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The Automatic Nature of Dismissals in Spain: Dismissal-at-Will under Civil Law

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Abstract
In this article, we explain that, in Spain, a relatively minor reform in unemployment benefits regulation has introduced a system to dismiss at will. Therefore, the fairness of the dismissal is not important in practice, although the whole legal system requiring a fair cause for dismissals remains. We present different empirical evidence supporting such statement.

Keywords: Dismissal, Labour Law, Severance Pay.

JEL classification: K310, J530, J320

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1. Introduction

The main objective of this paper consists of analyzing the recent legal changes affecting dismissals passed in 2002 in Spain. The interest of this national case rests on how a 'minor' legal change can affect to incentives of workers and firms creating an automatic mechanism for firms to dismiss workers without fair cause.

This result is highly interesting because such automatic nature for dismissals explicitly exists only under the North-American employment-at-will doctrine. But how a Civil Law system could include such automatic procedure? At first sight, it is difficult because of the traditional distinction in Continental Labour Law about fair and unfair causes for dismissals. The first type consists of two groups: fair reasons related to economic activity (economic dismissals) and fair reasons related to misconduct of the worker (disciplinary dismissals). In countries with a Labour Law developed under a system of Civil Law the catalogue of fair causes is complete and closed, and, therefore, any cause not included in the list of fair causes is considered as unfair. In the same way, a misuse of a fair cause (for example, alleging disciplinary reasons when there are economic reasons behind the dismissal) will be considered as unfair too.

Therefore, under a Civil Law system dismissals only can become 'automatic' developing a dismissal-at-will practice but not an employment-at-will doctrine. In other words, the legal framework will provide incentives to firms to use some legal mechanism where the fair or unfair cause for the dismissal is not relevant and to workers to accept the dismissal under these circumstances as a lesser evil. We will show that the Spanish case, in special, through a 'minor' legal reform implemented in 2002 is an example of this situation, explaining what are the incentives of firms and workers and the costs of this system for both.

The remainder of the paper is as follows. In the next section, we describe the Spanish legal framework on dismissals, focusing on the 2002 legal reform, and the main hypothesis related to our interpretation of the effects of this legal reform. In the third section, we present some data discussing whether the empirical evidence supports the predictions of our interpretation. Finally, a conclusions section closes the article.

2. The Spanish legal framework on dismissals

2.1. Background

The current legal rules on dismissals are compiled in the Workers' Charter, enacted at the end of 1980. The objective of this Charter was to develop a labour relations system adapted to the recently recovered democratic system (the current democratic Constitution is dated at the end of 1978). There have been different important reforms of the Workers' Charter. In 1984, the rules governing temporary contracts were changed, in order to foster employment (then, the Spanish unemployment rate was above 20 percent). In 1994, a new reform created a new type of dismissal and introduced limits to the use of temporary contracts (because they had reached around 30 percent of the stock of wage and salary workers). In 1997, a new open-ended contract was introduced with a lower severance pay in some cases and financial subsidies for the firms. And the last reform affecting the Workers' Charter has been agreed between employers and unions in 2006, in order to promote even more the new open-ended contract with a lower severance pay. However, a legal change related to dismissal (mainly to dismissal costs) was introduced in 2002, but not through a modification of the Workers' Charter, but the 45/2002 Act on unemployment benefits.

After this brief summary of the recent changes of the basic norms of the Spanish Labour Law we proceed to describe the legal framework related to dismissals.

The procedure to dismiss permanent workers in Spain is very different as between individual and collective dismissals.

First of all, we should remark that until 1994 collective dismissal was in practice the only way to dismiss workers on economic grounds. In Spain, a collective dismissal is called ERE (*Expediente de Regulación de Empleo*). The most distinctive feature of collective dismissals in Spain is the requirement of administrative approval, introducing important bureaucratic costs for this type of dismissal. If it has been agreed with workers' representatives the collective dismissal is always approved. If there is no agreement, the Public Administration decides. The most important issue of this bargaining is the severance pay, which has a minimum of 20 wage days per seniority year. There are no accurate data on this question, but many authors consider that the agreed severance pay are much higher than for individual dismissals, and that collective dismissal is the most expensive form of employment adjustment per dismissed worker (Toharia and Ojeda, 1999). The amount of individual dismissals is much higher than the amount of dismissed workers in collective dismissals (see, for example, Malo, 2005), which can be considered as an indirect proof of the disincentives related to the use of collective dismissals.

