the arena of multilateral trade negotiations are little more than a smokescreen for protectionism.

If these provisions are already a part of Philippine Labor Code, then setting up labor standards in a free trade agreement will cause no distortions in the labor. However, additional demands on the part of the EU can cause the dislocation of existing labor market conditions and can lead to unemployment. While there are inherently no disagreements about the importance of labor standards to any country, the labor processes that will bring about these high standards, rather than outcomes themselves, have to be taken into account in order to make allowance for differences and changes over time in the level of economic development and related factors.

This paper has three main objectives: First, it examines labor provisions in the previous FTAs of the Philippines as these relate to the proposed EU-Philippine FTA. Second, it provides an empirical analysis of the effects of FTA provisions on employment, using previous FTAs in which the Philippines has engaged. Third, it offers points for negotiation for government in drafting the said agreement.

The basis for core labor standards is an all-encompassing claim of “universality” made for a particular set of "core" labor standards viz. "freedom of association, the right to organize and bargain collectively, freedom from forced labor, and a minimum age for the employment of children." While there is nothing wrong with the labor standards, the main issue is whether economic sanctions should be imposed on countries that are not able to satisfy such standards (Srinivasan, 1996). The fact that the proposal for a social clause is being pushed by major developed countries when labor-intensive imports from developing countries are penetrating

their markets suggests that protectionist interests have captured the drive for labor standards. Because of this, the government needs to weigh carefully the weights and terms of labor standards agreements that are being forged.

The rest of the paper will consist of the following parts. The second section will consider further the labor provisions found in the Philippines' other engagements in FTAs, and the key features of previous EU FTAs in order to draw out conceptually their effects on the economy. The second part will present the empirical model that will be used to verify the tests the employment impact of an EU FTA with the Philippines. The fourth part considers the data that will be used in the study and discusses the results of the empirical analysis conducted. The last section will provide policy directions and recommendations to the negotiators of the FTA.

The Philippines has engaged in two FTAs. These are the ASEAN Free Trade Agreement (AFTA) and the Philippine Japan Economic Partnership Agreement (PJEPA). The two FTAs have contrasting treatment of labor standards. PJEPA has explicit provisions for labor standards while AFTA does not. The findings in this study are used as a basis for comparison in analyzing the potential impact of including labor standards in FTAs on employment.

### **Labor Provisions in Philippine FTAs and Previous European Union FTAs**

In high-standards regions, the costs of production for some firms and industries are higher than in regions with lower standards, causing them to be less competitive. At the same time, the opening up of several markets to the Philippines is expected to bring about structural changes in the economy as well as a reallocation of labor employment. These differences become ever more important as traditional barriers to trade and investment between regions fall (notably transport and communication costs).

The study will consider how labor standards can interact with the overall structural changes that arise with the FTA. In essence, labor contracts will serve to favor other demographic groups while discriminating against others. Nonetheless, there is no reason to presume that overall national economic and social welfare will improve because of

harmonization of social policies: it all depends on how much distortion these standards create in the economy. The point is that if the standards of the country compares with the trading partners, then the results will not necessarily be adverse. Hence, there is a need to verify empirically the effects of these agreements.

In the process of agreeing to set up AFTA, there was very little discussion on labor markets (Sussangkarn, 1997). This is very different to the North American Free Trade Agreement (NAFTA), where a "Supplemental Agreement on Labor Cooperation" was essential for concluding NAFTA. This apparent hush over labor standards is the result of a general view that freer trade with no labor regulations will lead to greater intra-ASEAN trade and investment flows, strengthen ASEAN's economic competitiveness vis-a-vis the rest of the world, increase the attractiveness of ASEAN as a destination for large scale foreign investment, foster faster economic development for all member countries, and benefit the labor and the population at large. Most FTAs avoided setting common standards, but as in NAFTA, such agreements encourage the members to promote many areas of labor market policies and enforce laws and regulations pertaining to the following areas:

1. Freedom of association and protection of the right to organize;
2. The right to bargain collectively;
3. The right to strike;
4. Prohibition of forced labor;
5. Labor protections for children and young persons;
6. Minimum employment standards, such as minimum wage etc.;
7. Elimination of employment discrimination;
8. Equal pay for women and men;
9. Prevention of occupational injuries and illnesses;
10. Compensation in cases of occupational injuries and illnesses;
11. Protection of migrant workers.

