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Care Crosses de River: the 2012 Spanish Labor Reform

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Abstract: This article provides a complete overview of the 2012 spanish labor reform. In addition, the author explains the reasons for enacting this law, in particular, the financial framework, the high unemployment rates, the low levels of professional qualification, the persistence in our labor market of high rates of temporary employment and the unique pattern of productivity. This paper reflects on this labor market reform and how it entails a true cultural change in the understanding of labor relations for all protagonists (judges, unions, businesses). Moreover, the article examines the measures of internal and external flexibility and the new kind of contract called employment contract of indefinite duration in support of entrepreneurs which aspires to reduce the labor market segmentation. The main argument of the author is that the 2012 reform produces a new model of labor relations characterized by flexibility and decentralization.

Keywords: Labor Reform, Spain, Labor flexibility, Collective bargaining.

I. A Labor Reform in Disconcerting Times

Social concerns are crossing the deep, fast-flowing river of this economic crisis with great difficulty. The current situation's scope and magnitude are hard to appreciate from an immediate perspective, but they clearly extend beyond mere circumstances surmountable in the short term. The particularity of the Spanish economy makes the stage in which we currently find ourselves without doubt one of the harshest, and most uncertain, that our country has ever experienced, paralleled only by the devastating situation of 1929. The high unemployment rates dramatically affecting young workers, the low levels of professional qualification, the persistence in our labor market of high rates of temporary employment, and the unique pattern of productivity, along with a financial framework that is full of uncertainties, demonstrate the seriousness of the current situation and the need to adopt real and effective measures.

Law 3/2012, urgent measures for the reform of the labor market, proposes a decisive reform whose immediate objective is the creation of jobs, which will be a key factor to measure its level of effectiveness in the future. It supposes a true "cultural" change in the understanding of labor relations for all protagonists (judges, unions, businesses, etc.) and understands the small and medium-sized enterprise as the strategic context in which its consequences will be deployed. In short, it is a reform that moves closer to Europe when it comes to defining a model of labor relations that is more flexible, more modern, and more decentralized, but that errs in being somewhat unbalanced by simultaneously affecting all the possible contexts of flexibility resulting from the dynamics of the labor contract: entry, internal or functional, and exit.

Nevertheless, the diagnosis of the situation it intends to tackle is clear. To respond to this situation, the reform offers a range of measures to encourage employability and reinforce a commitment to

the development of effective education policies in a reality such as the Spanish one, with high rates of lack of qualification. The reform, as we have noted, makes the fostering of permanent contracting its fundamental objective, but also the promotion of job creation at any price in a context of open destruction of the same and with a future scenario that is not conducive to optimism. Similarly, there is a firm commitment to measures favoring internal flexibility in the workplace as an alternative to employment "destruction."

Without a doubt, the fact that the 2012 reform continues to follow the path of those reforms made without a social agreement, as in 2010 and 2011, is not a good sign. The result of this failure was the recent general strike on March 29. Nonetheless, in this economic context of concern and uncertainty about the future of our productive system in which the sense of failure of the entire labor relations system is evident, moving forward with reforms is necessary. The dark shadow of intervention has been cast over our devalued economy, and the increasing rate of unemployment obliges all the relevant social and political agents to reflect responsibly in light of this situation. It is probably the time for setting differences aside and building, in a responsible way, a joint solution to this crisis that will undoubtedly have consequences for the future, not only for our labor market, but also for our prevailing social model.

II. Measures to Favor Employability

A first line of action of the reform makes employability and education as the main pillars on which the restructuring of our current productive model will be built. Employability, which may be defined as the capacity to take advantage of one's knowledge and abilities, has two dimensions, one internal and another external: the first refers to the capacity for adjustment of the person with respect to his organization; the second increases the value of the individual in the job market, increasing his capacity for personal and professional fulfillment. The reform is intended to address both dimensions. The labor reform regards education as a fundamental instrument to favor employment and a necessary mechanism to gradually support the changes that must be executed in our obsolete productive model. This explains why, throughout its text, there are continuous references to educational requirements as part of the definition of the legal regime defined for a variety of institutions (economic incentives, objective and collective layoffs, etc.).

1. Employability as Objective and Education as Center of Gravity

This conception, which makes education a basic pillar of contract dynamics, is based upon the recognition of promotion and training at work as a basic labor right, including that which is intended for adaptation to modifications in the nature of the job, as well as those actions meant to favor employability [art. 4.2 b) and 23.1 ET]. Professional retraining also becomes a response to the introduction of technical changes —technological innovations in particular—, and the modification of organizational structures deriving from such efforts to modernize the productive structure of the business. The regulation still needs future statutory developments that would define the new, albeit insufficiently precise figures of the "training account," which is associated with the Social Security registration number and where the training received by the worker throughout her professional career will be recorded (art. 26. 10 LE) [Final Clause 2 Law 3/2012], or, upon prior consulting with the worker representatives, the training check intended to finance the worker's individual right to training (Final Clause 3 Law 3/2012).

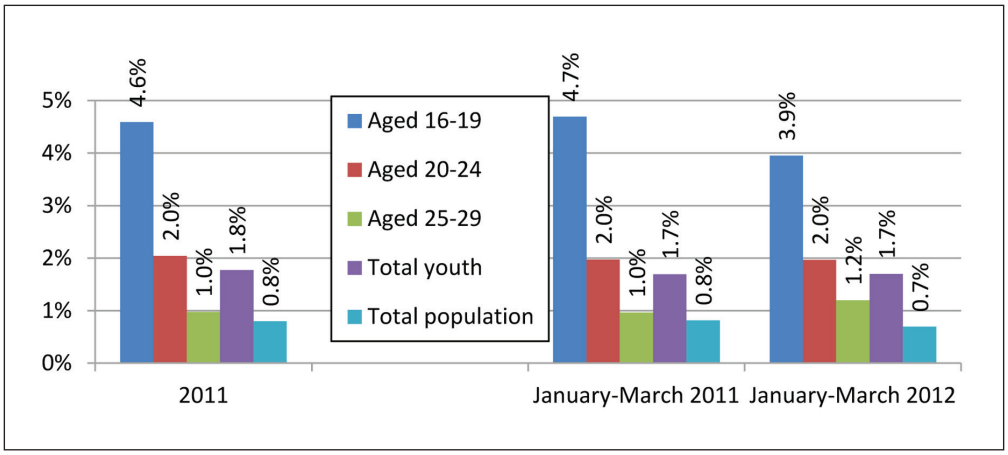
Training leave is, without a doubt, one of the most significant innovations. It provides workers with seniority of at least one year the right to paid training leave of 20 hours per year for training related to the company's activity. This leave may be accrued during a period of up to 5 years; its details will be arranged through mutual agreement between employers and workers whenever the issue is not specified in a collective agreement.

1.2. Persevering in the (Failed) Reform of Training Contracts

There is no need to be reminded of the curse of youth unemployment in our country. Spain is the country in Europe with the highest youth unemployment rate, affecting more than 45% of the economically active population, and surpassing countries like Austria, Germany, and Holland (with rates around 5%) by more than 40 points, placing us with rates close to those in Estonia, Lithuania, and Greece (which hover around 37%). The Spanish youth unemployment rate is three times greater than that of Denmark's, four-and-a-half times that of Germany, five times that of Austria and Holland, and 18 points higher than France. Data from the survey of the Economically Active Population suggest that unemployment is concentrated among those young adults with limited education, many of them, with only Primary Education completed. 31.2% of the population younger than 24 years old has not completed compulsory secondary education, which makes us the third highest country in school failure, doubling the average in Europe. The high percentage of young people who drop out prematurely continues to increase, in contrast to a decreasing tendency in most of the member states of the European Union.

One of the measures adopted to favor the insertion of young people has been the so-called training contracts. Despite the numerous reforms that these contracts have experienced throughout the last years, the results remain frustrating. The reforms adopted by Law 35/2010 in the contract for training and in apprenticeships looked to increase training opportunities for workers but only resulted in greater rigidness in the use of this contract. The Royal Decree-Law 10/2011 created, a few months later, a new contract type that led to the reemergence of the classic concept of apprenticeship: the contract for training and apprenticeship. Its objective is to increase employment among youth lacking education, going beyond the present contract for training through the simplification of the complex regulation that rendered it, as we have seen, seldom used in practice. Results remained discouraging according to the statistics (Figure 1).

Figure 1. Percentage of Training Contracts over Total of First Employment Contracts (excluding conversions to contracts of indefinite duration)



Source: Personal compilation based on the National Public Employment Service data

Law 3/2012 modifies, for the fourth time in less than two years, the training and learning contracts. The labor reform persists in the mistake of maintaining the existing contract type, incorporating different modifications that attempt to encourage its use: its minimum duration is decreased, and it can be extended and succeeded by other contracts of the same kind as long as they are linked to the achievement of a different professional qualification. The maximum percentages of effective working

time are set so that effective working time may not exceed 75% during the first year or 85% during the second and third years. The location of training is made more flexible by allowing the worker to receive the training at the workplace when it has the appropriate facilities and personnel for the purposes of the accreditation of the particular competence or professional qualification under the terms contemplated by the Organic Law 5/2002, "without affecting the requirement, if applicable, of carrying out complementary training periods in the training centers of the above mentioned network" (art. 11.2d ET).

As a provisional rule, using an entirely new technique in our legislation, it is established that, until the unemployment rate falls below 15%, training and learning contracts can continue to be offered to workers under 30 years of age (Transitory Disposition 9 Law 3/2012). The raison d'être of this measure is to be found, among other reasons, in the negative effects produced by the expansion of the construction sector. The development of the sector was characterized by a demand for low qualification jobs, especially those of manual labor (non-qualified workers, installation workers, and qualified manual workers), which represented almost 90% of the total. This demand encouraged, in many cases, premature drop-outs from the education system, with the result that, today, many of these workers find themselves unemployed and unqualified.

1.3. The Elimination (as a Rule) of Economic Incentives for Employment Development

With regard to hiring incentives, as has been noted repeatedly in the past, the current heterogeneity and range of groups for whom employment is encouraged contribute very little to the incentives' effectiveness and generates unfair competition among firms. Moreover, the current scheme of incentives is aimed at the promotion of permanent employment contracts instead of job creation or continuity, whatever the nature of the contract, objectives that should prevail in the current situation. Lastly, the different incentives programs for employment development have traditionally been characterized by their dispersal —a complicated set of regulations resulting from the accumulation of programs, each with its own incentive techniques, with different objectives and target groups, and with completely different conceptions of the employment policy.

The Transitory Disposition 6th Royal Decree-Law 20/2012, of July 13th, measures guaranteeing budgetary stability and promoting competitiveness, has in general eliminated the right of companies to receive Social Security reductions for hiring, maintaining employment or encouraging self-employment, when the Royal Decree-Law went into effect "in virtue of any norm, valid or repealed, under which they were established." The aforementioned rule provides an exception to a series of groups with special difficulties in gaining access to the labor market. These include the handicapped; people who have been officially recognized as victims of gender-based violence, domestic abuse, or terrorism; or, in short, workers suffering from social exclusion.