Before the 1994 legal reform of the Spanish Labour Law, there was only permitted one individual dismissal on economic grounds in firms with less than 50 workers, although it was very difficult to use this legal provision because the interpretation of the legal term 'economic grounds' was very restrictive (Toharia and Ojeda, 1999). Therefore, the only real way to dismiss one worker on economic grounds before 1994 was a 'collective' dismissal for only one person. Because of the relevant fixed costs of a collective dismissal (administrative authorization, negotiations with workers' representatives, etc.), it is obvious that there were strong incentives to use multiple individual dismissals instead of a collective dismissal in many cases. However, as disciplinary grounds were the only legal

fair causes available for firms before 1994, firms 'disguised' economic dismissals as disciplinary ones. See Malo (2000) for a detailed explanation of the incentives to use disciplinary reasons instead of economic reasons for individual dismissals.

In 1994, the legislation on dismissals was changed[1] to allow 'small' collective dismissals to be legally considered as individual dismissals, but explicitly on economic grounds and not 'disguised' as disciplinary ones. The adjustment should be below the 10 per cent of the workforce. However, even after reform, it is controversial whether firms have enough incentives to allege economic grounds in these individual dismissals. The dismissal on disciplinary grounds has fewer requirements. No advance notice is required and no initial severance pay has to be deposited, and the rest of costs and requirements are equivalent for both types of dismissals. Even the interpretation by judges of the economic grounds is controversial, because judges have to evaluate whether there are enough economic reasons to dismiss a worker, and this is not a judiciary issue but a management one (Malo, 2000). Therefore, the application of the economic dismissal is subject to a higher legal uncertainty, and the probability of a sentence declaring the dismissal as unfair (even existing real economic grounds) increases. As there are incentives for an improper use of disciplinary reasons, the main part of dismissals are solved by agreement (on average, for the time period of our data base only around 20 percent of all individual dismissals reached the judicial stage). Presumably, even the declaration of non existent disciplinary reasons is agreed with the worker to receive unemployment benefits and the agreement eliminates any stigma for the worker related to the dismissals and the disciplinary reasons alleged. Even when a disciplinary dismissal is declared as fair, the worker can receive unemployment benefits and subsidies, but with a delay of three months.

[1] See Toharia and Malo (2000) to have a comprehensive description of the 1994 Spanish Labour Law reform.

In 1997, another legal reform affecting firing costs was passed in Spain. A new open-ended contract was introduced including a lower severance pay for individual dismissals on economic grounds declared as unfair by tribunals. We would like to stress that this decrease in firing costs is only relevant for these new contracts and not for the rest of workers with open-ended contracts. In addition, the legal definition of economic grounds in individual dismissals was clarified in order to facilitate their use by tribunals.

2.2. Legal changes introduced in 2002

As we explained above, in 2002 a new legal change was introduced in firing costs[2]. Now, the government tried to decrease the bureaucratic costs of individual dismissals. When a dismissal is considered as unfair (directly by the courts or indirectly by firms in pre-trial agreements), the firm had to pay the 'intervening wages' (in Spanish '*salarios de tramitación'*), which consist of all wages from the date of dismissal to the judicial decision. When the legal procedure lasted for more than two months, the firm applied to the Public Administration for the reimbursement of all intervening wages in excess of this period. However, in 2002 the regulation of intervening wages was changed, introducing at the same time a new way to transfer the severance pay from the firm to the worker. When firms give the severance pay corresponding to unfair dismissal (45 salary days per seniority year or 33 days for new contracts introduced in 1997) until two days after the dismissal letter, then the firm will not have to pay intervening wages to the worker, even when the worker would file a suit against the firm for unfair dismissal.

Note that in this situation, firms recognise *de facto* that the dismissal is unfair (they are giving to the worker the severance pay for unfair dismissals), but they can save the cost of the intervening wages if the worker wants to go to the labour courts. As the worker has

[2] See García-Perrote (2003) for the legal details of this reform.

obtained the highest severance pay, why to go to the courts? Therefore, the new regulation introduces strong incentives to solve dismissals before to go to the labour courts and even before to go to the bargaining institutions.