Moreover, the socio-economic conditions in ASEAN are very different to those in NAFTA countries and the EU. First of all, the average per capita GDP in ASEAN-10 (assuming

that Cambodia is admitted in) was only about US\$ 1,121 in 1994. This compares to an average per capita GDP of US\$ 20,468 for the EU, and US\$ 20,181 for NAFTA member countries. Second, there is much more variation in per capita GDP among ASEAN-10 countries compared to that for EU and NAFTA. The coefficient of variation of per capita GDP for ASEAN was about 1.60 in 1994, compared to about 0.32 for EU and 0.55 for NAFTA. Even if Singapore and Brunei Darussalam, who are clearly outliers at the top end, are excluded, the coefficient of variation of per capita GDP for the other eight ASEAN countries was about 1.01.

Meanwhile, the JPEPA provision on labor invokes the following:

Each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws in a manner that weakens or reduces adherence to the internationally recognized labor rights that are directly related to the following internationally recognized labor rights:

- (a) The right of association;
- (b) The right to organize and bargain collectively;
- (c) A prohibition on the use of any form of forced or compulsory labor;
- (d) Labor protections for children and young people, including a minimum age for the employment of children and the prohibition and elimination of the worst forms of child labor; and
- (e) Acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health

Despite the lower amount of core standards that are included, this article constitutes a major break from AFTA. It states that investors should comply with labor laws and regulations consistent with internationally recognized rights, such as the right of association, and the right to organize unions and bargain collectively. The case studies on the labor disputes experienced not only by Japanese enterprises in the Philippines in fact show certain gaps that need to be filled to implement Article 103 of the JPEPA, as an instrument to ensure decent work in trade and investment. As such, it has a potential to reduce employment or serve to implement greater social

harmony and equity in the workplace as court litigations can be resolved by this provision, especially when dealing with Japanese firms.

In any case, it can also be seen that these standards are not entirely restrictive since the country is already complying with these standards even before the PJEPA was implemented. The main issue then is the introduction of labor standards that go beyond those standards that the country already has.

The labor provisions in the EU FTAs in fact can constitute an even more drastic movement from the status quo. Unlike the PJEPA provisions, core labour standards such as non-discrimination in employment and equal opportunities for men and women are guaranteed by EU law. Freedom of association and collective bargaining are enshrined in the European Charter of Fundamental Rights. For EU, labor market and social protection issues are very prominent since free movement within the EU is allowed so that the labor markets of the various member countries are closely integrated. With the signing of the Treaty of Amsterdam on June 17, 1997, the EU further ensured "to place employment and citizens' rights at the core of the Union; and to sweep away the last remaining obstacles to freedom of movement and to strengthen security." Certain moves were underway in the EU to explore modes of policy co-operation and co-ordination that will lead to a convergence of social protection objectives and policies. Although the EU does not expect developing countries to match its own high labour standards, it does not tolerate labour practices in its trading partners that fall below international norms.

It may be necessary to distinguish what are core labor standards from cash labor standards and arguable labor standards (Freeman, 1996). Table 1 shows the three different types of labor standards. The point here is that these cash labor standards are dependent on the levels of GDP per capita. In contrast, core standards are the non-negotiable measures that rule out the number of violations of human rights and democratic principles. It may be possible that EU will set conditions beyond these core standards.

Table 1. Types of Labor Standards

Core Labor Standards	Prohibition of Forced Labor (ILO Convention 29 and 105)
	Prohibition of Discrimination (ILO Convention 100 and 111)
	Freedom of Association (ILO Convention 87)
	Right to Collective Bargaining (ILO Convention 98 and 154)
Arguable Labor Standards	Minimum Age for Child Labor (ILO Convention 138)
	Prohibition of Exploitative Child Labor
	Minimum Occupational Health and Safety
Cash Labor Standards	Minimum Wage Fixing (ILO Convention 131)
	Minimum Day of Rest (ILO Convention 14)
	Right to Occupational Health and Safety Standards (ILO Convention Special Issues)
	Social Security (ILO Convention 102)

Source: Freeman (1996)

One can for instance consider the FTA between EU and Korea. In Chapter 13 trade and sustainable development firm commitments are included for both sides to labour and environmental standards. The agreement also sets up institutional structures to implement and monitor the commitments between the parties, including through civil society involvement. In particular, a shared commitment to ILO core labour standards and to the ILO decent work agenda is indicated by both countries, including a commitment to ratify and effectively implement all conventions identified as up to date by the ILO. This means that both countries are willing to commit beyond conventions relating to the core labour standards.

