Employment, Equity and Growth: Lessons from the Philippine Employment Mission

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MOST OF THE DEVELOPING COUNTRIES and many of those trying to aid them still adhere to the notion that employment, equity and growth are inherently conflicting objectives of development. While perhaps less is heard today about the inevitability of a clash between employment and growth objectives, most observers remain convinced that the size distribution of income must worsen as growth gets under way. The Mission's findings in relation to the Philippines indicate that, in both cases, the conflict is *not* dictated by nature but is likely to be man-made.

The Philippine Employment Mission is the sixth in a series sponsored under the ILO's World Employment Programme. No attempt will be made here to summarise the Mission's report.[2] The purpose of this article is, rather, to pick out of the Mission's main findings and conclusions some that may be relevant also to other developing countries with economies broadly similar to that of the Philippines.

The historical background

A first and primary lesson to be drawn from the Mission's work in the Philippines is that the present situation is not likely to be understood,

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[2] The report will shortly be published by the ILO under the title *Sharing in development. A programme of employment, equity and growth for the Philippines.* The earlier reports are: *Towards full employment. A programme for Colombia* (Geneva, 1970); *Matching employment opportunities and expectations. A programme of action for Ceylon* (Sri Lanka), two volumes (Geneva, 1971); *Employment, incomes and equality. A strategy for increasing productive employment in Kenya* (Geneva, 1972); and *Employment and income policies for Iran* (Geneva, 1973). A report on the Dominican Republic is currently in preparation. A critical evaluation of the first four reports was published in the May 1973 number of the *International Labour Review.*

nor planning for the future successful, unless the underlying historical causes of the conflict among the various objectives of development are themselves understood. And conflict there was in the postwar period, as evidenced by a persistent decline in real wages or income shares both in urban and in rural areas and by a general worsening of the distribution of income during a period of quite satisfactory over-all rates of growth. In 1956, for example, the poorest fifth of all families received only 4½ per cent of total family income; by 1971, their share had shrunk to 3 per cent. At the same time, regional disparities have widened and underemployment, however defined, has increased. Over the same period, the over-all growth rate averaged close to 6 per cent.

The questions that must be asked and which the Mission did ask itself are: to what extent is this the result of some inevitable law of development and to what extent could it have been avoided or, more relevantly, could it be avoided in the future? In other words, do things have to get worse before they can get better as a country attempts its transition to modern growth? Kuznets finds that the Philippine experience is by no means unique; yet there are also countries, admittedly in the minority, which seem to have avoided these conflicts; and, clearly, everywhere political and social pressures against a continuation of present trends are rising.

The Philippine economy is of the labour-surplus type.[1] It is, however, also blessed with a relatively good natural resources base, which has meant and still means a strong pattern of cash crop exports—logs, sugar, copra, coconut, tobacco, pineapples and bananas. It was exploitation of these basic resources which constitued the main economic driving force in the colonial period.

The Mission's analysis indicates that the post-Second World War era saw the initiation of two profound changes in the historical pattern of Philippine development: (1) a marked acceleration of population growth, and (2) an attempt to foster rapid growth of the relatively narrow large-scale industrial sector. This meant, on the one hand, that in spite of the relatively rich endowment in natural resources, population began to press increasingly against the land frontier by the end of the 1960s and, on the other, that the rural sector—with its two components of domestically-oriented food production and export-oriented cash crops—had to be relied upon to finance much of the rapid expansion of the industrial sector.

[1] A labour-surplus economy is one in which the real agricultural wage is often higher than the marginal product of agricultural labour and in which the relative price of the capital-intensive good understates its opportunity cost in terms of food, i.e. the wage good. For a theoretical exposition, see J. C. H. Fei and Gustav Ranis: *Development of the labor surplus economy: theory and policy* (Homewood (Illinois), Richard D. Irwin, 1964); also M. S. Ahluwalia: "Tax-subsidy intervention and employment", in ILO: *Fiscal measures for employment promotion in developing countries* (Geneva, 1972), and I. Little, T. Scitovsky and M. Scott: *Industry and trade in some developing countries* (London, New York and Toronto, Oxford University Press, for the OECD Development Centre, 1970).