It is important to note that whether the cause of dismissal is fair or unfair is not important any more, only for those cases arriving to labour courts. But theses cases will be rather different and they, probably, will be related to other aspects of the dismissal beyond the monetary compensation for the worker, because he/she can not obtain more money going to the tribunals. As the cause is not more important, this system could be called as an dismissal-at-will system, but with a cost for the firm. The cost is paying the highest severance pay, 45 salary days (or 33 salary days for the new open-ended contracts). Now, dismissals are 'automatic' for the firm but paying a higher severance pay. However, we have explained before (Malo, 2000), in the most part of dismissals the agreed severance pay was 45. Therefore, with the 2002 legal reforms firms have obtained the automatism of dismissals without changing the above limit for severance pay, and even obtaining a decrease in bureaucratic costs related to dismissals, because they have not to pay the intervening wages and the dismissal process is usually solved in only two days. On the other hand, workers obtain in a very short time period the severance pay and they obtain rapidly the highest one[3]. For them, the cost is the lost of importance of the true cause of the dismissal, open the door to a lack of legal protection.

2.3. The effects on dismissals: three hypotheses

The above reasoning allows us to state three hypotheses which can be tested with suitable data.

[3] Even they can immediately apply for the corresponding unemployment subsidies or benefits, and any importance is given to the cause of dismissal, either economic or disciplinary, because the firm, implicitly, has accepted that the cause was unfair.

First, if the 45/2002 Act has introduced the described incentives for firms and workers, we will see that the majority of dismissals in Spain follows this legal mechanism.

Second, if the 45/2002 Act has decreased firing costs (mainly the bureaucratic part of these costs) we will see more dismissals after the legal reform.

Third, those dismissals solved at bargaining institutions should be rather different and relatively more expensive affecting workers with a high bargaining power (otherwise, why would the worker persist in the case going to bargaining institutions?).

In the next section, we present an empirical analysis trying to check these hypotheses.

3. Empirical analysis

First of all, we must stress that the 2002 legal reform has dramatically modified the statistical data on dismissals in Spain. Before this reform, almost all dismissals were solved at bargaining institutions and, therefore, their figures on dismissal cases were a very accurately information about the total amount of dismissals[4]. However, after the passage of the 2002 reform there are few incentives to go the bargaining institutions (because firms try to elude the payment of the bureaucratic costs offering to the workers the corresponding unfair severance pay) and their figures on dismissals are never more a proxy for the total amount of individual dismissals. However, we can circumvent this lack of data about the number of dismissals for 2002 using the administrative data on new beneficiaries of unemployment benefits by entry reason (the different types of dismissal are reasons included in this administrative data).

[4] Only a very small fraction was solved before to go to bargining institutions, and therefore administrative data from these institutions provided before 2002 an accurate estimation of the number of dismissals in Spain.

As the published information using this administrative data source, we will use micro-data from the Historical Register of Unemployment Benefits of the Public Employment Service (known in Spain as HSIPRE) in order to check the main hypotheses of our interpretation of the 2002 legal reform. Our empirical analysis is based on micro-data of entries in this Register between May 4th of 2002 and December 31st of 2004.

The entries in the unemployment benefits register can be considered a good approach to the amount of dismissals because practically all dismissed workers can apply for these benefits.

The first hypothesis can be checked with Table 1. This table shows in the first column the number of dismissals considering the entry in the Register during the whole period described above, the distribution in the second column and the distribution without considering collective dismissals in the third column.

Table 1. Number of dismissal and characteristics of dismissed workers, by dismissal type. May 2002-December 2004

Type of dismissal	Number	%	% (w/o ERE)	% women	% above 45 years old	% below 30 years	% men 31-44 years	Av. Age	Median Age
45/2002 Act	571,702	59.4	65.0	45.6	26.4	23.3	8.7	38.51	36
Objective*	127,795	13.3	14.5	48.5	31.4	19.7	7.2	39.98	37
Bargaining institutions (SMAC)	106,115	11.0	12.1	41.8	39.7	14.1	5.5	42.84	40
Labour courts	22,712	2.4	2.6	44.5	37.8	14.9	5.3	41.52	40
Collective dismissals (ERE)	82,596	8.6	-	30.6	64.7	6.0	2.5	48.35	51
Other	51,472	5.3	5.9	42.2	22.6	28.9	11.1	36.80	34

Source: Micro-data of the Register of Unemployment Benefitos of the Public Employment Service
***** Objective economic dismissals introduced in 1994 (art. 52 of the Workers' Charter)

Dismissals using the 45/2002 Act is the most important category: 59.4 per cent of all dismissals of the period and 65 per cent of all individual dismissals (i.e. excluding collective dismissals). Therefore, the first hypothesis is confirmed by the simplest examination of the data related to dismissals, showing that the majority of dismissals are automatic in Spain. In addition, if we consider that the second row includes

objective economic dismissals accepted directly by workers, we will have that almost 80 per cent of all individual dismissals are accepted by workers without questioning the choice of the firm.