Moreover, a confirmation of the parties' right to regulate, while aiming at a high level of protection in the fields of environment and labour, can be seen as well as a commitment to refrain from waiving or derogating from such standards in a manner that affects trade or investment between the parties. This suggests the countries can unilaterally regulate and set up barriers if standards are not met.



Finally, strong monitoring mechanisms, building on public scrutiny through civil society involvement by both South Korea and the EU, are enshrined in the EU-Korea FTA. Each side will set up a civil society advisory group, including a balanced representation of environment, labour and business organizations. The two groups will meet annually in a civil society forum to discuss the implementation of the sustainable development aspects of the chapter.

### **Conceptual and Empirical Framework**

Setting up an FTA can cause a dislocation in the economic structure as much perhaps as the imports from the partner countries that enter the domestic market. Such imports can replace goods that are produced in the country, and can lead to substantial unemployment. Nevertheless, the implications can also be beneficial for the country (Feenstra, 2003). First, the FTA can offer the country a change to restructure an inefficient industrial structure. Given imperfect competition, an increased supply of goods from the foreign markets allow for efficiency as consumers are offered a cheaper set of goods. Second, the FTA creates an avenue for maximizing the production possibilities available to each country as opposed to opening up the domestic markets to the rest of the world. Preferential rates to a select group of countries allow for a more profitable exchange of goods and services. The record has shown that members of trade agreements can secure agreements in FTAs for rules that confer advantages upon their trading partners and reduce trade irritants and restrictions that could not otherwise be secured from multilateral trade agreements. Third, FTAs are often forged across countries that are geographically close to one another, thereby minimizing transaction costs.

Traditional trade models often assume that the countries' technological capacities and/or relative endowments with production factors like capital, land, skilled and unskilled labor would determine the competitiveness of different sectors at the global level. As a consequence each country would have a set of identifiable exporting sectors and import-competing sectors. Exporting sectors would expand production and their demand for labor, while import-competing sectors would reduce production and possibly lay off workers. But traditional trade models were not concerned with the reshuffling process itself, i.e. the loss of jobs and the process involved in

finding a new one. It was assumed that all workers were employed before trade liberalization and that adjustment to the reform would take place instantaneously.

Given this assumption that laid-off workers would automatically move into new jobs, the issue of trade-related unemployment did not arise. However, this assumption of full employment does not imply that there are no other effects of trade liberalization on workers. Although it may not affect the quantity of jobs, trade liberalization can affect the quality of jobs. Since it was assumed that exporting and import-competing sectors employ different types of workers or employ them in different proportions, trade liberalization would in the long run affect the relative demand for different types of workers; and this change in relative demand would result in relative income changes. In other words, traditional trade models would not allow for the conclusion that trade affects the level of employment or unemployment. They would rather lead us to expect that some workers may be better or worse off in the long run because of changes in their wages. In particular, economists predicted that trade between industrialized and developing countries would lead to decreases in the (relative) wages of low-skilled workers in industrialized economies and increases in those wages in developing countries. On average, though, individuals would be better off as a result of the overall economic efficiency gains and higher employment triggered by trade liberalization

Similar assessments of costs and benefits can be said for the imposition of labor standards in the FTAs. Assuming that labor standards for the two partners are substantially different, then the rationale for trade may be changed. The issue is whether such diversity of standards alters the course for free trade. Srinivasan (1996) has investigated this issue theoretically. He concluded that the diversity of labor standards between nations will reflect differences in factor endowments and levels of income, and that such diversity is consistent with the case for free trade. He noted further that if minimum international labor standards are to be attained, it will be necessary to have arrangements for international income transfers and domestic tax/subsidies. This will be the case as well when consumers in countries with high standards have a moral preference to raise standards in their trading-partner countries with lower standards. Further, if there are market failures that prevent the attainment of minimum labor standards, income transfers and domestic tax/subsidies will be required to achieve optimal conditions for resource

allocation and consumer welfare. Finally, the use of trade intervention could hinder the attainment of higher labor standards, and it may accordingly be in the collective interests of countries to cooperate in setting labor standards.