1.4. Temporary Employment Agencies as Global Employment Agencies

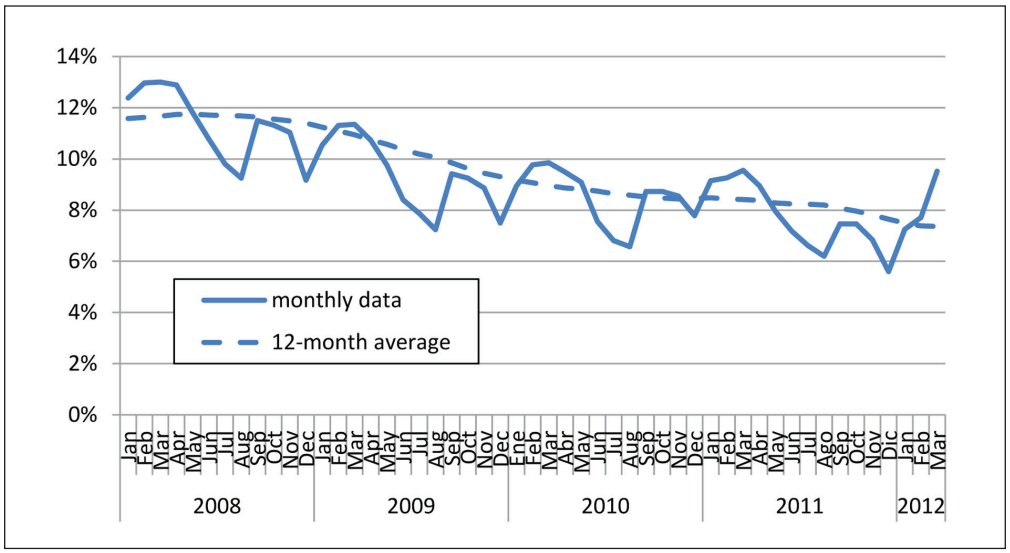
The inadequacy of the public employment systems to face new demands is a reality: among the slightly more than 14.5 million job placements that took place in Spain last year, only 360,000 occurred through the National Public Employment Service (2.5% of the total). The labor reform considers Temporary Employment Agencies as another institutional tool that may facilitate mediation in the job market. The experience, professionalism, geographical spread, and infrastructures that Temporary Employment Agencies currently possess may be, in this way, taken advantage of by the Public Employment Services during such important times for the management of labor market supply and demand. To this end, Temporary Employment Agencies are evolving toward a figure known in comparative law as Global Employment Agencies, entities exclusively authorized for the three-way relationship of legally and temporarily assigning workers, but also authorized to carry out recruitment, orientation, and training activities for any type of contract.

Temporary employment agencies may act as employment services as long as they receive the corresponding administrative authorization. In any case, when temporary job agencies act as employment services, they will need to adapt themselves to the regulations of the latter, including the obligation of guaranteeing the cost-free provision of services to workers.

III. Promoting Permanent Contracting and Other Measures Favoring Job Creation

The data on permanent contracting in our country are truly worrisome, for they remain less than 10% of the total number of signed contracts; a percentage that, with some isolated cases of variation, has constituted the general tendency of employment in Spain. With respect to the weight of employment contracts of indefinite duration, in the historic series (since 2002), more than 90% of the monthly figures reveal permanent contracting rates of between 7% and 13%. Indeed, the evolution of permanent hiring has been continuously decreasing since the start of the crisis. It is, therefore, not possible to assert that the measures introduced by the preceding reforms to decrease labor market segmentation by contract type have had any particular effect (as observed in Figure 2).

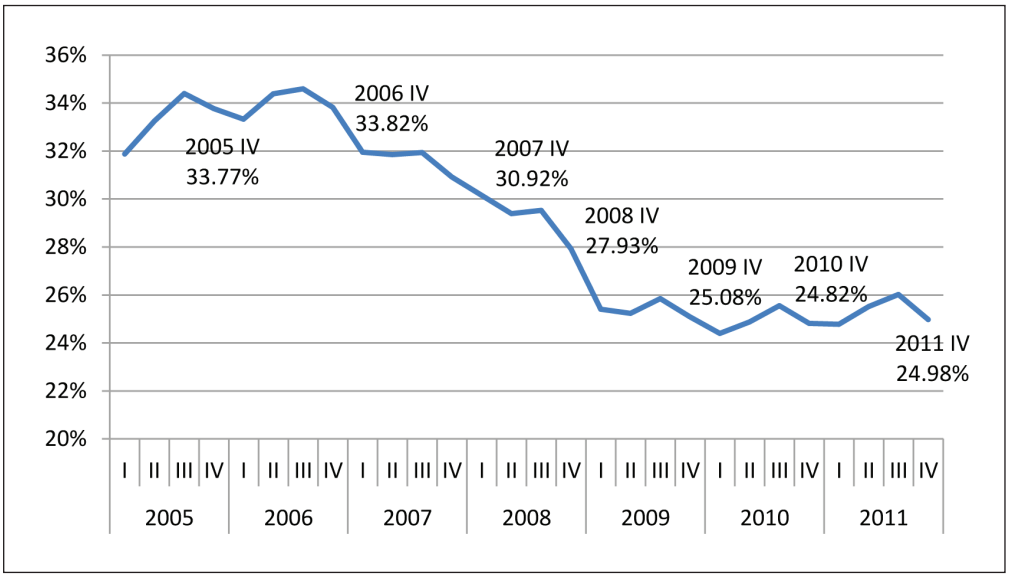
Figure 2. Percentage of Contracts of Indefinite Duration Signed (including conversions from other contracting categories).



Source: Personal compilation based on the National Public Employment Service data.

The current reform does not, however, provide a thorough readjustment of the system of temporary employment contracts (something that had been requested by employers), but instead keeps its structural definition intact. Temporary employment continues to hold an important role in the structure of our job market, so that approximately one in every four wage earners has a relationship of fixed duration with his company (Figure 3). The desire and need to keep all possible options for job creation available have probably influenced the decision not to reduce the number of existing temporary employment contracts in practice (although it eliminates the contract for the promotion of permanent contracts), while committing to a model of employment contract of indefinite duration —the contract for the support of entrepreneurs— which is intended to become the main contract model and provide an alternative to the controversial "single contract" proposal that caused a huge storm during the previous years.

Figure 3. Rate of Temporariness



Source: Economically Active Population Survey

1. Employment Contract of Indefinite Duration in Support of Entrepreneurs

Companies employing less than 50 workers may offer a new contract called the "employment contract of indefinite duration in support of entrepreneurs." The contract can be signed for an indefinite term and a full-time position, using a pre-established contract model. The contract's legal framework and the rights and obligations resulting from it will be governed, in general, by what has been stipulated in the ET (Workers' Statute) and the relevant collective bargaining agreement for indefinite-term contracts. The sole exception lies in the length of the probation period, referred to by art. 14 ET (which will be of "one year regardless"). The validity of this contract modality will be effective until the unemployment rate falls below 15% (Transitory Disposition 9.2 Law 3/2012).

The regulation excludes part-time positions, which is in some sense contradictory with the law's Explanatory Statement for this contract modality. The contract is exclusively aimed at companies with less than 50 workers. SMEs represent 99% of Spanish businesses, while social security data (Ministry of Employment and Social Security) indicate that 42% of workers are employed by companies with less than 50 workers, and 59% by companies with less than 250. The question that must thus be asked, given the fundamental role the Legislator has assigned to this contract modality, is whether this legal option should be extended to all businesses, regardless of their size. Should this contract type be generalized to all firms, access to the associated subsidies and reductions in social security contributions could be restricted.

Nonetheless, the application of the regulation raises some questions: What is the relevant unit to define the application of this contract: company or workplace? Does it apply to a group of companies? Who counts as a worker? The regulation forbids the use of this contract modality whenever there have been prior layoffs ("the company that, during the six months prior to the contract celebration, had adopted non-causal layoff decisions"). In any case, the regulation provides an amnesty for terminations that took place before the Law 3/2012 became effective, limiting the prohibition to firms where non-causal layoffs have taken place subsequent to the Law.

However, the issue that raises most doubts has to do with the length of the probation period to which art. 14 ET refers, which will be of "one year in any circumstances." Doubts immediately follow the interpretation of this precept, and the most significant one is whether said period is contradictory with respect to the Council Directive 99/70/EC or the Convention 158 ILO that imposes a "reasonable-

ness" requirement on the length of the probation period (art. 2.2 d). One recalls the conclusion of the decision of the High Court on July 20, 2011 regarding this point: "compliance with a one-year probation period is, by any reckoning, excessive, for the objective of the probation may be more than satisfied during a more reduced time period." It would have been less problematic to make this contract conditional with respect to a "minimum service time" as its aim is to allow the company to verify the job's viability and sustainability, and not, as in this case, to put the worker to the test. The experience of the French "*contrat nouvelles embauches*" [for an indefinite period for companies with up to 25 workers, 2-year period for job consolidation (early notice and indemnization (8% of the salary)], which was accepted by the Council of State, questioned by the Court of Cassation for going against ILO Convention 158, and considered by the ILO as contrary to the mentioned Convention for establishing a non-reasonable probation period, may be a good comparison for the legislator and an incentive to create new foundations for this contract. One possible option could have been the establishment of a system of increasing indemnizations based on seniority.

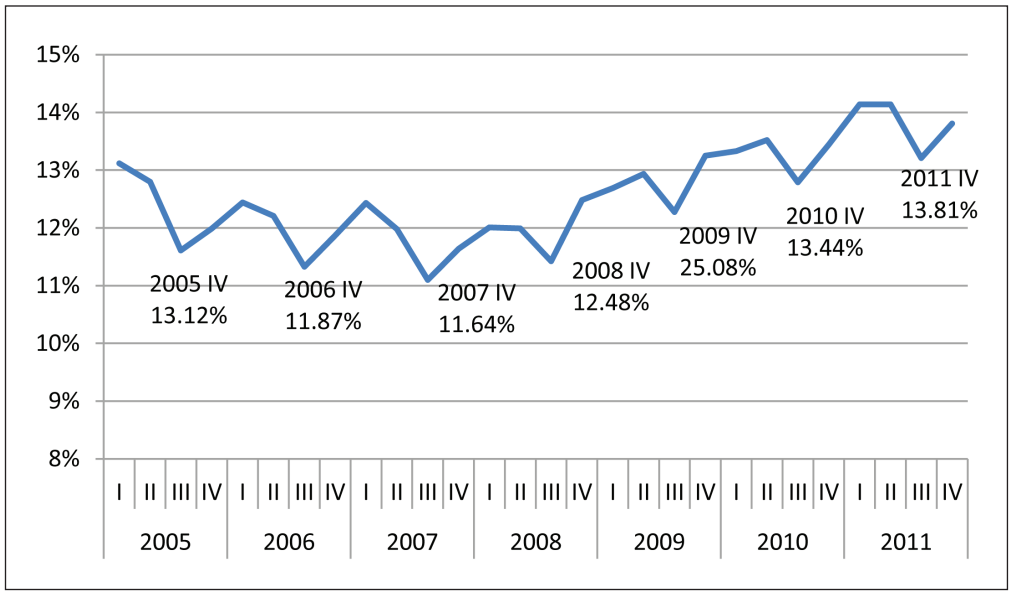
The contract in support of entrepreneurs is accompanied by a considerable number of incentives as long as the employer commits himself to secure employment in his company in accordance with the legal terms (art. 4.7 Law 3/2012 and art. 43 Law on Corporate Income Tax). To that effect, reductions are offered in the firm's Social Security contributions for the hiring of young adults between 16 and 30 years old, as well as of people older than 45 years old. However, the main tax incentives offered for this contract consist of a reduction in an amount equal to 50% of the worker's pending unemployment benefits at the time of hiring, with a limit of 12 installments. The hired worker who is eligible for unemployment benefits (based on prior contributions) will be able to receive each month, along with his or her salary, 25% of the amount of the said benefits that have been both recognized and are pending for payment at the time of hiring for up to 12 months. The aim of the system of unemployment protection becomes two-fold: to save the State costs and to promote employment. Contributory unemployment benefits involve a higher cost than non-contributory benefits; their quantity is higher because they are structured according to the principle of contribution. With this measure, the amount that the State had planned to spend in unemployment would be invested instead in the tax reduction for the employer (50% of the total), and, if applicable, in the improvement of the salary (25% of the total), with remainder being saved. The underlying argument is that it is always preferable to promote employment rather than to preserve unemployment.