The second hypothesis is related to the number of dismissals, increasing after the passage of the 45/2002 Act. Figure 1 shows the evolution of the number of dismissals as a ratio respect to the total of workers with open-ended contract in the private sector. The blue line represents the ratio of dismissals respect to the total of workers using the administrative data from bargaining institutions to estimate the number of dismissals. The number of workers with open-ended contract in the private sector has been calculated with the Labour Force Survey. The blue line shows a clear decreasing trend from 2002 onwards. However, as we have seen before, almost 80 per cent of all individual dismissals never arrive to bargaining institutions. Therefore, these figures do not provide an accurate estimation of the evolution of this ratio. Using data from HSIPRE (as in Table 1) we have estimated the same ratio from 1998 (see the pink line). Before the reform both data sources provide a very similar estimation, but after the reform, the data from the Register of Entries in the Unemployment Benefits System show a clear increase in the dismissals ratio. This increase is not related to any economic downturn of the Spanish economy during these years (the unemployment rate has been around 12 per cent and even slightly decreasing from 2002). Although this is a simple 'before-after' comparison is not against the second prediction of our reasoning.

The third prediction was related to those dismissals going beyond the automatic procedure of the 45/2002 Act and arriving to bargaining institutions. Our hypothesis was that these cases are characterized by a stronger bargaining power of workers. We have considered that an effect of a larger bargaining power would be an increase in average severance payments. Figure 2 shows the average of severance payments for

those dismissals solved by agreement in bargaining institutions and by agreement or sentence in labour courts. We see that after the passage of the 2002 legal reform there is not any change in the series related to labour courts, while the average severance payment in bargaining institutions increases in a very spectacular way, even doubling in the last years the average severance payment obtained in 2001. Therefore, after 45/2002 Act cases arriving to bargaining institutions are rather different than before. As the other cases are solved before to go to these institutions, we should observe relevant differences in workers characteristics. Coming back to Table 1, we can see that the average (and the median) age of workers with dismissals finished in bargaining institutions is above the age of workers dismissed using the 45/2002 Act (and above also those who accepted an economic objective dismissal). The severance payment is calculated as salary days per seniority year, and assuming a positive association between age and seniority we have that the average severance pay should increase. However, maybe it is not enough for the huge increase observed in Figure 2. Table 2 shows the entitlement period for unemployment benefits (strictly related to seniority) and the salary day used to estimate the unemployment benefits. We can see that both variables are clearly higher for those workers whose dismissals were finished in bargaining institutions. Again, data are not against the predictions of our interpretation of the effects of the 2002 legal reform.

Table 2. Characteristics of dismissed workers by entitlement period and dismissal type. May 2002-December 2004

Type of dismissal	Number	% "short" entitl.	% "medium" entitl.	% "long" entitl.	Median entitl. period	Salary per day	
						Average (pta.)	Median (pta.)
45/2002 Act	571,702	25.5	46.2	28.3	16	3,864	3,370
Objective*	127,795	21.4	46.3	32.3	18	3,642	3,321
Bargaining institutions (SMAC)	106,115	16.0	37.9	46.0	22	4,642	3,911
Labour courts	22,712	20.9	41.1	38.1	18	4,011	3,461
Collective dismissals (ERE)	82,596	4.3	20.6	75.0	24	6,107	6,182
Other	51,472	46.0	36.1	17.9	10	3,519	3,228

Source: Micro-data of the Register of Unemployment Benefitos of the Public Employment Service
***** Objective economic dismissals introduced in 1994 (art. 52 of the Workers' Charter)

4. Conclusions

In 2002, a 'minor' legal change concerning dismissals was introduced in Spain. So minor, that this change was not a modification of the Workers' Charter but a new Unemployment Benefits Act. However, the impact has been dramatic creating de facto a sort of dismissal at will mechanism under a Civil Law system, where there is a clear distinction of fair and unfair reasons for dismissals. Nevertheless, the irrelevance of the fairness of the dismissal causes is obtained supporting some costs: for firms, the costs is paying the highest legal severance pay (the corresponding unfair severance pay), and, for workers, the cost is a decrease of the legal protection against an unfair break of the labour contract.