Brown, Deardorff, and Stern (1996) have analyzed the effects of labor standards on economic welfare and do not concern themselves directly with issues of the diversity of standards and the case for free trade. They assumed that the absence or non-compliance of labor standard is a sign of market failure and concluded that economic welfare is best served when countries act on their own to correct their domestic (labor) market failures. But, since these market failures will likely differ between countries, there is no obvious case on welfare grounds for pursuing universal standards and the international harmonization of standards that this may imply. This conclusion is consistent with that of Srinivasan (1996), i.e., that diversity of working conditions between nations is the norm and is by no means in itself “unfair” so long as the extant labor standards are consistent with efficient resource use.

There is also an issue of whether labor standards are to be considered as *public* or *private* goods. As long as the same standards are shared generally for all consumers, the standards are public goods. Public goods tied with labor standards include:

- Enhancement of Social Production
- Increased quality of work
- Decrease the share of informal sector in labor market
- Decent work
- Reduce poverty

The positive effects come with a price in the same way as other benefits from globalization. This means that a proper mixture of taxes and subsidies will be necessary in achieving the optimal provision of these public goods.

One of the main problems in analyzing labor markets is the fact that there are many individual factors and government policies that can affect labor market performance over time. In other words, employment outcomes may also be associated with the distortions which are caused by other policies in the areas of labor market policy, production assets, population control, domestic subsidy-tax regimes, industrial policy, market structures and other trade policies. The key challenge then is how to isolate the effects of trade from the rest of the other factors. Using a panel data set extracted from the Labor Force Surveys from 2003 to 2010, the impact of the FTA on employment will then be measured using the econometric data analysis. The strategy is to use data with a time or cohort dimension to control for unobserved-but-fixed omitted variables.

The study will then look at the employment from the workers' perspective, emphasizing differential effects that the policy may have on different groups of workers. Using a model designed to determine the effects of minimum wages; the model can reflect the effect of policy on a broad measure of unemployment and consider its differential effects on demographic sub-populations. Montenegro and Pages (2000) used a model similar to Maloney and Mendez (2000) in order to determine how labor market policies can affect demographic groups differently. Using panel data and conditioning for regional effects, the model is as follows:

$$y_{imt} = \sum_m \delta_m x_{imt} + \sum_t \theta_t t + \sum_R \delta_R R + \sum_s \gamma_s Z_t + \sum_s \sum_m \rho_{imt} (x_{imt} \cdot Z_t) + \varepsilon_{imt}$$

where  $y_{imt}$  is the observable employment status of individual  $i$  who belongs to subpopulation  $m$ , indicating whether at time  $t$  he or she will be employed or not. This variable takes a value of one if the individual is employed and zero if it is not. The  $x_{imt}$  is a vector of variables that reflects the personal characteristics of individual  $i$  at time  $t$  such as age, gender, skill level, number of children, and number of children interacted with gender,  $t$  is variable for year fixed effect,  $R$  is for the regional fixed effects, and  $Z_t$  is a vector of  $s$  variables that may vary with  $t$ . Among the variables in  $Z_t$  is an index for labor market policies, including a dummy variable for the years when the FTA was implemented. Hence, the years after the FTA will be given a value of one and zero before the FTA. The direct effect of the FTA on employment will be reflected in the

coefficient,  $\gamma_i$ , while the interactive term,  $x_{imt} * Z_t$ , then will account for the impact of the FTA on particular demographic sub-groups.

Hence, the effect of the FTA on employment status will be based on the following:

$$\frac{\partial y_{imt}}{\partial Z_t} = \gamma_i + \rho_{imt} \cdot x_{imt}$$

The basic hypothesis is that apart from the direct effect of the FTA on employment (measured by the coefficient,  $\gamma_i$ ), a specific effect on the demographic sub-groups can be significantly observed assuming a set of binding core labor standards. While there are may be other intervening factors that can affect  $\rho_{imt}$ , such as technological changes and other distortions introduced by the FTA, it is presumed that the other factors in the model are able to control for these factors. In particular, the time variable  $t$  refers to dummy variables for each time period and is intended to capture changes that occur over each time period. Regional effects on the other hand are controlled also by the dummy variables  $R$  that account for the events occurring in different regions. These variables are expected to control for policy variables both at the national and regional level.