2.2. Part-Time Employment: A Still Pending Reform

Reform of the part-time employment contract continues to be a pending issue, given the limited use of this modality in comparison with other European countries. The slight increase in the use of this contract observed in the last few years (Figure 4) has failed to encourage the Legislator to promote it more clearly openly. Law 3/2012, despite the declaration of intentions in its Preamble (stating that "part-time jobs constitute one of the unresolved matters of our job market"), limits changes in this modality to allowing for overtime for part-time workers. The purpose of this change is to found in the objective of making the currently existing framework on overtime more flexible. In any case, the sum of standard, additional and overtime hours may not exceed the legal limit of part-time jobs as defined on art. 12.1 ET, and overtime under a part-time employment contract will be taken into account for the purposes of establishing rates for Social Security contributions and the pension-related benefits. Still, the incorporation of this change raises numerous doubts that do not always have easy solutions.

Without the need of introducing in our country the questionable German mini and midi jobs (according to the data from the Federal Employment Agency, these represented 7.3 millions in June 2011), the part-time model should be simplified, which would, no doubt, be very useful when it comes to generalizing its use. Regulation of the part-time employment contract should avoid excessive complexity, reduce legal insecurity in the management the contract, and address problems of rigidity in work organization. The re-elaboration of this contract type could involve the development of a "flexisecurity" part-time employment contract. This contract could be based on the reinforcement of the flexibility of rules

Figure 4. Rate of Part-Time Jobs.



Source: Economically Active Population Survey.

regarding working time organization according to the company's needs while centering its attention on the employment of the young, albeit subject to a reinforced framework of social protection to avoid the possibility of workers being penalized in the course of building a secure career.

2.3. Shortening the Suspension of Limitations on Repeated Temporary Contracting

Royal Decree-Law 10/2011, August 26 (art. 5, which has been redrafted) suspended the limitation on repeated temporary contracting contemplated by art. 15.5 ET for two years (August 31, 2011/August 31, 2013). This suspension is shortened by Law 3/2012, setting December 31 of the present year as the deadline for the above-mentioned suspension. This suspension leaves without application the requirement automatically changing to permanent status those workers who, in a period of 30 months, have been employed for more than 2 years (24 months), with or without continuity, for the same or different job, with the same company or group of companies, by means of two or more contracts of temporary duration.

2.4. The New Telecommuting Contract

Telecommuting is gradually prevailing in our country and in other advanced countries, especially so in times of crisis. For the first time in Spain, the reform legally regulates what is defined as "remote jobs," commonly known as telecommuting. It is true that the 2002 European Framework Agreement on telecommuting had already been annexed to the 2003 Inter-confederation Agreement for Collective Bargaining (ANC). However, there were no previous statutory provisions, and the ANC only had a compulsory effectiveness, for which, as the decision of the High Court on April 11, 2005 highlighted, the European Framework Agreement had not been incorporated into the Spanish Law. With the new denomination of "remote jobs," the new art. 13 ET leaves behind the well-known "home-based jobs," thus opening the way to a detailed regulation of telecommuting as a form of organizing and/or undertaking a job that makes use of information technologies to regularly carry out, within an employment relationship, the provision of services outside of the company's premises.

In line with the fact that telecommuting should be voluntary for the worker and employer, and, therefore, may be specified at the time of hiring or later, art. 13.2 ET establishes that in any of the cases

where a remote job is agreed upon and formalized on paper, the rules regarding the basic copy of the contract will be applicable, as contemplated by art. 8.3 ET. These remote workers will have the same rights as those who provide their services on-site at the company, with a special mention of their right to at least receive the total payment established according to their professional group and position, and adequate protection in terms of security and health. They will be able to exercise their rights to collective representation in compliance with the law, to which end they must be assigned to a specific company workplace. The employer will guarantee their effective access to on-going training and inform them about the existence of vacant, on-site positions at the company.

IV. Measures to Favor More Internal Flexibility at Companies as an Alternative to Job "Destruction"

Our regulatory framework has brought about a very high rate of precarious employment and limited permanent hiring. As a result, there has been less adaptation to new financial circumstances through internal flexibility measures that have been much more developed in other countries (adaptation of working days, salary, functional mobility, etc.). The Preamble or Explanatory Statement of the Law mentions and includes the "scarce development of possibilities for internal flexibility at companies that the current legislation offers" among the "weaknesses of our labor relations model"; a model whose "financially and socially unsustainable nature" has been "demonstrated" by the financial crisis. For the Explanatory Statement, the "general objective" of chapter II of Law 3/2012 is "to set up instruments that allow businesses to improve their competitiveness, safeguarding the rights of workers and specifically making it easier for them to keep their jobs." The development of measures favoring internal flexibility constitutes a guarantee for job protection and an instrument favoring employability. The aim of the reform is clear, and the heading introducing these measures conceives internal flexibility at companies as an alternative to job "destruction."

1. Preference for the Professional Group and Functional Mobility

The outdated definition of the professional classification system based on professional categories constitutes a clear factor in our system's rigidity. Until now, collective bargaining had maintained a dual model in which, on the one hand, there was the so-called "classic" model, defined as a reference to the content of the main tasks of each professional category, and, on the other, the so-called "modern" one, in which different professional groups were defined according to the knowledge, level of autonomy, ranking, or complexity of the tasks carried out by each professional group. The labor reform's preference is clear: professional classification must be exclusively based on the professional group (art. 22 ET). This option sweeps the reference to professional categories defining in a more precise manner the concept of group as that which includes "the different tasks, functions, professional specializations or responsibilities assigned to the worker." This categorical preference is intended to materialize itself immediately by establishing that collective agreements have one year to adapt their system of professional classification to the new drafting of art. 22 ET (Additional Clause 9th Law 3/2012). Nevertheless, the effectiveness of the regulation may be, for obvious reasons, more symbolic than real.

The regulation intends to provide companies with a greater employee mobility to carry out functions in other jobs before proceeding to layoffs. As noted, the professional group becomes the axis of functional mobility in a line that has been accepted by the social partners themselves during the 2012-2014 2nd Agreement for Employment and Collective Negotiation. This agreement expressly stipulated that a "professional category will not be considered for reasons of functional mobility" and that collective agreements should specify the "adaptation procedures in case of still being governed by professional categories." The labor reform makes this framework more flexible by eliminating the reference to functional mobility being carried out "without prejudice to (the) professional training and promotion" of the worker, as well as to the assignment of lower functions to resolve "*urgent and unpredictable needs of production*" (former, art. 39.2 ET). The need, however, to "*communicate the decision*" and its "*reasons*" at all times is established.

2. Legal Attribution of Unilateral Competence for Irregular Distribution of Working Hours to Employers

The intention of opting for the irregular distribution of the work day as a mechanism of internal flexibility is clear. Art. 34.2 ET points out that: "*Through collective agreement or, failing that, through agreement between the company and the workers' representatives, it will be possible to establish the irregular distribution of working hours throughout the year. If this is not possible, the company will be allowed to irregularly distribute ten percent of the working hours throughout the year. This distribution shall respect the minimum daily and weekly resting periods at all times, in accordance with the Law, and as a result of the same, the worker shall be notified of the work day and time with a minimum five-day prior notice.*" The norm allows the employer to freely manage an annual percentage of irregular distribution set at 10% (around 160 hours annually), although this right is contingent on prior notice to the worker, thus avoiding the possibility for an employer to demand immediate availability for work. This clearly represents a stronger protection of the interests of the worker facing this type of modifications in the structure of his working hours.

3. Substantial Modifications as Engine of Internal Flexibility

As we have been pointing out, our system of labor relations suffers from a notable rigidity that complicates efforts to respond to situations of contract crises through internal flexibility tools. However, a frequently used tool at companies that is meant to achieve the required adjustment between company needs and the employment relationship may be found in substantial modifications of working conditions in the event of economic, technical, organizational, or productive reasons justifying the changes. The labor reform has introduced important changes in the legal framework with the aim to facilitate the use of these modifications.

Even though the causal assumptions required for substantial modification remain (economic, technical, organizational or productive), there is an evident softening of the connection of causality or reasonableness. The labor reform eliminates the abovementioned demand requiring that "the adoption of the proposed measures contribute to the prevention of a negative development of the company or to improve the situation or perspectives of the same through a more appropriate organization of its resources, favoring its competitive market position or a better response to the market's demands." The Legislator has clearly opted to focus the measure's control, solely and exclusively, on the existence of causality without the need for a complementary judgment of proportionality, meaning that in order to resort to a substantial modification, it will only be necessary to justify economic, technical, organizational, or productive reasons related to "the competitiveness, productivity, or technical or work organization at the company." The employer is thus given broad leeway in the use of this measure as a regular tool of business management.

One of the thorniest and most difficult issues to specify until the labor reform came into force was whether a substantial modification could directly and immediately affect salary. Until then, the qualitative aspects of the internal distribution of salary, i.e., the compensation system, were a matter subject to modification; whereas that which had a bearing on the quantitative aspects of compensation itself, that is, the total wage amount received by the worker, was unchangeable. Nonetheless, the issue was largely artificial because, as we have already pointed out, in the end, any modification of the compensation system, however small, has repercussions for the monthly amount received by the worker. Following the precedent of different rulings that had fully accepted these effects, the labor reform expressly introduces, under the illustrative list of causes, the "wage amount" as one of the working conditions susceptible to modification. It is obvious that the potential decrease will be limited to the appropriate minimum range established by the collective agreement, which can only be altered by means of the opt-out regulated under article 82.3 ET. The scope of this measure may have important financial consequences in the future. Thus, as has been suggested, it should be kept in place only until the accumulated loss of wage competitiveness with respect to the Euro zone is cancelled out and new coordination mechanisms to avoid salary increases that are excessive with respect to the growth of productivity are established.