In addition to the main effect of this legal reform (the creation of an automatic mechanism for dismissals in Spain), the new legal framework has decreased the amount of bureaucratic costs related to dismissals (specially, intervening wages). Although Figure 2 shows a huge increase in average severance pay in bargaining institutions, the whole picture rather shows a decrease in firing costs. Otherwise, it would be difficult to interpret the increase in the dismissal ratio (Figure 1).

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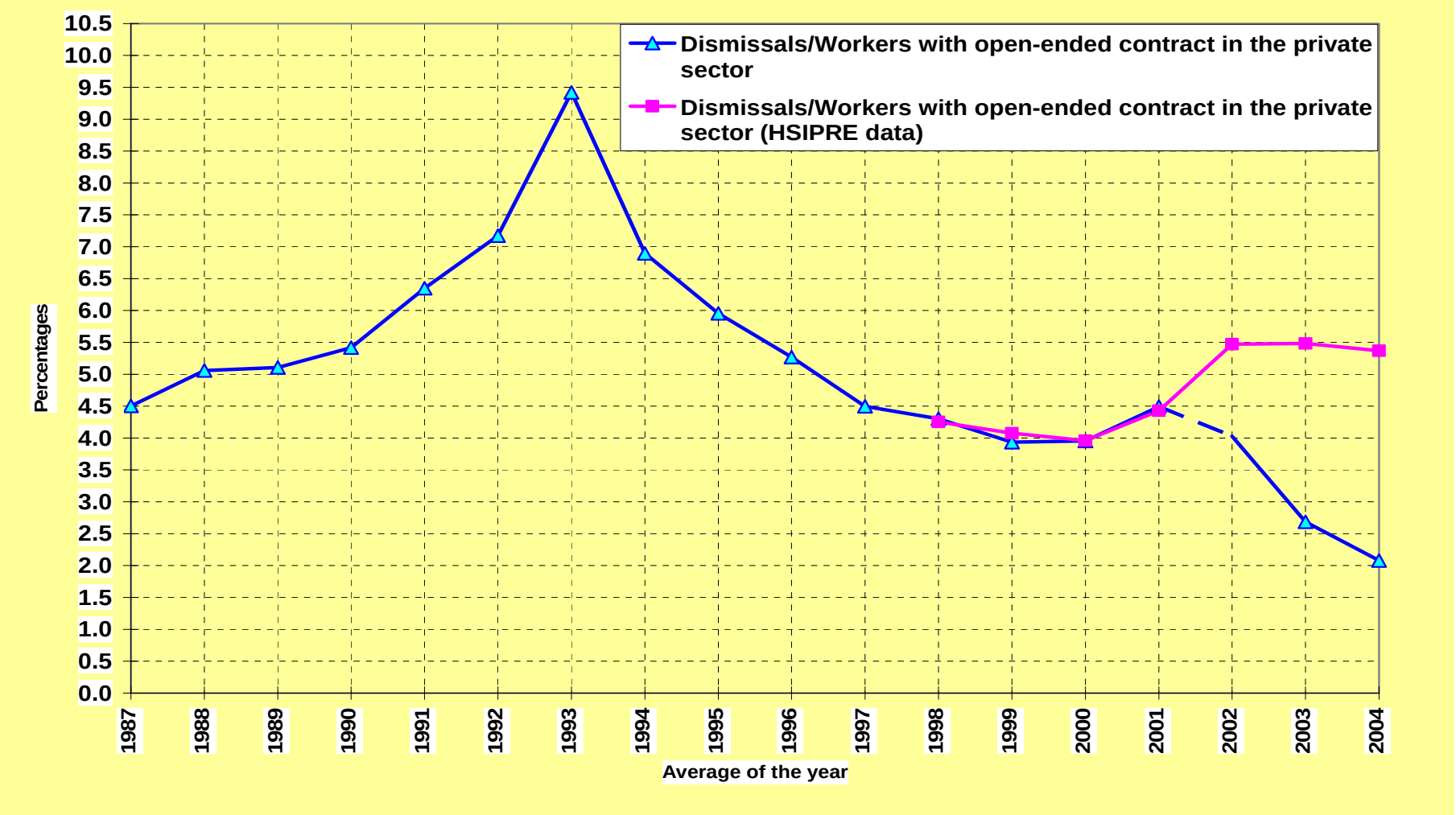
Dismissals/Workers with open-ended contract in the private sector
Dismissals/Workers with open-ended contract in the private sector (HSIPRE data)
Percentages
10.5
10.0
9.5
9.0
8.5
8.0
7.5
7.0
6.5
6.0
5.5
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
Average of the year

Figure 1.