In this situation, some import substitution sub-phase of transition growth was probably inevitable and, in fact, desirable if the economy was to be restructured away from its pre-independence colonial pattern. Under import substitution the proceeds of the cash crop agricultural sub-sector, augmented by the reinvestment of industrial profits and foreign capital inflows, were typically used to build up the large-scale industrial sector. The record of the past quarter of a century in the Philippines indicates, however, that import substitution, while constituting a legitimate and desirable post-independence political package, was pursued too much and too long and that one of its major consequences was the above-mentioned conflict among the various desirable goals of national development. It resulted in the relatively vigorous continued growth of both export-oriented agriculture and large-scale domestically-oriented manufacturing but in the relative stagnation of subsistence agriculture and virtually everything else. A careful review of the past quarter of a century makes it possible not only to place the present problems in proper perspective but also to marshal the local evidence bearing on the probable consequences of major policy shifts in the future. For example, while industrialisation aiming at the substitution of consumer good imports—with all the normal paraphernalia of protection, overvalued exchange rates, low interest rates, etc.—was a major phenomenon of the 1950s and 1960s, examination of a particular sub-period, such as 1962-68, during which there was some deviation from that pattern, is bound to be particularly instructive.

A quarter of a century of accelerated industrialisation and population growth, impinging on a mainly rural economy which had not drastically changed since the colonial era, led to mounting difficulties. On the one hand, with domestic markets running out and with no encouragement of international competitiveness, the industrial sector's own growth began to run out of steam. On the other, the rural sector's ability to continue to finance this growth through the contribution of agricultural exports and/or domestic agricultural surpluses diminished with time. This was reflected in a long-term deterioration of the urban industrial sector's terms of trade, both domestic and foreign, as well as in declining rates of return—certainly social and even private—within that sector.

Meanwhile, left to one side in the course of this 25-year effort to maximise urban industrial growth through import substitution were the majority of the would-be economic actors in the society: the medium- and small-scale producers, both agricultural and non-agricultural. The sub-period 1962-68 showed some deviation from extreme import substitution policies and also gave rise to a much faster growth of medium- and small-scale industry than took place before or since. But it is essentially the non-participation of more than four-fifths of the population in productive and innovative activity which lies at the root of the problems to which the Mission was asked to address itself.

A two-pronged strategy

With respect to the future, all of the Mission's suggestions fall under two strategic headings: to achieve, on the one hand, balanced rural mobilisation and, on the other, a shift towards export-oriented labour-intensive industrial growth. This basic two-pronged strategy reflects the Mission's assessment that the so-called employment problem, which is fundamentally one of low incomes, can be solved only if both the agricultural and the non-agricultural components of the rural sector are mobilised in a balanced, mutually reinforcing fashion and if the industrial sector is able to contribute to its own further growth by exporting competitively in labour-intensive industrial export markets. Only in this fashion can the narrow growth of the past be replaced by broadly based development in the future.

So far as the first aspect of the proposed two-pronged strategy is concerned, the underlying cause of the unemployment and income maldistribution problem and of the social and political unrest threatened thereby is seen by the Mission as the failure of the rural sector to hold its people in productive employment—a failure due especially to the inability of secondary crops and rural industrial activities to become important contributors and, in turn, to help generate sustained productivity increases in the traditional food crop sector. This has resulted in substantial migration to the city which, in the absence of a simultaneous increase in the wages fund to provide additional urban jobs, has caused ever-increasing urban underemployment. The temptation must be resisted to continue to rely exclusively on exports of commercialised cash crops, even under the present temporarily favourable terms of trade. To give way to that temptation would be to forgo substantial additional incomes, additional markets and the entrepreneurial and innovative involvement of the majority of the population.