The new language provided by Law 3/2012 for art. 41 ET makes a new distinction between individual modifications and collective modifications, thus abandoning the definition that depends on the legal source recognizing working conditions (individual contract or collective bargaining agreement). As in the case for collective layoffs, those modifications exceeding a certain numeric (exactly the same ones as in the case of collective layoffs) threshold are now considered collective, while those that do not surpass the same threshold are considered individual. A collective modification is that which, in a period of 90 days, affects at least: 10 employees at companies with less than 100 workers; 10% of the staff at companies employing between 100 and 300 workers; 30 employees at companies with more than 300 workers. An individual modification is that which, in the established period of reference, does not reach the indicated threshold for collective modifications.

The regulation maintains the preexisting procedural duality. If the substantial modification of working conditions is individual, the employer will need to notify the affected employee and his legal representatives at least 15 days (the deadline used to be 30) prior to becoming effective. The employee's options are limited to acceptance, challenging the change before the labor jurisdiction (art. 138 Social Jurisdiction Act), and contract termination. The increase in the number of causes allowing the modification is significant with respect to the the preceding regulation. From now on, according to the circumstances outlined in paragraphs a), b), c), d), and f) of art. 41.1 ET (all list items except for those relative to the "system of work and performance"), if the employee is affected by the substantial modification, he will have the right to terminate his contract and receive a compensation of 20 days of salary per year of service, prorated monthly for periods under one year and with a maximum of nine months.

In cases of a collective modification, it will require, "without affecting the specific procedures that may be established in collective bargaining," a consultation period with the legal representatives of employees or their ad hoc legal representation ex art. 41.4 ET during a period of no more than 15 days. Mutual agreement will be assumed to demonstrate that the causes are justifiable; such agreements can now only be challenged before the competent jurisdiction for fraud, bad faith, coercion, or abuse of rights in reaching the agreement. In this case, the terms of the execution of the agreed change will be specified by the agreement itself. In the absence of an agreement, the employer shall notify the employees of his decision, and it shall become effective "in the period of seven days following the notification" (art. 41.5 ET).

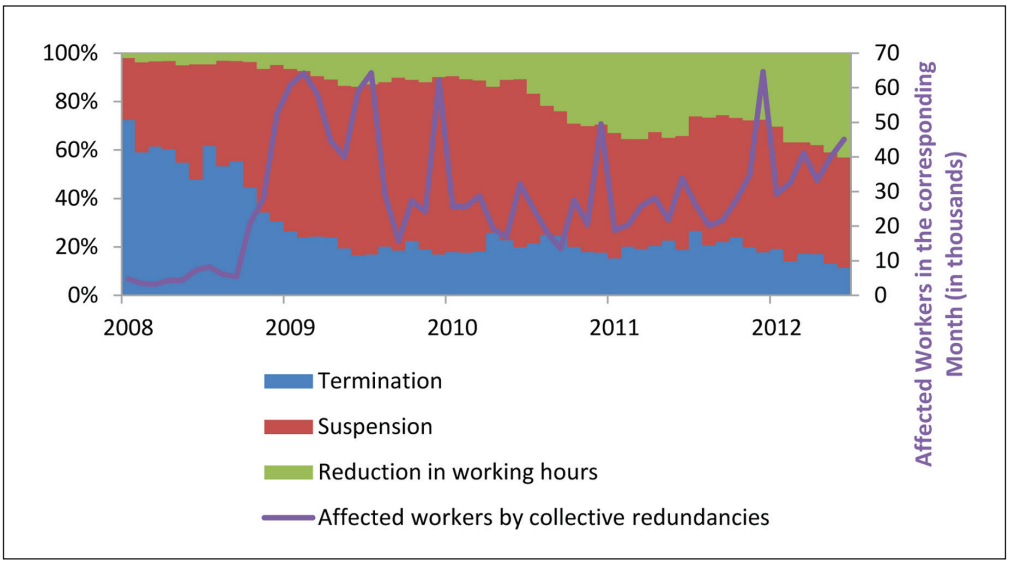
However, the substantial modification of working conditions of art. 41 ET continues to be confined to "the conditions recognized for workers in employment contracts or collective agreements, or the conditions applicable to them by virtue of the employer's decision whose effects have a bearing on groups of workers." The introduction of a quantitative grading criterion in detriment of the preexisting qualitative one now opens the possibility of individually modifying what has been established through a collective agreement, which could raise significant doubts on the possible encumbrance that the right to collective bargaining suffers in this manner, despite the contract validity that the legal system grants to such collective agreements.

Finally, the labor reform does not introduce significant alterations in the system of geographical mobility, limiting itself to applying the relaxation of causes established in art. 41 ET to geographical transfers as a subtype of substantial modifications.

4. Tradition and Reform in the Suspension and Reduction of Working Hours

Our country has successfully followed the steps of the German model with regards to responding to situations of business crisis with suspensions or reductions of working hours. This ordinance, the *Kurzarbeit*, consists in the reduction of ordinary working hours, stemming from a volume decrease of work; a reduction that may be full or partial, and during this period, the worker receives a public subsidy (*Kurzarbeitergeld*). This model, which first appeared with Royal Decree-Law 2/2009, March 6, urgent measures for the maintenance and promotion of employment and the protection of unemployed persons, and has been adapted by subsequent reforms, has provided an important boost to the proceedings for the suspension and reduction of working hours as opposed to terminations (Figure 5), thereby saving an important number of jobs. The 2012 labor reform incorporates this positive tradition

Figure 5: Labor Force Adjustment Plans Authorized and Total of Workers Affected.



Source: Economically Active Population Survey

and continues to support it by extending reductions in Social Security contributions the the common contingencies fund and the subsidizing of unemployment benefits in cases of suspension or reduction of working hours.

In the procedure, established without reference to the precepts for contract termination due to these causes, there is a change in the role of the labor authority, eliminating the requirement of obtaining its authorization, but, nonetheless, maintaining its important intervention and supervision role throughout the same (art. 47 ET). The decision now corresponds to the employer through the applicable legal procedure, regardless of the number of workers at the company and the number of those employees who are affected, during which a consultation period with the employees' legal representatives must be established.

V. Measures Favoring Job Market Efficiency and Reducing Duality

Layoffs are at the epicenter of the seismic zone defined by the institutional framework of labor relations at all times and circumstances. Imbued with this logic, labor market reforms during the last few years have faced the need to permanently adapt their scope and content in order to strengthen the causality of terminations and restrain the continuous evasion of the legal system through formulae such as wrongful dismissals ("express layoffs"). Originally established to dejudicialize layoffs, these express layoffs have become at will terminations. The costs of trials and salaries accrued during proceedings were avoided, thus facilitating and lowering the costs of individual unjust cause dismissals, which, in turn, acted as an incentive for compensated terminations of individual contracts. This allowed for staff reductions outside of art. 51 ET, operating as an indirect mechanism for personnel restructuring. This dynamic completely deformed the entire system, transforming into the rule that which was logically the exception: dismissal on disciplinary grounds.

The Preamble of Law 3/2012 is especially revealing with regard to the executive's motives. The reform's goal is to modify the current situation by increasing the level of legal security in firm restructurings and to shift the system's center of gravity from the dismissal on disciplinary grounds to the natural scenario within a context of crisis: layoffs based on economic, technical, organizational, or productive reasons. The motive of this goal can be found in the additional costs that the disciplinary layoff proceed-

ings entail and in the difficulties firms face in pursuing layoffs for economic causes with with reasonable costs in temporal and financial terms.

1. The Death of the Labor Force Adjustment Procedure and the Automaticity of Causes for Collective Layoffs

The reform of the causality system of layoffs on economic grounds constitutes one of the most significant novelties of this reform. An economic cause for layoff is defined: "when the results of the company stem from a negative economic situation, such as the existence of current or foreseeable losses or the continuous decrease in its ordinary revenues or sales. In any event, it shall be understood that the decrease is continuous if the level of ordinary revenues or sales in each quarter during three consecutive quarters are lower than what was registered during the same quarter in the previous year." The reform of art. 51 ET has eliminated the requirement for the firm to justify with their financial results the reasonability of contract terminations in order to preserve or favor its competitive market position. The objective of the regulation is to allow for companies to directly and automatically associate the volume of their staff to the development of their revenues or sales. It is thus intended to limit the scope of judicial control by not requiring the courts to assess whether the measure is ideal or proportional to the company's situation.

The grounds for this legal objective are clear in accordance with what is set out by the Explanatory Statement of Law 3/2012: "The law now restricts itself to delimiting the economic, technical, organizational, or productive causes justifying these layoffs, eliminating other regulatory references that have been introducing elements of uncertainty. Beyond the specific legal meaning introduced by different reforms since Law 11/1994, […], such references included future projections that are impossible proof, and a conclusive assessment of these layoffs, which has opened the door on many occasions to judgments of opportunity by the courts with regard to the management of the company. It is now clear that judicial control of these layoffs must keep itself to assessing the concurrence of certain facts: the causes."

A second important modification is the elimination of administrative authorization of collective layoffs. This reform puts an end to a long tradition that, until now, had been offering acceptable results manifested in a high number of proceedings that concluded in settlements by mutual consent, albeit with high compensation costs. The change in the logic, which eliminates the value of these settlements, could pose important practical problems, especially if we take into account that the new drafting by Law 3/2012 of art. 124 of the Social Jurisdiction Act allows open contestation, whether or not there is settlement, against "the workers' legal or union representatives."

The regulation incorporates other novelties, such as the so-called mandatory "outplacement," by which companies carrying out a collective layoff affecting more than 50 workers are obliged to offer the affected employees an outplacement plan through authorized placement agencies. Likewise, and in order to make access to early retirement mechanisms more difficult—a general policy objective that is perfectly acceptable—there is a new drafting of the Final Clause 4th of Law 3/2012 to the 16th Additional Clause of Law 27/2011, whereby in collective layoffs involving employees with more than 50 years of age in companies with benefits, the company shall credit the Treasury a quantity established in accordance with the unemployment benefit costs and Social Security contributions made by the Public Employment Service.

Finally, the application of economic, technical, organizational or production causes is now applied to public organisms and entities in order to justify employment contract terminations by means of both collective and objective layoffs, something that had not been accepted by the Courts in the past. For the purposes of the causes for these layoffs in the Public Administration referred to by the Law of Contracts of the Public Sector (for example, the General State Administration, the Autonomous Community Administrations, and the Entities comprising the Local Administration; autonomous organizations, public business entities, Public Universities, State Agencies, etc.), it shall be understood that economic causes concur when an unexpected and persistent situation of budgetary insufficiency arises, thus affecting the financing of the corresponding public services. In any case, it shall be understood that the budgetary insufficiency is persist-

ent if it occurs during three consecutive, three-month periods. Surprisingly, the Law 3/2012 establishes that what is laid out in art. 47 ET shall not be applicable to Public Administrations and entities of public domain that are associated with or dependent upon one or several of them and on other public organisms, except for those that are mainly financed with the income obtained from market operations.

It is important to remember that the Government should have approved within one month from the date that the Royal Decree-Law 3/2012 came into effect the regulations governing proceedings for collective layoffs, contract suspensions, and reductions of working hours to develop what had been laid out in the Law. Until this intervention takes place, the Order ESS/487/2012, of March 8, on the transitory validity of certain articles of the Regulations of proceedings on employment regulation and administrative actions regarding collective redundancies, passed by Royal Decree 801/2011, June 10, has been in place to clarify this situation.