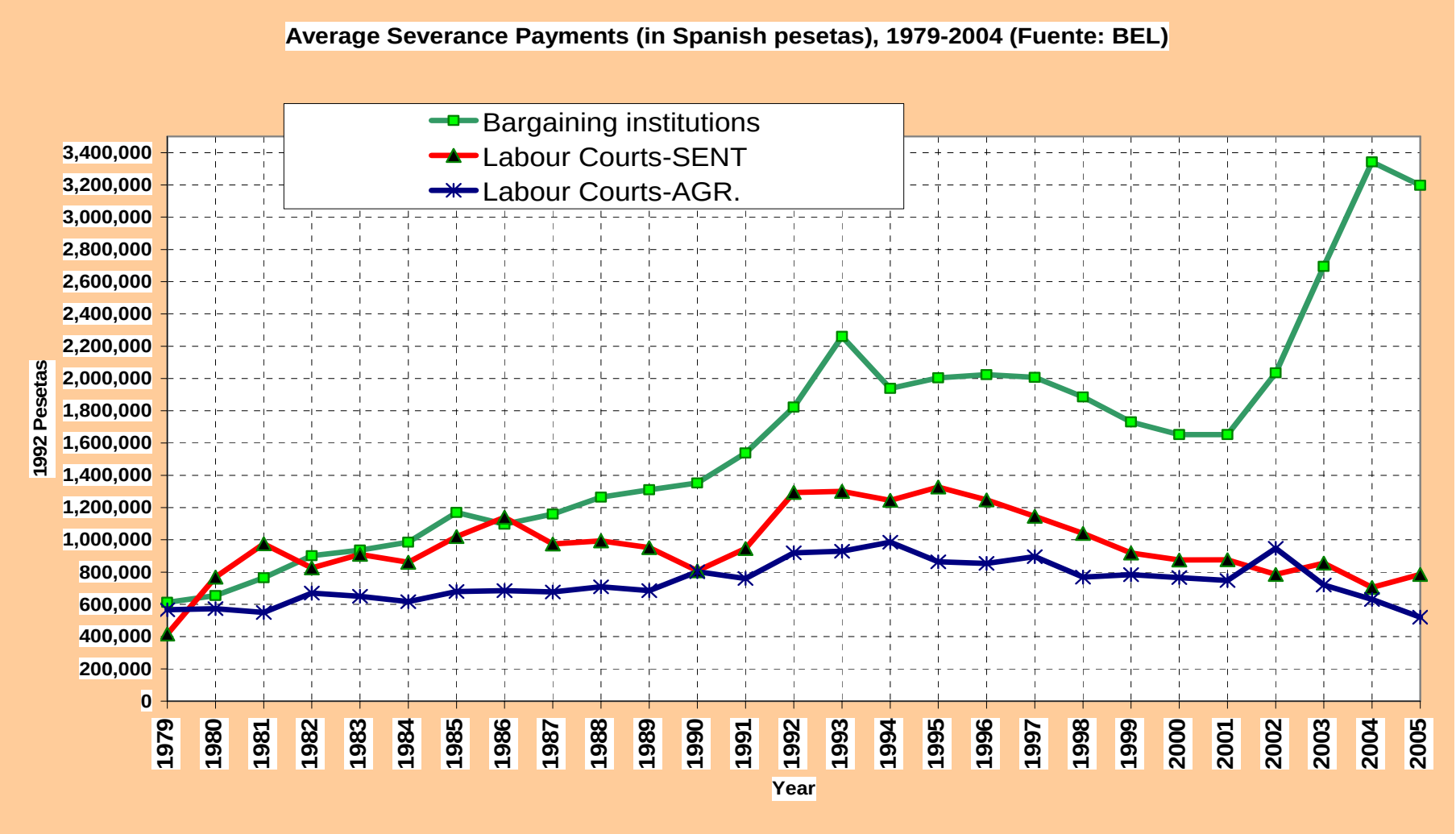
Average Severance Payments (in Spanish pesetas), 1979-2004 (Fuente: BEL)
Bargaining institutions
Labour Courts-SENT
Labour Courts-AGR.
1992 Pesetas
3,400,000
3,200,000
3,000,000
2,800,000
2,600,000
2,400,000
2,200,000
2,000,000
1,800,000
1,600,000
1,400,000
1,200,000
1,000,000
800,000
600,000
400,000
200,000
0
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
Year

Figure 2.