The second and related aspect of the proposed strategy is concerned with the nature of future as opposed to past urban industrial development. The Philippines should now be ready to combine its relatively plentiful supply of indigenous entrepreneurs with its relatively high-quality labour force in order to penetrate international markets through major changes in output mix and technology. In other words, the path of urban industrial growth can substantially change to absorb the rural migrants arriving in the urban areas complete with their wages fund, i.e. additional food to help provide the additional urban jobs. In view of the labour shortage and substantial wage increases which other labour-intensive exporters in the region such as South Korea and Hong Kong have been experiencing in recent years, the Philippines has an opportunity of stepping into their rather profitable shoes. If the response is inadequate, there are other labour-surplus countries in the region which might well push ahead.

In short, the Mission's analysis of the past indicates that accelerated growth along the old path, that is, " more of the same ", cannot work. An increasingly capital-intensive urban industrial sector which at present absorbs less than 10 per cent of the total working population cannot be expected to absorb the new migrants from the rural areas, quite aside from mopping up the existing backlog of urban underemployment. Moreover, the fuelling of import-substituting industrialisation through the generation of food surpluses and/or the export of the traditional products of the soil would become less and less adequate and more and more expensive.

A programme of priorities

A second lesson emerging from the Mission's work is that there is a priority need to plan policy changes which will effect certain basic transformations in the structure of the economy before attempting to make any precise resources planning calculations or projections along the proposed new growth path. This is not to question the desirability of attempting to forecast the growth, employment and income distribution outcomes of the planned structural changes but it is to warn against the dangers of engaging in such exercises without paying at least as much attention to ways and means of changing the rails along which future resources planning should take place.

Moreover, any mission such as ours must be candid as to what it can and what it cannot do. Attempts at a refined resources calculation within an aggregative planning framework should be left to local planners. The proper function of a mission is to suggest, if it can, on the basis of the country's historical record and of cross-sectional micro evidence and relevant experience in other developing countries, the direction of possible changes in the policy environment. However carefully it might be calculated, any precise forecasting of growth, employment or income distribution outcomes would be fundamentally misleading.

The Mission believes that a redirection of the economy of the Philippines from unbalanced growth to balanced development is eminently feasible. It sees the possibility of: (1) a marked change in the performance of the rural sector resulting from a substantial expansion of rural industrial activities which are at present, by international standards, much too restricted—activities which would grow, in a mutually reinforcing fashion, with primary and secondary food crops and animal husbandry; (2) a rapidly growing role for both existing and new labour-intensive industrial exports, which would be directed to the markets not only of developed but also of other developing countries; (3) an increase in the demand for the (efficient) use of labour in rural and urban industrial activities sufficient not only to absorb the increments in the labour force over the next decade but also to mop up much existing rural and urban underemployment; (4) an improvement in the distribution of income during the next decade resulting from increases in family incomes as more members of the typical working family find jobs, as each member of the family works longer hours and as hourly wages rise, even if only moderately; (5) sustained increases in wages and major improvements in the distribution of income once underemployment has been eliminated and unskilled labour has become scarce and (6) as a consequence of this much more labour-intensive and broadened development path, the immediate achievement of much higher annual rates of savings and growth than in the past—in excess of 15 per cent and 9 per cent respectively.

What is, perhaps, a third major lesson to be learnt from the experience of the Philippine Employment Mission is that it is one thing to project a " vision " of the future and quite another to map the exact course of the transition. The Mission does not presume to be able to chart a detailed course as to what precisely the Government should do to move the economy onto this new growth path. Only those who have to deal with these problems year in and year out are in a position to make fully detailed proposals and fiscal estimates which take all the local institutional, political and legal complexities into account. The Mission was not content, however, to proffer only very general advice on planning for policy changes and to cover only terrain that had already been well traversed elsewhere. The challenge to the Mission was, rather, to try to chart a responsible intermediate course, by presenting the contours of the minimum policy " package " required to implement the over-all two-pronged strategy referred to above.