Because the dependent variable,  $y_{imt}$ , is a qualitative variable, indicating whether the person is employed or not, a panel logit model will be applied. This is a probabilistic model which measures the likelihood that the person will be employed. In estimating the effects of the FTA, two econometric models are used. The first is the fixed effects which controls for the individual's unobserved characteristics. While this corrects for possible omitted variable bias arising from these unobserved heterogeneity, the results cannot be generalized since these estimates are conditioned on the characteristics of workers who are part of the sample. In order to determine if the estimates can be generalized to a larger Philippine population, the second model is used. This refers to the random effects model which assumes that the unobserved household characteristics are part of the error term. In which case, there is no need to control for unobserved characteristics which is presumed to be independent of the other independent variables.

If the random effects prove to be correct about its assumptions, then the differences of the fixed effects and the random effects should not be statistically significant. On the other hand, if these models result in significantly different coefficients, then the fixed effects model is chosen over the random effects model. This means that the results cannot be generalized beyond the available data. Since only the fixed effects model is acceptable, and the results of the fixed effects are controlling only for the fixed (unobserved) characteristics of those individuals found in the sample, the population characteristics cannot be inferred from the results, hence indicating the sample is not random.

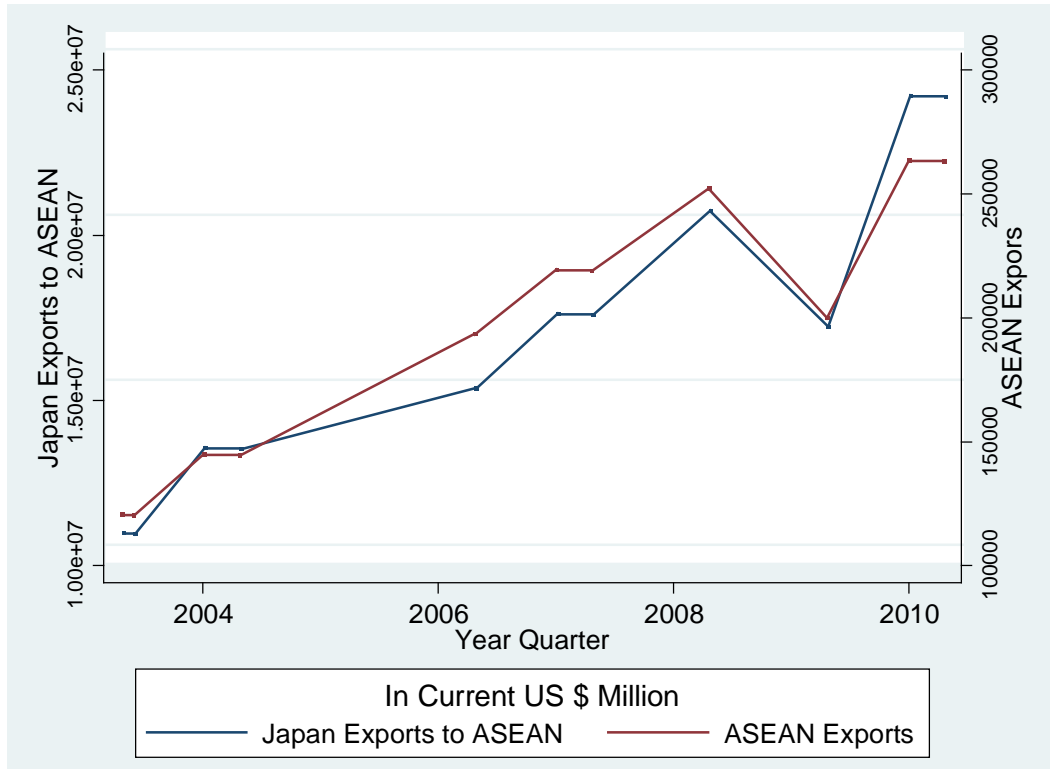
### **Data and Empirical Results**

The study will use panel data extracted from the Labor Force Survey which runs from 2003 to 2010. This allows us to control for individual worker heterogeneity (unobserved characteristics that are invariant in time) and also determine if regional factors are important in affecting the results. Panel data contains observations on multiple phenomena observed over multiple time periods for the same individuals. This kind of data offers an opportunity to conduct analysis of dynamic changes.