2. Modifications in the Regime of Objective Layoffs: Training and The Battle Against Absenteeism

There are two significant modifications in relation to objective layoffs. In the first case, the polyvalent dimension of training is now present. The Law 3/2012 establishes that the contract may be terminated by the worker's lack of adaptation to the technical modifications made in his job whenever those changes are reasonable. Previously, the employer will have to have offered the worker a course aimed at facilitating adaptation to the new modifications. During this training, the employment contract shall be suspended and the employer shall pay the worker his average salary. The contract's termination cannot be decided by the employer until at least two months from the date the modification was implemented or from the date that the training aimed at the worker's adjustment concluded.

According to employer associations, absenteeism remains a problem of great impact, especially in medium and large-sized enterprises. Once again, the labor reform deals with this historic demand, and modifies art. 52 d) ET. Through the same, it is established that for the calculation of job absences as an objective cause for contract termination, the staff's absenteeism rate will not be taken into account; and thus, it will be enough for the worker to incur in this cause for layoff when, in a 12-month period, his absences from work, justified albeit intermittent, reach 20% of the working days in two consecutive months as long as the total days of absence during this period reach 5% of the working days, or 25% in four discontinuous months within the 12 months mentioned above. Among others, absences resulting from medical treatments of cancer or serious illness shall not count. In relation to the control of absenteeism, in the case of temporary disability, the Law includes the mandate for the Government to study, in 6 months, the modification of the legal regime governing Mutual Insurance Companies "for a more effective management."

3. Lowering Severance Pay and Other Significant Reforms

One of the most heated debates in recent times has precisely been about the termination costs of employment relationships. The current economic crisis has raised many comments on the rigidity of Spanish regulations and high contract termination costs which make it difficult for our labor market to function properly, placing us at a disadvantageous competitive position with respect to our European partners.

The labor reform has significantly lowered severance pay for unfair dismissals: on the one hand, by lowering severance pay to 33 days per year of service, where periods lower than one year are prorated monthly, with a maximum of 24 monthly payments (a reduction that permits the elimination of the employment contract modality for the encouragement of indefinite-term hiring); and, on the other, by eliminating interim back payments, unless the employer decides to readmit the worker. The abovementioned reduction is logically associated with the cause for contract termination, based on the employer's failure to comply by the law in a serious manner, as regulated by art. 50 ET.

However, the effect of freezing severance payments earned prior to the reform established by the 5th Transitory Disposition of Law 3/2012 constitutes a minor effect in the reduction of layoff costs. For those contracts that have been valid prior to the reform, there will be a double calculation: the seniority accumulated before the reform will receive a severance pay of 45 days of salary per year of service, whereas that

accumulated after the reform will have 33 days of salary per year of service. The main limitation of the severance pay amount, which does affect the rights generated in the past, corresponds to the application of maximum amounts. Before, there was a maximum of 42 monthly installments. The new Law establishes 24. The old contracts continue to be subject to a maximum of 720 days. The only exception to this rule shall be when the days applicable to severance pay corresponding to the seniority prior to the labor reform exceeds the 720 days, in which case severance pay will be set to this maximum amount (Table 1).

Table 1. Transitory Disposition Fifth of the Law 3/2012.

	Before 2/12/2012	**After 2/12/2012**
Worker's seniority higher than 720 days	Freezing whatever corresponds to 45 days per year of service, up to 42 monthly installments	No severance pay applicable
Worker's seniority lower than 720 days	Calculated as 45 days per year of service	Continuing to calculate the severance pay as 33 days per year of service, up to 24 monthly installments
Contracts signed after RD-L 3/2012 coming into force	No previous period	33 x up to 24 monthly installments

The reform has eliminated interim back payments in case of wrongful dismissal, except in cases where the employer opts for for readmission or if it concerns a legal representative of workers or a shop steward. If the layoff is of a legal representative of workers or a shop steward, whether he chooses the severance pay or his readmission, he will have the right to interim back payments. An issue that has especially raised controversy is the source of those interim back payments for layoffs that had taken place prior to the reform. Even though there are contradictory judicial rulings, several have considered interim back payments as appropriate by virtue of their compliance with the principle "tempus regit actum;"; and therefore, with the 2nd Transitory Disposition of the Civil Code.

Law 3/2012 has ended what has been known as the "express layoff" (wrongful dismissal, acknowledged as such by the employer) that had become, according to the most recent data, the main channel for the termination of employment contracts of indefinite duration, significantly exceeding collective and objective layoffs in number. According to its Explanatory Statement, the labor reform eliminates it because it "creates insecurity among the employees, for company decisions are probably, and many times, adopted on the grounds of a mere economic computation based on the worker's seniority, and therefore, on the cost of the layoff, independent of other aspects relative to discipline, productivity, or need of the services provided by the worker." The question that remains open is whether, in the future, there will be a resurgence of the "express layoff," considering that the grounds of the new model of collective layoff pose the risk for significant judicialization.

Finally, the labor reform omits any reference to the controversial Austrian Fund, and aware of the budgetary limits of the Wage Guarantee Fund (the Additional Clause 4th Royal Decree-Law 10/2011 included an assessment of the financial situation of the Wage Guarantee Fund), it establishes that this organism reimburse the employer the amount equivalent to eight days of salary per year of service (previously it was 40% of severance pay). Following the Law 3/2012, the abovementioned provision is exclusively limited to terminations of employment contracts of indefinite duration at companies with less than 25 workers, and that have not been legally declared unfair dismissals. The regulation introduces an important and practical detail, declaring that the severance pay corresponding to the worker will be reimbursed to the employer by the Wage Guarantee Fund. Therefore, the organization shall only intervene when the employer has paid the total amount of the severance pay, and it will not be possible to contact the Fund to apply for reimbursement without the prior confirma-

tion that the worker has received the amount due. Additionally, the abovementioned Royal Decree-Law 20/2012 has decreased the amount of benefits paid by the Wage Guarantee Fund, limiting the amount to twice (before, triple) the guaranteed daily minimum wage with a maximum of 120 days (before, 150 days).

VI. Reforms to Collective Bargaining: The Company as New Center of Gravity

The latest reforms on this subject have not reached, or even approached, the desired objectives. The scarce applicative experiences of the last reform, articulated through Royal Decree-Law 7/2011, June 10, urgent measures for the reform of collective bargaining, demonstrated, as will later be confirmed, that it was an incomplete or unfinished reform. It was necessary, therefore, to move forward and suggest new solutions. Law 3/2012 is a strong and solid step toward the renewal of the structure of collective bargaining in our country.

There is no need to remind the reader of the essential role that collective bargaining plays in all the advanced economies. Its economic role, both macro- and micro-economically, is evident, at the same time that it also constitutes the essential backbone of labor relations: their spine and heart. However, precisely for this reason, the host of factors to be taken into account when modifying the regulatory design that supports this negotiation, and the fragile balance on which the same is based, makes any regulatory change a highly complex issue.

1. Full Opt-Outs and the Leading Role of Company Negotiations

Extending the conventional opt-out to issues other than wages has long been demanded by companies as an instrument of internal flexibility that would allow for more flexible management, adapting the more general directives of sectoral negotiations to individual firm conditions. The above claim has been attended to through a new tool established in art. 82.3 ET, whereby the derogation ("*opt-out*") of the collective agreement is no longer limited to the wage system, but extended to working conditions established in the applicable agreement, whether it is sectoral or company-level.

The reform has shaped a practically full opt-out from working conditions with respect to the single issue (salary) that existed previously. The derogation requires an agreement between the company and the workers' legal representatives in order to negotiate a collective agreement in compliance with art. 87.1 ET, following a prior consultation period under the terms of art. 41.4 ET. Finally, for its viability, economic, technical, organizational, or production causes will need to concur. With Law 3/2012, these causes are defined in art. 82.3 ET under the same terms defined in the Royal Decree-Law itself for cases of collective layoffs, from art. 51 ET, and objective layoffs, from art. 52 c) ET. In other words, without prejudice to the fact that the former is an internal flexibility measure whose encouragement is actively sought out, and that the latter is an external flexibility measure. This similarity is only broken in case of the accreditation of economic causes. In this latter case, it occurs by specifying the time frame as "two consecutive three-month periods" in order for the decrease of revenues and sales levels to be considered "persistent," thus defining the cause of the same.

What has been especially controversial is the means articulated to unblock, as a last resort, a possible lack of agreement. For cases in which the derogation of conditions affects company workplaces in more than one Autonomous Community, any of the parties shall be able to take their disagreements, as a last resort, to the National Consultation Commission for Collective Agreements. For other situations, they shall go to the corresponding organs of the Autonomous Community. This solution is not exempt from questions. Doctrinally, it has been pointed out that this mechanism ends up "materially imposing a mandatory arbitration, however much this is camouflaged, once again falling into problems of the unconstitutionality of this type of formulae." Likewise, some political parties have specified that "the reform imposes a mandatory arbitration" by the National Consultation Commission for Collective Agreement when the parties do not reach an agreement. It is clear that, in order for a mandatory

arbitration to exist, a set of exceptional circumstances must concur, as was set out in the Sentence of the Constitutional Court 11/1981, April 8, whereby it proscribed mandatory arbitration, established in art. 25 b) of the Royal Decree-Law of March 4, 1977, based upon the lack of justifiable, concurring elements to restrict the right to bargaining protected in the Constitution by art. 37 EC. All in all, the issue is questionable.

2. "Relative" Supremacy of the Company Agreement

The wording of the new art. 84.2 ET provided by art. 14.3 of Law 3/2012 modifies the existing concurrence rule to reserve the applicative preference of company agreements for certain subjects. The following are the subjects on which the provision sets, under the terms below, the applicative priority of the company level collective bargaining agreement: "*a) Quantity of base salary and complementary salaries, including those linked to the situation and results of the company. b) Payment or compensation for overtime and the specific salary for shift-based work. c) Schedule and distribution of working time, system of shift-based work, and annual planning of vacation time. d) Adaptation of the system of sectoral professional classification to the company level. e) Adaptation of aspects of contract modalities that are attributed by the present Law to company agreements. f) Measures to favor the reconciliation of professional, family, and private life.*" If the legal proposal materializes in our negotiation practices, these reforms should generate more incentives for wage restraint, which, in the mid-term, should result in a greater economic stability and more creation of jobs.

It is important to point out that the establishment of art. 84.2 ET is not an attribution of absolute or unconditional preference for company agreements in relation to the contents established in higher level agreements. Rather, it is a relative preference within the specific subjects that the Law expressly ascribes to company-level agreements where a sector-wide agreement already exists. This means, of course, that for those subjects that are not expressly reserved for the company level, the prohibition of concurrence that is generally admitted in art. 84.1 ET continues to be fully in force, and, consequently, the "applicative ineffectiveness" or "mere inapplicability" of the company agreement that affects or invades a previous agreement reached at a higher level one. Two additional issues must be highlighted. In the first place, concurrence is admitted according to the precise terms that are legally reserved, that is, either through the provision of full competence (letters a), b), c), and f), of art. 84.2 ET, or under the terms of merely adaptive competence (letters d and e) of the same article. In the second place, the exception of competence operates in relation to national, Autonomous Community, and lower level sectoral agreements, which *contrario sensu* prevents the application of this rule whenever there is an intention to negotiate within the company, group, or cross-sectoral unit.