Any team of outsiders should also exercise another kind of self-restraint by keeping its recommendations as modest in number and as realistic in scope as possible. There is little point in touching lightly on every topic and having something to say that may be sensible but is hardly likely to be profound about every one of the hundreds of useful things that could surely be done in support of each aspect of the recommended two-pronged strategy. Few governments have the capacity to focus on more than two or three major policy matters at any one time and any report purporting to provide a textbook listing of all the desiderata which together spell development is bound to become quickly self-defeating.

Much of the Mission's diagnosis and many of its policy recommendations have been discussed and debated for many years; for that matter, many of the recommendations have been, or are currently being, adopted. A mission of this type should not expect to have discovered any new truth in any particular area. But where a contribution can be made is in shedding some new light on the interrelatedness of fairly well-known things and in providing focus and cohesion to both the analysis and the recommendations for policy. The Mission hopes, therefore, that it has achieved some order of priorities among the many things the Philippine Government can do and is continually being asked to do. The main contribution that a group of professionally skilled and experienced outsiders can make is to explain clearly the reasons for the policy package underlying the proposed two-pronged strategy, to point to the more urgent things needing to be done immediately, and to indicate what is likely to happen in the absence of substantial progress along the lines suggested.

" Radical " and " conventional " solutions

Another point to be emphasised is that the distinction often drawn between so-called " radical " and " conventional " solutions to the problems of unemployment and maldistribution of income is largely artificial. The policy package that the Philippine Mission recommends contains proposals for a number of structural reforms. They include a vigorous land reform extending beyond what is currently being planned, by providing for differential compensation according to size of holding, a lowering of the existing retention limits for rice and maize and possible reforms in respect of other crops; a thoroughgoing decentralisation of public sector administrative and fiscal powers, at the *barrio* and sub-municipal government level, in order to improve the quality of decision making on issues affecting small farmers and rural industrialists; a comprehensive review of the regional dimensions of development in the Philippines, with a programme of both differential taxation and reallocation of direct expenditure designed to correct the present excessive concentration of economic activity in Manila; and, last but not least, a substantial overhaul of the machinery for promoting investment and innovative activity in a now dormant rural industrial sector oriented to the domestic market.

Much of the rest of the Mission's policy package may be regarded as " conventional ". One of the proposals is for a major reform of the system of interest rates whereby a larger share of the function of credit allocation would be shifted to the banks and away from unofficial markets; medium- and small-scale participants in both the agricultural and the non-agricultural rural sector would be provided with easier access to credit; and unearned or windfall profits would be withdrawn from the large-scale urban industrialist and landlord classes, with the incidental result that a narrowing of the spread between lending and borrowing rates would stimulate the banks to become more competitive by opening more branches in the rural areas. Another proposal is for a progressive readjustment of public sector tax and expenditure policies, including programmes designed to ensure stable prices for the major wage goods and a modest programme of poverty redressal in favour of the poorest sections of the population. There are proposals, too, for a major effort of technical assistance to rural medium- and small-scale industry focusing both on the scope for adaptive technology and on adaptive commodities serving mainly the domestic market, and for a strategy of liberalising the industrial protection and tariff system linked to an adjustment assistance programme for affected existing industries.

But the difference between the so-called " radical " and " conventional " components of the Mission's proposed package pales into insignificance on closer examination. Major changes in the equity with which various groups are treated, e.g. in access to credit before and after an interest rate reform, are just as " radical ", in terms of their impact on the elimination of windfall profits, as is asset redistribution (e.g. land reform). To the extent that existing inequality is due to the accumulated effect of market imperfections, monopoly positions, the existence of protected sectors benefiting from tariff policy, credit discrimination, etc., liberalisation is a most effective way to improve the functioning of the system, including the distribution of income. The policies suggested by the Mission with a view to promoting institutional change and improving markets are intended not to discourage profits *per se* but to discourage unearned profits and ensure that more profits accrue to the small competitive enterprise rather than to the large protected oligopoly, to small owner-operated farms and rural industries rather than to absentee landlords and metropolitan firms.