One of the challenges of this study is to choose the instrument intended to capture the FTAs. Given the available data, two instruments are used for the Philippine FTAs. For the AFTA, since the agreement was implemented 2003, it would no longer be feasible to use a dummy variable to control for the conditions before the AFTA. In order to identify the effects of AFTA, the total value of all ASEAN exports will be used as an instrument. This defines the potential effect of the AFTA on the Philippine economy. With the opening up of the domestic market to other ASEAN countries as well as the opening of other ASEAN markets to our product, the AFTA can potential be an opportunity or a threat to our economy. Fundamentally, since the Philippine exports are part of the total exports, the exact effect or sign of this FTA proxy variable cannot be determined a priori.

For the PJEPA, since the agreement started in 2009, a dummy variable for the years, 2009 and 2010 can be used as an instrument for the agreement. Fundamentally, given the model discussed in the previous section, we can determine the employment status of the workers before and after PJEPA. In addition, the same instrument used to instrument AFTA above will also be adopted here. This is the total exports of Japan to the ASEAN region which are now the potential imports of the Philippines as a result of the economic partnership. Hence, we consider the effects of Japan's exports before and after the PJEPA was implemented. Combined with the JPEPA dummy variable, these variables capture both the goods and service aspects of the JPEPA effects on the economy.

Figure 1 features the exports of Japan to ASEAN and the total ASEAN Exports. Except for the decline in 2009 due to the tsunami disaster in Japan, both are seen to increase. What is crucial here is that both of these offer opportunities as well as pose as threats to the employment. If these exports are complementary to the Philippine products, then employment is seen to improve. However, if these serve to substitute for Philippine employment, then decrease in the demand for labor may occur. The simultaneous increases in the both factors also offer a sense of relief after 2009, a period of the financial crisis.



Source: UNCTAD and World Bank

Table 2 features the means of the time varying variables that are used in the model, and hence the same variables that will be reflected in the fixed effects model. Several points are important. First, the observations are distributed across quarters and years. These are intended to generate greater observations for the same individuals. Second, employment status which takes a value of 1 if worker has a job is consistently on the high level on the average. On the whole, most of the persons who are part of the sample are also apparently those who have no difficulty in finding work. On this aggregate level, it seems very hard to determine the effects of the FTAs. Some may be able to lose their jobs in some periods while others are able to find work in certain periods. In any case, since the recent months are periods of financial crisis, it would seem that the commitments with these other countries helped in stabilizing the employment picture. Third, the ASEAN exports (in current millions US\$) can be noted to increase over time, except in 2009 due perhaps to the tsunami in Japan, and the US and global financial crisis. . Sixth, the proportion of college graduates have increased slightly over time, as some of the individuals may have progressed to post-graduate studies (MA, PHD, Law, etc.) studies over time and as college is now seen to be essential in getting a job. Nevertheless, the variation in



schooling is quite limited and of course the proportions are correlated to one another, making it difficult to determine the effects of each level on employment. Finally, the variation in age seems to be more prominent. Over time, the proportion of young worker—those who are 20 to 35 years of age-- has fallen over, while the share of younger working individuals has increased. The key demographic variable in this sample seems to be the age of the individuals as education shows very limited variation.