3. The Rule of Ultra-Activity in the Labyrinth

The objective of the reform that will be incorporated in art. 86.3 ET is clear in the Explanatory Statement of Law 3/2012. It aims, "in the first place, to encourage the renegotiation of a collective agreement before its expiration date and without the need to reject the entire agreement, a situation that is sometimes conflictive and does not facilitate a calm and balanced negotiation. But, also, when this solution is not possible, it seeks to avoid a "petrification" of the working conditions agreed in the agreement and excessive delay in its renegotiation through a temporal limitation of two years on the agreement's ultra-activity." Certainly, it makes no sense to preserve the validity of agreements that, due to difficulties of mutual understanding during negotiation or many other causes, continue to be applicable during many more years, thus maintaining in their text working conditions that may be considered "zombies," in many cases oblivious to the legislation currently in force. In other cases, the strategic conducts of the negotiating agents would lead to negotiations that would go on virtually forever, such as the case of the collective agreement for air traffic controllers.

The new legal option has come from the establishment of a specific deadline, after which, if a new agreement is not reached, will render invalid the existing agreement in favor of the relevant sectoral agreement or, in the case that no such agreement exists, the agreement would be invalidated in favor

of the legislation in force. Thus, the important novelty of Law 3/2012 consists in that, "after one year following the rejection of the collective agreement without the reaching of a new agreement or the approval of an arbitration agreement, the agreement shall lose, unless the parties agree otherwise, validity and, if available, the collective agreement of higher level shall be applied, if it exists." The fact that the law accepts pacts that will prevent the application of the law is noteworthy. The real scope of this new measure will need to be assessed based on its future practice, but this exception no doubt raises numerous questions.

The Pros and Cons of the Latest Labour Market Reform in Spain

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Abstract: In this paper, I analyze the main novelties of the new labour market reform approved in Spain in 2012 in relation to the changes that were already introduced in the preceding short-lasting reforms of 2010 and 2011. On the positive side, it is argued that the new reform goes in the right direction in achieving higher internal flexibility as a means of adjustment to business cycle fluctuations. However, on the negative side, it fails to be transformational enough in other relevant areas, like suppressing dualism, improving the effectiveness of active labour market policies, enhancing productivity and maintaining the overall level of social protection of Spanish workers. Given these limitations, it is unlikely that this will be the ultimate reform curing once and for all the Spanish labour market "disease".

Keywords: Labour market reform, dualism, severance pay, political economy, Great Recession.
JEL codes: H29, J23, J38, J41, J64.

I. The negative consequences of a highly dysfunctional labour market

The chronic problems of the Spanish labour market have dramatically reappeared during the Great Recession. Having converged during the preceding long expansionary phase to the EU average of 8% in 2007, the unemployment rate has jumped to 24.4% in 2012q1. Further, it is very likely that it will exceed 25% before the end of 2012, marking the third time since the advent of democracy that such socially unbearable heights have been reached. Besides being astonishingly high, another prominent feature of the Spanish unemployment rate is its extreme volatility relative to other countries. This is illustrated in Figure 1 where it is plotted alongside the French rate, a representative of the Euro Zone (EZ) average. As pointed out by a large body of available evidence, two main institutional factors seem to behind the persistent problems of the Spanish labour market.[1] On the one hand, it is a highly segmented labour market characterized by excessive worker turnover —historically, 33% of employees had a temporary job, and currently 24% still do, even after massive job losses since 2008— and, on the other, it suffers from a rigid collective-bargaining system which prevents the use of internal flexibility as a means of adjustment to shocks.

In effect, the combination of dual Employment Protection Legislation (EPL) and both nominal and real wage rigidities leads to adjustment to negative shocks mostly taking place via dismissals, rather than through wage moderation —like e.g., in the UK— or working time reduction –as e.g., in Germany. During the Great Recession, the increase of 3.5 million unemployed between 2008q1 and 2012q1 has been the result of a 3.0 million job loss (0.76, 1.72, and 0.52 million among permanent, temporary, and self-employed workers, respectively) plus a 0.5 million increase in the labour force (mainly due to large

[1] See, Bentolila *et al*. (2011) for an overview of the relevant literature.

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Figure 1. Harmonized unemployment rates in France and Spain, 1978-2011.

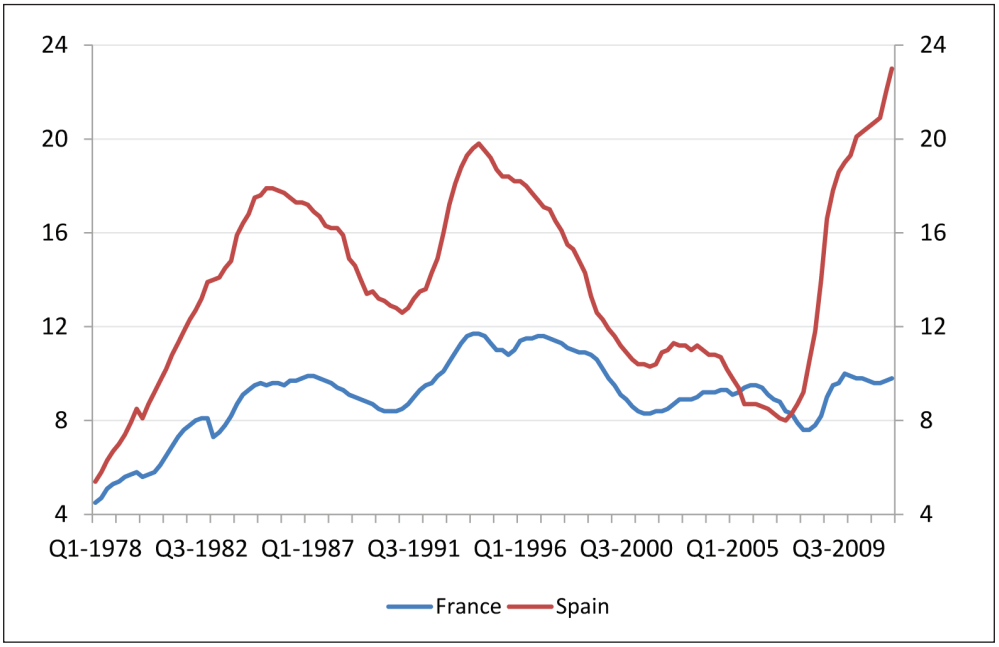
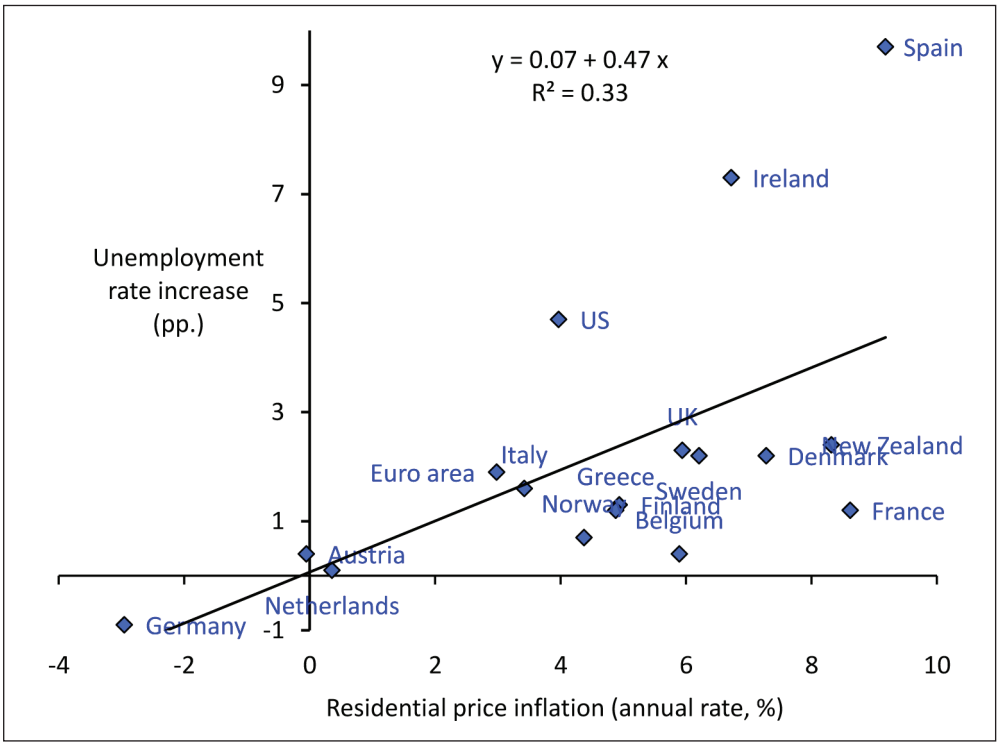


Figure 2. Unemployment rate increase in 2007-09 vs. Residential price inflation in 2000-07.



immigration inflows since 2000, which receded only in 2011).[2] Admittedly, a significant part of the job shedding has been due to the bursting of a big real-estate bubble that started around 2000 and which has given rise to the destruction of 1.5 jobs in the construction sector since 2007. Yet, as shown in Figure 2, this stark response is out of line with what has happened in other countries that have also witnessed booms

[2] See Bentolila *et al.* (2008a) for an analysis of the effects of these large demographic changes on the labour market.

and subsequent busts in this sector, as is the case of Denmark, Ireland or the UK. Despite the fact that Spain's main natural resources —good climate and tourist resorts— call for a higher share of employment in the construction sector (it reached 13.5% in 2007, against 6.8% in 2012q1), the investment boom that took place in this industry —triggered by the large drop in real interest rates as a result of joining the EZ in 1999— is also closely related to Spanish labour market regulations. In effect, rigid labour contracts turn out to be inadequate for specializing in more innovative industries, where labour flexibility is required to accommodate the higher degree of uncertainty typically associated with producing high value-added goods (see Saint-Paul, 1997). Hence, more mature sectors, compatible with the use of less skilled labour through flexible temporary contracts were chosen by Spanish investors. This is clearly illustrated by looking at what happened in Finland, another country which shared with Spain a large fall in real interest rates when accessing the EZ. In contrast to Spain, Finland not only had a much less segmented labour market but also a much more efficient educational system, as has been later confirmed by the well-known PISA studies. While Spain invested heavily in bricks and mortars, Finland did so in IT industries. Moreover, the prevalence of industry-wide collective bargaining agreements in Spain resulted in a slowing down of job creation in high-productivity sectors, while it increased job destruction very significantly when the crisis hit (see Jimeno and Thomas, 2011).

II. A long sequence of ineffective labour market reforms

As explained in Dolado *et al.* (2002) and Bentolila *et al*. (2008b), the Spanish government reacted to the burst in unemployment during the early 1980s by introducing a large gap in EPL between permanent and temporary workers in the two-tier 1984 labour market reform. Political-economy constraints in the smooth political transition process from dictatorship to democracy implied that flexibility could only be introduced at the margins (only for newcomers). This was achieved by extending the use of temporary contracts with very low dismissal costs to hire employees performing regular activities, rather than just seasonal/replacement ones. As a result of this reform, the temporary employment rate increased from about 12 % of employees before 1984 to 33% in the early 1990s.