The really critical issue is not, however, one of differentiating between the " radical " and the " conventional " portions of the Mission's proposed policy package: both portions have the same purpose of releasing the energies of large numbers of persons who are at present economically disenfranchised. The real issue is, rather, to make sure that the various parties to the social contract understand that there is a need for a change in the nature of the growth path and that a changed path can be expected to yield a better distribution of income, a solution to the employment problem and higher growth rates to boot.

A major lesson to be drawn by other labour-surplus developing economies is that the basis for a simultaneous solution to the employment, income distribution and growth problems lies in the encouragement of a much more sustained demand for unskilled labour. The Mission has suggested policies having significant direct and indirect income redistribution effects, as, for example, through a redistribution of assets, through a decentralisation of public infrastructure, especially in the rural sector, through improvements in the functioning of the credit market, through public sector tax and expenditure readjustments, but mainly through an increase in the demand for labour due to the changes in technology and output mix resulting from balanced rural mobilisation and a new industrial export orientation.

The politics of change

The Mission is convinced that, from a technical point of view, major increases in output and employment are possible and that they would result in a simultaneous improvement in the distribution of income, both family-wise and regionally. It is, in fact, the Mission's belief that, in a labour-surplus economy, the only reliable and sustainable way of improving equity is to make fuller use of the country's resources by adopting a more employment-oriented growth path.

This potential complementarity of improved distribution of income and of increases in output and employment in a labour-surplus economy can be realised if the government is prepared to act vigorously, resolutely and, most of all, persistently—both with respect to basic institutional reforms and in the equally crucial matter of establishing fairer and more reliable " rules of the game " so as to ensure the participation of millions of dispersed decision-makers in both the private and the public sectors.

To move the economy of the Philippines onto the new growth path proposed by the Mission requires both technical competence and the political will to bring together and secure agreement among the various parties to the social contract. That some groups in the society, e.g. landless rural workers, small farmers and medium- and small-scale entrepreneurs, would be bound to benefit from the proposed change of strategy is clear. On the other hand, some sacrifice would be called for on the part of certain groups benefiting from the present narrow growth path. This does not mean, however, that such groups, e.g. landlords or large-scale industrialists, would have to be permanently penalised nor that they would not have important contributions to make to a gradual transition to a new state of affairs. Rather, it would call for changes in the *way* in which profits are made. For example, the large capital-intensive manufacturing firm which has, in the past, benefited from the windfall profits deriving from government-induced restraint of competition, cheap capital imports, low interest rates, etc., could expect to *increase* its future rate of return by taking advantage of the opening up of large industrial export markets. With a change from windfall to earned profits, the considerable entrepreneurial and managerial resources of the society could be induced, in their own self-interest, to contribute to the achievement of the new societal goals that have been indicated here. The only alternative would be to keep things as they are, which, in spite of all efforts to prop up declining private rates of return, dwindling domestic markets and the increasingly difficult process of fuelling import substitution, must eventually boomerang on the urban industrial class itself.

In the same way, the real wage of industrial workers would not be likely to increase markedly until the existing labour surplus had been mopped up as a consequence of the proposed employment-oriented strategy. Yet even during the transition period, significant benefits would accrue to working families as the demand for additional family members to participate in gainful activity increased and as the wage gap between rural and urban workers and between large and small establishments narrowed with the more rapid growth of rural and small-scale industry and services generally.

The establishment of a social consensus as to the need for such a change in the nature of the development path—on as broad a basis as possible—is undoubtedly the most important task facing the Philippines. The entire package, elements of which are already being applied or considered by the Government, requires it to manage substantial and growing public investment activities, especially in terms of rural infrastructure; to protect the welfare of certain low-income groups by means of modest programmes of poverty redressal; to improve the functioning of certain markets in order to ensure the broadened participation of many persons who are at present economically disenfranchised. All of this implies a larger public sector role than in the past, but also a more selective role, since less effort will be expended in attempting to exercise direct control of decentralised decisions in both the public and private sectors and since there will be more opportunity to concentrate on the key levers that can secure a response from millions of dispersed individuals.