Table 2. Means of Time Varying Variables

	Jul-03	Oct-03	Jan-04	Jul-04	Jul-06	Jan-07	Jul-07	Jul-08	Jul-09	Jan-10	Jul-10
Proportion employed	0.70	0.73	0.72	0.72	0.71	0.73	0.71	0.72	0.71	0.71	0.71
Real minimum wage	53.59	53.59	52.04	52.06	52.35	49.20	49.21	51.26	49.65	49.36	49.32
Proportion of college graduates	0.09	0.09	0.09	0.10	0.10	0.10	0.10	0.11	0.11	0.10	0.11
Age of workers	39.09	39.16	39.27	39.60	40.31	40.40	40.52	40.72	40.86	40.88	41.07
Proportion of young workers	0.30	0.30	0.30	0.29	0.25	0.24	0.23	0.22	0.21	0.20	0.20

Source: Panel Data from the Labor Force Survey, NSO

Table 3 features the key results of the empirical tests. The following points for both the fixed and random effects models are important. First, PJEPA has positive significant effect on employment. Nevertheless, because of its nature as a dummy variable, it is hard to interpret this as the effect arising from the JPEPA or from some other variable that is correlated with the implementation of JPEPA. Second, Japanese exports constitute a negative impact. The impact of Japanese exports is understandable since these constitute the imports to the Philippines. In the

process, these goods and inputs could have displaced labor in production. In any case, the overall effect of PJEPA, which includes the impact of exports and investments on employment are still positive when combined the results of the JPEPA variable. In effect, the negative effects of increased openness resulting from globalization seem to be mitigated by the FTAs. Third, AFTA has positive significant and substantial effects on employment. Increasing openness to ASEAN Exports had resulted in greater probability for employment. To some extent, the exports of the Philippines which are included in this variable are complementary to the additional imports from the ASEAN region, hence resulting in a significant increase in employment. Third, core labor standards, as defined in JPEPA, seem to have significant effects on employment. Results indicate the PJEPA has a negative effect on college educated workers but a positive effect on the young workers. This seems to suggest that PJEPA puts a premium on the production workers mainly in the formal manufacturing sector where such workers are valued highly. Conceptually, the labor standards could have played a role in making such arrangements more profitable and thus not contrary to the country's interests. In summary, what then constitutes a threat are the economic adjustments that may result from the FTA as certain industries may be affected adversely by the FTA. This can be seen in the effect of Japanese exports to the ASEAN. Nevertheless, this is to be expected from any form of globalization. It is important then the FTA be designed to mitigate such negative effects, including the expected challenges arising from a financial crisis. Moreover, it should be formulated in a way that will support the country's weakest sector, i.e., manufacturing.

Table 3. Key Results of the Empirical Tests

Employed	Fixed Effects	Random Effects
PJEPA	1.017** (3.69)	0.913** (3.32)
Japan exports to ASEAN (in M US\$)	-0.458** (3.32)	-0.447** (3.25)
ASEAN Exports (in M US\$)	50.40** (3.41)	48.90** (3.32)
Real Minimum Wage	-0.015** (2.63)	-0.019** (4.45)
College	-2.124 (1.06)	-2.320 (1.15)
Age	0.415** (20.94)	0.501** (37.19)
Age Squared	-0.005** (19.99)	-0.005** (32.43)
Young Work Age	0.295** (2.03)	0.472** (3.48)
ASEAN*College	2.030 (1.58)	2.111 (1.63)
PJEPA*College	-0.323* (1.72)	-0.290 (1.53)
ASEAN* Young Work Age	-3.74e-07 (0.49)	-8.61e-07 (1.19)
PJPEPA*Young Work Age	0.178** (2.07)	0.187** (2.19)
N	31850	63520
Likelihood ration test	1195.810	2.10E+04
Hausman Test		138.62

Notes: \*\*, \* indicate significance at 5 and 10 percent levels.

The results of Hausman test also indicate that there is a significant difference between the fixed effects and random effects estimates. This suggests that results generated will only be applicable to the sample individuals included in the dataset. In any case, the difference seems to relate only to the values of the coefficients, and not on the sign of these coefficients. This indicates that the direction of the change can in general be generalized for the whole population. Hence, both AFTA and JPEPA have positive effects on the probability of employment on the whole economy.

## Summary and Points for Negotiation

The results of the empirical test constitute one of the first evaluations of the FTAs of the Philippines. Indeed, while there may be some trade diversion resulting from an FTA, positive results had been seen at least from the point of view of employment. FTAs are appropriate in any economy that is characterized by substantial imperfect competition. If a gap exists between price and marginal costs, distortions in output and excess capacity are possible outcomes. Increased trade and investments induces firms to exploit increasing returns to scale, resulting in increased output, greater employment and higher welfare of households. This seems to be the case for the AFTA.