Later on, an *insider-outsider* model of industrial relations became well entrenched, with several regulations helping to maintain it. For example, as documented in Dolado *et al.* (2010), by law both workers in firms with less than six employees and temporary workers with less than one-month of tenure are not allowed to vote in firm-level union elections. This regulation, which rules out almost 30% of the potential electorate more likely to oppose labour market segmentation, suits the unions in their goal to press for larger wage rises for permanent workers (their decisive/median voters in the elections for workers' representatives). This happens because unions anticipate that firms will respond to unjustified wage pressure by dismissing temporary workers with low firing costs rather than highly protected permanent workers (see Bentolila and Dolado, 1994) —as has indeed been once more the case during 2009-2010. Likewise, the main employers' association (CEOE), in which small and medium-sized (SMEs) enterprises are scarcely represented, also has an incentive to go along in keeping the *status quo*, to some extent. This is so since typically large firms can afford higher wages due to their greater market power and therefore use collective bargaining as a barrier to prevent free entry into those industries where they have a dominant position.

Preceding the 2012 reform, there have been seven other important labour market reforms (1984, 1994, 1997, 2002, 2006, 2010, and 2011) and 52 additional minor legal changes that have tried to correct this course of events. Their main goal has been to reduce the EPL gap, either by constraining the use of temporary contracts in sequence or by slightly cutting severance pay for permanent contracts while mildly increasing legal indemnities paid at the termination of temporary contracts. These reforms have mainly taken place when workers under permanent contracts felt the risk of losing their jobs (see Saint-Paul 2002 and Dolado *et al.* 2010) or when there was a favourable impulse from an external driver, like joining the European Community in 1986 or entering the EZ in 1999.

The current scenario is quite different. First, there is no positive external impulse, as international demand remains subdued and devaluations, which were often pursued in the early 1980s and

1990s, are not available anymore in a single-currency area. If anything, there is the need to avoid the negative threat of being intervened, like Greece, Ireland and Portugal. Secondly, the level of indebtedness —with public debt approaching 80 percent of GDP, and net external debt close to 100 percent— and the resulting difficulties for external financing prevent the use of further fiscal stimulus, which in any event proved fairly inefficient during 2008-2009. Finally, the need to restore fiscal sustainability also limits the scope for a fiscal devaluation (consisting of a rise in VAT and a reduction in social security contributions; see Farhi *et al*. 2011), whose medium and long-term potentially favourable effects would be, in any case, conditional on achieving a downward adjustment of input costs and price margins.

Trying to cope with this situation, the previous socialist Government initially decided that a labour market reform was not required. However, when the euro crisis erupted and external pressure from international institutions and financial markets heated up, it abruptly changed its views. As a result, an agreement with the social partners was attempted twice, in 2010 and 2011, which predictably failed. Consequently, the socialist Government —which remained unconvinced of their necessity— implemented two consecutive reforms that appeared to be quite comprehensive in scope but were in fact quite shallow. The key changes affected the following areas (see Bentolila *et al.* 2011 for more details):

Severance pay. The causes justifying fair dismissals for economic reasons were defined more explicitly. Advance notice was reduced from 30 to 15 days. The employment-promotion permanent contract introduced in the 1997 reform was extended to almost every worker (except for prime age workers with short unemployment durations), for which the so-called *express dismissal* procedure established in 2002 now applied. This meant paying severance of 33 days' wages per year of service so as to avoid the red-tape costs of going to court, giving advance notice, and paying interim wages altogether (previously, the prevailing route was to get these advantages by disguising economic dismissals as disciplinary, but with the highest severance pay of 45 days and a cap of 42 months). An existing fund (Fogasa) fed by employer contributions, which had accumulated a surplus of about one billion euros, was allowed to reimburse firms 8 days' wages in all dismissals of permanent employees. Severance pay for temporary contracts was raised progressively from 8 to 12 days (to be attained in 2015).

Collective bargaining. Firm-level agreements were given priority over the corresponding industry-wide agreements, unless explicitly overruled by the latter. In practice (e.g., in the collective agreement for the construction sector which was signed soon after this reform), this meant an insurmountable obstacle for many small firms in distress willing to opt out of the higher-order agreements. Further, those firms that were allowed to opt out had to reach a previous agreement with their workers and the corresponding wage level agreed at the industry level had to be attained in no more than 3 years. Over the subsequent year, any expiring agreement that could not be renewed through consensus would be subject to arbitration.

Thus, broadly speaking, these two reforms closely followed the same ineffective strategies of the past. Regarding EPL, they mildly reduced dismissal costs and relaxed dismissal restrictions under the employment-promotion permanent contracts while they slightly increased severance pay for temporary contracts. Yet, the EPL gap remained high. As for the regulation of collective bargaining, they upheld the principles favouring industry-level bargaining, while marginally lifting some restrictions on opt-out clauses.

III. What is new in the 2012 reform?

The new conservative Government elected in November, 2011 soon announced that the previous reforms were deemed as insufficient and gave a short period of time for the employers' confederation (CEOE) and the main trade unions (CCOO and UGT) to agree on further proposals for reform. A bilateral pact on wage moderation and the use of early retirement as the main tool of employment adjustment was presented in late January 2012. However, once more, no substantial agreements were reached on either reducing labour market segmentation or facilitating internal flexibility for firms in

distress. The government found this unsatisfactory and immediately announced a new reform in February 2012, which in most cases follows the same direction as the 2010-2011 reforms but with more drastic changes. In a nutshell, the 2012 reform aims at increasing overall external flexibility (facilitating dismissals for workers with permanent contracts) with the hope that this threat will enhance internal flexibility (i.e., adjustments in wages and working time). Specifically, it affected the following areas:

Severance pay. The causes for fair dismissal for economic reasons have been further clarified to include 3 quarters in a row of declining revenue/sales relative to the same quarters in the previous year. The difference between regular and employment-promotion permanent contracts is eliminated and the severance pay for unfair dismissals is unified at 33 days, with a cap of 24 months' pay, i.e., the cap introduced in the 1997 reform for the latter type of indefinite contacts. Those workers dismissed under unfair conditions with job tenures starting before February 2012 would be entitled to a weighted average of the former regulation of 45 days and the new one of 33 days, with a cap of 720 days' wages under the previous EPL regime. The reimbursement of 8 days' wages in dismissals of permanent employees is now limited to fair dismissals in firms with less than 25 employees. The *express dismissal* procedure (see above) and the administrative approval of collective dismissals are both abolished. Training contracts are extended to workers up to 30 years of age (previously 25 years). Lastly, a new permanent contract for entrepreneurs is introduced for firms with less than 50 employees. Workers hired under this new contract are subject to a one-year probation period (i.e., with no severance pay), while firms using these contracts will enjoy substantial fiscal subsidies insofar as the workers remain employed for at least 3 years. Once the probationary period is over, workers are entitled to 20 or 33 days ´wages per year depending on the fair or unfair nature of dismissals, with retroactive effects on the first year. Hence, e.g., a worker with this type of contract who happens to be dismissed after 3 years in the job, would receive either 60 (=20x3) or 99 (=33x3) days wages.

Collective bargaining. Priority of firm-level agreements over industry-wide agreements is no longer subject to overruling by the latter. Employers are allowed, for reasons related to competitiveness or productivity, to unilaterally change working conditions, including wages, as long as these are above the industry collective-agreement level (the worker may then quit and receive the severance pay for economic dismissals or else challenge the changes in court). The causes allowing firms in distress to opt out of the industry collective-bargaining working conditions, including wage levels, are further clarified as firms having 2 quarters in a row of declining revenue relative the same quarters in the previous year. Expired agreements that cannot be renewed by consensus will be subject to compulsory arbitration, and industry agreements will no longer be able to rule out this eventuality. The maximum duration of working conditions after the expiration of a collective agreement is set at one year (previously being unlimited). Administrative approval of collective contract suspensions and work-time reductions is abolished.

Overall, these changes reduce firing costs and re-establish the causal nature of dismissals. Note that dismissals for economic reasons were previously almost fully blocked by labour courts (so that they only represented 8% of all labour contract expirations in 2010, i.e. including those of temporary contracts). Thus, even during a very deep and prolonged recession, firms preferred to avoid legal uncertainty and the red-tape costs associated to presumably fair dismissals. Instead, they ended up paying the prevailing 45 days' pay for unfair dismissals, which was too high by international standards. The *express dismissal* (30% of expiring contracts) made economic sense (see Blanchard and Tirole, 2004) but turned out to be a legal aberration. Lastly, administrative approval for collective dismissals, which is very atypical in the European Union, was ultimately a way to raise severance pay in economic dismissals (on average, up to the level of unfair dismissals) as well as a source of revenue for unions who often charged workers a fee related to legal assistance. As a result, collective dismissals had also been strongly curtailed (amounting only to 4% of contract expirations). This induced an intense use of temporary contracts (accounting for 56% of all expirations).

There is a continuing risk that labour courts will not apply the new criteria justifying economic dismissals mechanically, leading to an increase in uncertainty about firing costs and in litigation by workers trying to obtain the 33 days severance pay, rather than the lower 20 days.

IV. The shortcomings of the new reform

The main measures of the 2012 reform basically amount to a substantial shift of bargaining power from workers to employers. In this fashion, it has the potential to achieve the wage adjustments that have not taken place since the start of the Great Recession, nor in the previous downturns, and which are badly needed to restore competitiveness. However, in a context of high indebtedness, substantial productivity growth is also required, not only as a complementary way of restoring competitiveness but also as a means to sustain internal demand and, hence, restart employment growth. It is on this second front where the recent reform falls short of what is needed unless, as will be argued below, the internal flexibility mechanism is activated soon.

Once again, a key issue not properly addressed in the latest reform is the suppression of dualism. For instance, this could have been achieved through the introduction of a single open-ended contract (the so-called Equal Opportunities Contract, or EOC in short) at the same time that temporary contracts were abolished --with the exception of replacement contracts for maternity or sickness/disability leaves. The key feature of the EOC is that it has no ex-ante time limit (unlike fixed-term contracts) and that severance payments smoothly increase with seniority (unlike current open-ended contracts), instead of having the same indemnity per year of service applying from the start of the contract. Hence, in contrast with the current regulation of permanent contracts, the EOC provides a sufficiently long entry phase and a smooth rise in protection as job tenure increases. The rationale for the gradually increasing severance pay is that the longer a worker stays in a given firm, the larger is her/his loss of specific human capital.

Recent research based on simulation exercises (see, e.g., Garcia-Perez and Osuna, 2011 and Conde Ruiz *et al*., 2011) points out that, e.g., an EOC which starts with a severance pay of 10 -12 days' wages and grows by 2-3 days per year up to a maximum of 33-36 days' wages could have greatly reduced the huge worker turnover rate that leads to the very large frictional unemployment rate in Spain. This contract is badly needed because, even after the massive destruction of temporary contracts since 2008, currently they still comprise almost one-quarter of all employees and about 93% of the total labour contracts signed each month.

