



## **The Labor Market Reform in Spain: a brief outline of the Royal Decree-Law 10/2010**

This short paper tries to present a general picture of the recently approved Royal Decree-Law 10/2010 (officially published on June 17<sup>th</sup>: [www.boe.es](http://www.boe.es)). The Decree-Law is a very miscellaneous legal text that amends more than 20 articles of different labor laws, affecting such diverse issues as fixed-term contracts, redundancies, lay-offs, unilateral changes of working conditions, collective agreement opening clauses, employment agencies and temporary work agencies.

Before discussing the content of the reform, it is important to make clear that though the Decree-Law is in force since June 18<sup>th</sup>, it will most likely be changed by the end of this year. What we basically have here is an inconsistency: after the failure of a slowly-paced social dialogue (the Spanish social partners have been bargaining over a labor reform for the last two years), the Cabinet of Ministers compels itself to urgently pass a reform without hammering out the political support needed to obtain the majority vote in the Parliament. Thus, what we all know is that the current reform will be transformed by the Parliament, whose legislative action is already in motion in order to conclude as soon as possible, but definitely not before September. For most employers this is an open invitation to stay still until the definite legislative text is in force.

Two are the main problems this reform is trying to tackle. The first one is structural; it has been with us for decades: a persistent two-tiered employment system. The second problem, an old companion of the Spanish economy, has just come back with the current crisis: high unemployment, especially among the young people. (The worst part of it is that many of these young people dropped out attracted by the decade-long boom of the construction industry. Some measures of the reform are intended to deal with this acute problem.)

### **1. Making fixed-term contracts less attractive to companies**

The two-tiered employment system was born in the eighties of the last century, when fixed-term contracts were more or less liberalized as a response to persistent unemployment. This situation contrasted with a rigid regulation both of internal flexibility and of the proper motives for redundancy and dismissal of permanent employees. Therefore, as a result of the reforms of the 1980s, employers understood flexibility mainly as numerical flexibility, which they obtained not by making permanent



employees redundant, but preferably by the employment/termination of temporary or fixed-term employees. The high level of fixed-term employment in Spain (at approximately 30 percent of total employment) is said to be one of the causes for low investment in training by companies. Though in the last 15 years several legislative reforms (especially that of 1997) tried to address this problem of the dual labor market, the result has been insignificant.

Generally speaking, employers may choose between fixed-term contracts or contracts for an indefinite duration. Though fixed-term contracts may be entered into only under certain circumstances defined by the law (it all boils down to attesting the existence of a cause of temporality: substitution of an employee, definite and temporal task, etc.), the practice during the last two decades has proved that employers have interpreted those circumstances very broadly. Neither unions nor employees have been able to effectively fight against this broad interpretation. Action taken by the labor inspectorate or by employees before the courts has not been effective either.

Now the Government proposes a number of measures that intend (a) to make fixed-term contracts less attractive to employers and, correspondingly, (b) to attain more flexibility regarding permanent employees. The implicit trade-off is therefore: fixed-term contracts will be more rigid, permanent employment will be more flexible as to changing working conditions or even as to making employees redundant.

Type (a) measures are the following:

- (1) An increase in the severance payout for fixed-term employees: from current 8 to future 12 days' worth of salary per year worked. As we will see below, redundancy payments are the same amount (taking into account the public subsidy) for permanent employees. Thus the reform equalizes the cost of terminating a fixed-term and a permanent contract (provided in the latter case that the company has a proper motive for redundancy; otherwise the cost may raise to 33 or 45 days' worth of salary per year worked). The problem about this measure is that the increase will not be immediately implemented: the 12-day severance payment will apply to fixed-term contracts entered into after the end of 2014. This slow pace is difficult to understand, because the equalization of termination costs of temporary and permanent employees is an important step in the right direction.
- (2) The new law establishes a maximum duration of 3 years for the most popular temporary contract (the contract for a definite task). This duration may be extended by collective agreement up to an additional one year. The impact of this measure in subcontracting, especially in the construction industry, is likely



to be huge. However, if you take into account that severance costs on companies will be the same, no matter if you terminate a fixed-term contract or a permanent contract (with a proper motive for redundancy), the limit may urge companies to prefer permanent contracts that will be terminated (for redundancy) when the task or service ends.

- (3) The new law makes it easier for a temporary employee to attain permanent status where he/she has been working on two or more fixed-term contracts for at least 24 months. As yet, the condition imposed on employees was hard to prove: same job, same employer. From now on, this condition is no longer there, so that a change of job or functions, even of employer in the same group or because of a transfer of undertaking, does not affect the right to become permanent.