Yet, in the case of PJEPA, the potential increase in imports from Japan poses as a threat to the employment. The trade agreement can cause a movement in the production of certain goods, leading to the closure of firms. Nevertheless, the FTA can induce an increased amount of investments and exports to the partner country, resulting in more employment. Moreover, the core labor standards seem to favor workers in the manufacturing which is the least productive sector of the country. In effect, the imposition of core labor standards would still increase the overall welfare in the country.

Nevertheless, an insistence on labor standards can create constraints for more involvement in trade arrangements. This is true if the standards that are being imposed go beyond those that the country is already complying. This then calls for greater sensitivity in the Labor Market Cooperation and Integration. For the negotiating bodies to take into account social and economic conditions obtaining in developing countries in the determination of their compliance with these standards. The negotiators can work within the same core labor standards in which the Philippines is already complying. The main challenge is the likelihood that the labor provisions may go beyond these core standards.

While there is no issue about the benefits of core labor standards, the main area of contention is the process by which these standards are going to be met. To illustrate further, Aggarwal (1995) has proposed that a distinction be drawn between standards related to *labor*

*processes and structures* and standards related to *labor outcomes*. This distinction would apply some definition of what constitutes a “minimum” standard to the determination of basic worker rights in terms of labor processes. Presumably, the point of taking labor processes, rather than outcomes, into account is to make allowance for differences and changes over time in the level of economic development and related factors. What remains ambiguous, however, as Aggarwal acknowledges, is the difficulty of deciding whether the identification and guarantee of labor processes lead to the improvement of labor outcomes.

There is a need to implement tax and subsidy measures to increase human capital and enhance manpower training in the country. In particular, the labor standards (along with factor and commodity prices) are also a reflection of the real income distribution. Those complying with the standards are the most likely to benefit financially from these standards. Hence, changing the income distribution through policy is equivalent to a change the equilibrium labor standards (Srinivasan, 1996). There is nothing peculiar to labor standards in this and, as seen in the international context earlier, non-distortionary lump-sum income (or wealth) redistribution policy is the first best to move the income distribution (and consequently the equilibrium labor standards in the right direction). If the first-best policy is infeasible, then other policies (such as, for example, commodity or factor taxes or subsidies) could in principle be used to achieve a better income distribution and labor standards albeit at the cost of a dead weight loss.

In general, which taxes and what levels are to be used in achieving the desired change in labor standards while minimizing the dead-weight loss associated with them will vary across economies. If the question of labor standards could hinder the completion of the FTA, it may accordingly be in the collective interests of countries to cooperate in setting labor standards (Stern, 2003). With sufficient encouragement and increased financial support, the ILO can also provide a multilateral forum that would serve to strengthen its role and authority in pursuing improved labor standards internationally. The effort of Europe and some other industrialized countries have tried to link trade and labor standards in the WTO have been unsuccessful. The challenge then is to reinforce the institutional role for which the ILO has been designed.

## References

- Aggarwal, M., (1995), "International Trade, Labor Standards, and Labor Market Conditions: An Evaluation of the Linkages," USITC, Office of Economics Working Paper No. 95-06-C
- Brown, D. K., A. Deardorff, and R. Stern, (1996), "International Labor Standards and Trade: A Theoretical Analysis," in J. Bhagwati and R. Hudec (eds.), *Harmonization and Fair Trade: Prerequisites for Free Trade?*, Cambridge: MIT Press.
- Feenstra, R. , (2003), *Advanced International Trade: Theory and Evidence*, New Jersey: Princeton University Press
- Freeman, R., (1996), "International Labor Standards and World Trade: Friends or Foes?" in J. Schott (ed.), *World Trading System: Challenges Ahead*, Institute of International Economics
- Sussangkarn, C., (1997), "ASEAN Beyond AFTA: Initiatives in Labor Market Co-operation and Integration", TDRJ Quarterly Review 12, pp. 3-8
- Stern, R., (2003), "Labor Standards and Trade Agreements," Research Seminar in International Economics Gerald R. Ford School of Public Policy Discussion Paper No. 496
- Srinivasan, T.N., (1996), "Trade and Human Rights," Yale University Economic Growth Center Discussion Paper No. 765