As for the question which of the policies suggested should or can be implemented and in what order, this is something that, of course, only the Filipinos themselves can decide. But it is also clear that the political economy of effecting the proposed changes, once all the parties are fully agreed on the nature of the problem, is of crucial importance. As much political wisdom and courage is required for the reform of interest rates as for land reform. Both can be carried out only if there is the fullest possible understanding and consensus as to what needs to be done and a realisation that the alternative of inaction or delay is no longer acceptable.

A related question is whether a labour-surplus economy which, like that of the Philippines, is relatively rich in natural resources stands at an advantage or a disadvantage vis-à-vis one which, like that of Japan in an earlier period or of South Korea in the postwar period, is relatively poor in natural resources. It is clear that the latter type of economy has little option but to try to effect the shift from import substitution to an industrial export orientation with as much rural mobilisation as possible. It has to try to utilise its only major resource—a highly literate unskilled labour supply—to penetrate international markets. On the other hand, an economy rich in natural resources like that of the Philippines has the apparent advantage of being able to call on a continued flow of traditional exports to provide the foreign exchange and budgetary resources required to ease the always difficult transition from one policy régime to another. Finance ministers and central bankers may be expected to consider such shifts more favourably when there exists a dependable flow of cash crop exports—possibly even, as now, at improving world prices. In other words, natural resources, like foreign aid, can ease the real and psychological adjustment costs inherent in any major change in a growth régime.

Any reform raises a problem in political economy, however, and it may well be that a country rich in natural resources, while more *able*, may be much less *willing* to effect the necessary policy changes because it is not

" up against it ". Especially at a time when raw material prices are on the upswing, at least temporarily, there will be a natural human temptation to avoid painful policy changes and to maintain things as they are. Much of Latin American development can be said to have suffered from this attitude, the extreme cases being, perhaps, represented by some of the oil-rich countries of the world in the past.

It is natural, and human, for governments to avoid unpleasant decisions if some ready-made alternative is to hand. This makes all the heavier, perhaps, the political burden of understanding and explaining to others that any such alternative is not really viable in the longer run. The ILO Mission to the Philippines is convinced and hopes that it has been able to convince others that even the relatively well-endowed Philippine economy is facing an increasingly serious natural resources constraint; that the terms on which further industrialisation of the old variety can be financed are becoming ever more costly; that domestic markets for the goods of further (" secondary ") import substitution will ultimately run out; and that further urban industrial growth will thus be curbed both by the constraints of demand and by the need to allocate relatively declining foreign exchange resources not only to capital goods and raw material imports but increasingly also to food imports to make up for the growing domestic deficit. Even if temporarily higher export prices or the possible discovery of oil did enable the Philippine economy to continue to move along the traditional path at greater speed, the writing on the wall would be clear. Putting higher-octane fuel into the present vehicle could only delay the ultimate day of reckoning. Not only would growth be retarded and the rate of return on further industrial expansion of the traditional variety further decline but the fundamental social and political problems caused by a deteriorating income distribution and employment situation would become increasingly intolerable. Thus there can be little doubt that the ability to fall back still a little longer on the bounty of nature, and yet not to yield to the temptation, requires a high degree of statesmanship. To mobilise the rural sector in a balanced, persistent and sustained fashion and to permit the industrial sector to turn outward and begin to make its contribution to the financing of its own future growth through export diversification calls for policy changes which have to overcome the substantial obstacles of a quarter of a century of protectionist habits and an even longer record of paternalism and centralisation in agriculture and local government. This is indeed a formidable challenge, and one that very few developing societies have thus far managed to meet successfully.