Type (b) measures are the following:

- (1) Motives for redundancy are defined in a more liberal way. From now on, it ought to be enough for the company to prove that the intended redundancy or collective dismissal is minimally based on a reasonable ground (economic, organizational, technological or productive). If the business motive is enough, employers may expect to pay just 12 days' worth of salary per year worked. Enlarging the proper motives for redundancy has a direct economic impact on the costs of restructuring the workforce: the employer may reasonably expect to pay each employee made redundant 12 days' salary per year worked, instead of 45 (or 33: see below) days' salary per year worked. However, the precise interpretation of the new legal text rests with the judiciary (for individual redundancies) and with the labor administrations (that must authorize or refuse collective dismissals in case of lack of collective agreement between the company and the employees' representatives). Therefore, the real impact of this new definition will depend to a large extent on how the judges or public administrations will construe it.
- (2) The Spanish Salary Guarantee institution (*Fondo de Garantía Salarial*) will subsidize 40 per cent of the legal redundancy payment, now at 20 days' salary per year worked: the public institution will pay 8 days per year, the company just pays 12 days per year. It is not clear whether the Fondo de Garantía Salarial will also subsidize 8 days' salary per year worked in cases of unfair dismissal: here the legal wording is rather confusing and should be improved by the political parties at the Parliament, since this is a matter of great importance. (The Government's plan is that in 2012 a so-called Capitalization Fund will be in operation; from then on the 8-day-per-year subsidy will be paid not by the



Salary Guarantee institution but by that specific Fund. The Government plans to regulate in the near future the new “Capitalization Fund, the very idea of which comes from Austria’s employee pension fund [*Abfertigung*]. If this new Fund begins to operate in 2012, it will replace the FGS’s role in subsidizing severance payments.)

- (3) If the company does not have a proper motive for redundancy, they should expect to pay the unfair dismissal compensation of 45 days’ worth of salary per year worked. However, since 1997 the law allows companies to enter into permanent contracts that feature a reduced unfair dismissal compensation of 33 days’ worth of salary per year worked. This “special” contract was as yet limited to certain groups in the labor market. Now, the reform almost makes this “special” contract the rule, since it permits companies to hire under this kind of contract almost all people on the unemployment list.
- (4) Some measures of internal restructuring are made easier. Salary opening clauses in branch collective agreements ought to be less demanding in the future, and any company that shows evidence of serious difficulty because of the branch salaries should be able to temporarily avoid paying those high salaries. However, the agreement with the employee representatives continues to be critical.
- (5) The new legal framework for temporary lay-offs is also less rigid, especially when it comes to temporarily reducing working hours. The new law tries to avoid dismissals by making less traumatic adjustments more attractive to employers. Generally, the new law tries to encourage internal flexibility, calling for conciliation and even arbitration of labor disputes concerning geographical mobility, changes in working conditions, etc., with a view to avoiding dismissals and definite redundancies. It is important to insist on the idea that the agreement with the employee representatives is critical for the success of most business demands of internal flexibility.
- (6) The amendments related to geographical mobility and substantial changes procedures are not really significant. The most noticeable of the amendments is the need to submit to conciliation in case of disagreement between the parties that negotiate at company level a substantial change of conditions established in collective agreements. The law also contemplates the possibility that the parties submit their dispute to an arbitration procedure. However, the culture of arbitration is almost nonexistent in Spain.



## **2. Fighting youth unemployment and improving the intermediation services**

Another important part of the reform tries to fight unemployment, especially youth unemployment. As for the special measures aimed at the problematic situation of young people without qualifications, the new law practically removes the social security cost of the apprentice's employment contract: for contracts entered into during 2010 and 2011, the Government will subsidize the social security taxes of both employer and employee. During 2010 and 2011, it will be possible to enter into an apprentice's contract if the employee is younger than 25 (afterwards, the employee must be younger than 21). Employing young people (16-30 years old) with difficult employment outlook on contracts other than the apprentice's is also subsidized by the Government (€800 per year during 3 years).

Other measures to combat unemployment in general concern the intermediation services in the labor market. On the one hand, the new law allows private employment agencies to operate for profit, though they must obtain administrative authorization from the public employment service. On the other hand, the reform amends the law on temporary-work agencies. If the main aim is to implement the Directive 2008/104, a mention should be made to the law's intent of curtailing all restrictions and prohibitions on these temp agencies by the end of 2010.

Last but not least: the way the Government has decided to reform the labor market (by approving a Decree-Law that is in force since the day following its official publication, but that will be changed in the next weeks or months) brings forward uncertainty, definitely not a good thing for the economy. Besides this general uncertainty, some new rules in the reform are too open to interpretation by the judiciary and labor administrations. This is especially the case with the new definition of proper motives for redundancy: if we are dealing with individual redundancies, it will be up to the judges to choose between a strict and a liberal reading of the definition; if we are dealing with collective dismissals, the lack of agreement between company and unions must be solved by an administrative decision: it will be a political decision of 17 Autonomous Communities to pick a liberal or a strict approach to redundancies. This specific uncertainty may impel employers to continue walking the expensive (though certain) way when reducing their workforce: to pay the unfair dismissal compensation (33 or 45 days' worth of salary; or 25 or 37 if you bet that the Fondo de Garantía Salarial will subsidize also unfair dismissals, which is not clear).

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