It is true that the new reform reduces the EPL gap between temporary and permanent contracts, especially for future hires, and that this should encourage firms to use temporary contracts less. However, once again the incentives at the margin to reduce the widespread use of precarious contracts seem to be insufficient. For illustrative purposes, let us compare the expected firing costs for a firm deciding on whether to hire a new worker under a temporary or a permanent contract. For simplicity, we assume that the job lasts for two years, which is the longest duration of fixed-tem jobs. In this first case, at the termination of the contract, the firm will have to pay 18 days' wages (=2x9 in 2012), while in the second case it would have to pay either 40 (=2x20) or 66 (=2x33) days, depending on whether the dismissal is considered to be economic or unfair. The EPL gap, amounting to 22 or 48 days (plus red tape costs if there is an increase in workers' appeals to labour courts) still remains rather high relative to the 2 or 3 extra days of wages entailed by the EOC. For example, Bentolila *et al.* (2012) find through a calibrated model that, had the previous Spanish government implemented a reduction of 73% in the firing cost gap in the mid 2000s (adopting the extant EPL regulation in France), the rise in Spanish unemployment during the subsequent slump would have been 45% lower than what it has actually been (i.e., it would have risen from 8% to 17% rather than to 24%). The reason is that a much lower EPL gap decreases the worker turnover rate while it increases job creation flows as well as job mobility. Since the reduction of the EPL gap for new hires in the new reform amounts to about 33%, a "back of the envelope" prediction based on previous simulations is that, all else being equal, the unemployment rate may fall by 20% in the medium term (from 24% to 19% in 2015). By any measure, this reduction seems insufficient.

Nevertheless, it is worth highlighting that the EPL gap and the average level of firing costs in general would be rather irrelevant for employment if bargained wages become sufficiently flexible. As Lazear (1990) has argued, the insight for this result is that one of the main roles of EPL is to serve as an insurance device against the risk of job loss. Consequently, the risk-neutral firm and the risk-averse worker may agree in the wage bargain to design an optimal contract which neutralizes the effect of job

protection. For example, suppose that the expected duration of a job is again two years and that severance pay is X euro in total. Then, the worker and the employer could agree to reduce the wage during the first year by X euro and give this amount back to the worker at the end of the second year (if the interest rate is say 5%, the wage in the last year should raise by approximately 1.1 times X euro). The employer will not experience a rise in its labour costs and the worker will succeed in getting higher income to smooth out consumption when it is most needed, namely, when he/she becomes unemployed. However, this efficient wage scheme will become unfeasible if bargained wages have a floor that does not allow them to go down by X euro during the first year of the contract. In other words, whenever wages are downward rigid, the effect of EPL on employment may be detrimental.

Will wages become more flexible after the new reform?. As discussed earlier, this reform arguably facilitates small firms' opting out from the wage levels bargained at industry-wide collective agreements. Yet, it seems that the administrative costs of doing so remain quite sizeable. For example, a small firm in distress willing to avoid bankruptcy will have to obtain the sequential approval of four legal institutions to be allowed to opt out from a higher-level agreement.[3] It is quite likely that many small and medium sized firms may find all this paperwork insurmountable and therefore will prefer to remain in those collective agreements. Hence, if the reform does not succeed in achieving enough internal flexibility, the frictional unemployment created by the volatility of temporary contracts may not subside. For example, 1.2 million contracts were signed in May 2012, out of which 8% were indefinite contracts, a proportion that is 7% smaller than in May 2011, before the reform was passed.

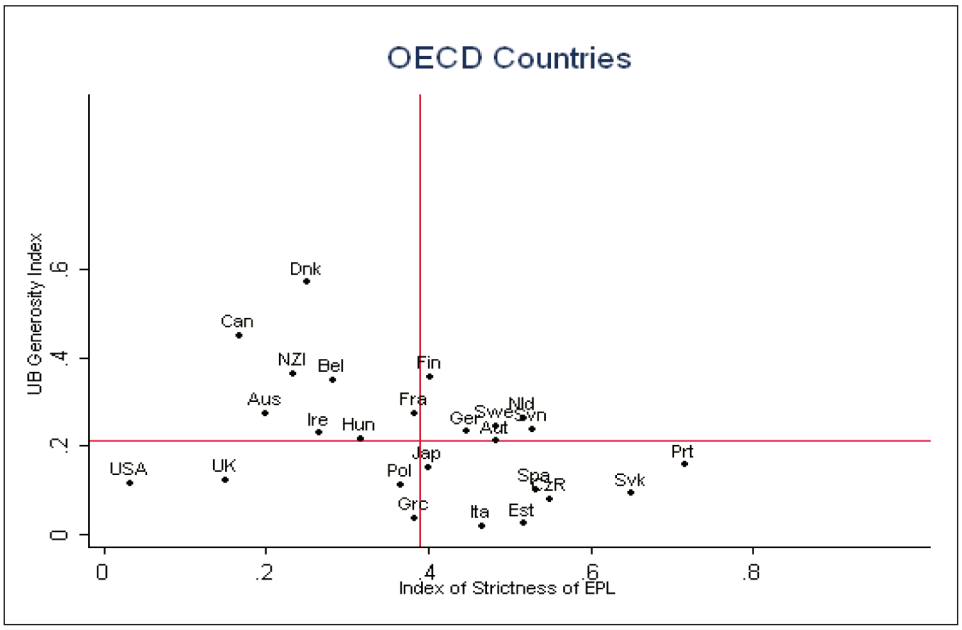
The second important shortcoming is the lack of changes in unemployment insurance and the very limited nature of the changes in active labour market policies (ALMP). The reform relies once more on generous job creation subsidies in both a new training contract and the contract for entrepreneurs, favouring youth, older workers, women, and the long-term unemployed. The share of ALMP going to these subsidies in Spain was already 32 percent in 2009, vis-à-vis 16 percent in the average OECD country (OECD Stats. Extracts), while the shares spent in training were 22 and 29 percent, respectively. Job subsidies have a negligible impact on job creation in Spain, due to their large deadweight losses and substitution/ displacement effects (see García-Pérez and Rebollo 2009). Increased expenditures on job creation subsidies will prove too costly against the backdrop of a planned reduction in the Government budget deficit from 8.9 percent of GDP in 2011 to 3 percent in 2014.

Moreover, while the reform announces future measures to promote the training of employees, it scarcely alters training programs for the unemployed and it fails to ask for a rigorous evaluation of the effectiveness of ALMP, a practice that is almost unknown in Spain. Nonetheless, it does break up the monopoly that labour unions and employer associations had as beneficiaries of subsidies for training programs, a situation that led to a lot of fraudulent practices in the past, and it allows temporary job agencies to operate also as placement agencies.

Lastly, and related to the previous point, a third problem is that the reform ignores the possibility of maintaining workers' overall level of social protection by compensating the effect of the reduction in the level of employment protection (lower severance pay) through a rise in the protection offered while unemployed (more generous and shorter unemployment benefits, UB, to provide a buffer stock against bad states while avoiding the moral hazard problems associated with UB long duration). Notice that both types of social protection are somewhat substitutes, in the same way as an automobile insurance company could provide insurance to a driver either by offering periodic checkups of the state of the car or, in the case of breakdown or accident, by providing the customer with another car. As Figure 3 shows, with the exception of the fully flexible anglosaxon labour markets (UK and US), there is a clear negative relation between the generosity of UB and the degree of strictness of EPL. Spain is clearly among those countries where EPL is more rigid and UB are not so generous while, other economies like Austria or Denmark, the promoters of the so-called *flexicurity* scheme, have chosen the opposite route. The fact that this last group of economies have experienced much lower unemployment rates than the former both before and throughout the recent slump indicates that their mix of labour market regulations is a much more successful one.

[3] *Comisión Paritaria*, *Acuerdos Interprofesionales*, *Comisión Consultiva* and *Arbitraje*.

Figure 3. The Trade-off in workers´ social protection (2005-2009).



V. Concluding remarks

In sum, the latest reform has advanced towards *flexicurity* only in the *flexi* side (firing costs and internal flexibility), but does very little regarding passive and active labour market policies and it actually makes the latter harder to fund. It also lacks significant productivity-enhancing measures. Though the current reform represents an improvement over the past ones and it may steer the Spanish economy towards a lower structural unemployment rate, once the financial crisis is overcome, it remains yet unclear how large this reduction will be and whether it will contribute to higher economic growth. Given these limitations, it is quite likely that this will not be the ultimate labour market reform curing the "Spanish disease" and that, sooner rather than later, another more ambitious reform will need to be approved.

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The Spanish Labour Reform and the Courts: Employment Adjustment and the Search for a Legal Certainty

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Abstract: Legal uncertainty over the fair reasons for redundancy and for substantial modifications of working conditions is an important factor explaining some of the worst imbalances of the Spanish employment relations system. In 2012 the Spanish legislature has passed a comprehensive labour reform, a fundamental part of which attempts to overcome that uncertainty. After identifying the main causes of legal uncertainty, this paper asks if the new role assigned to the labour courts will serve the purpose of the reform and if eventually this will succeed in bringing legal certainty to the realm of employment adjustment measures.

Key Words: Labour courts, dismissal, modification of working conditions, labour reform. legal certainty.

I. Introduction

The labour courts have played a central role in the Spanish employment relations system. It is impossible to understand its major institutions —such as termination of employment, internal flexibility and collective bargaining— without extensive reference to the decisions of the labour courts. On the one hand, the courts have had the final say on the meaning of the legal reasons for dismissals and for unilateral substantial modifications of working conditions (one of the legal techniques enabling internal flexibility). On the other hand, judicial litigation has been much more important than mediation and arbitration when interpreting all kinds of collective and workplace agreements on any matter (compensation, working hours, etc.).

The centrality of the labour courts, especially in collective matters, relates in part to their historical development during Francoism: the dictatorship (1939-1975) adopted an interventionist approach towards employment relations as a means of repression of collective action; active state intervention in all kinds of employment disputes, especially through the courts and the labour administration, was a key feature of the industrial relations system just before the Constitution (1978). Hence, alternative, private dispute resolution procedures remained fully undeveloped in the realm of employment relations. This state of affairs has only begun to change for collective disputes: during the 1990s a number of autonomous bilateral bodies (e.g. the SIMA, which is the cross-industry body for mediation and arbitration) were established by national and regional agreements on collective dispute resolution (e.g. the ASAC, which is the agreement on autonomous resolution of labour disputes). However, alternative dispute resolution is virtually nonexistent for individual claims, especially for dismissal cases or for cases of unilateral substantial modifications in working conditions.

The judicialization of the Spanish labour market has made it impossible to properly assess its functioning without considering judicial interpretation and enforcement of the law. After the most comprehensive labour reform in decades (the 2012 labour reform, approved in February by Decree-

Law 3/2012 and finally in July by Law 3/2012), one of the pertinent questions to address is the new role of the labour courts. In this paper I confine my attention to the question of the legal reasons for dismissals and unilateral substantial modifications of employment conditions. What I show is the complex interaction between the law and the courts on an issue that is critical to employers (labour flexibility) and employees (employment protection), and to the very characterization of the Spanish employment relations system. I focus here on the matter of litigation over dismissals and unilateral substantial modifications of working conditions because it has had the most profound effects on the functioning of the Spanish labour market and has given major support to those who argue that the level of employment flexibility in Spain is low. As a leading judge has recently put it, the crucial issue raised by the 2012 labour reform is to define the scope of judicial review and the limits of the powers of management[1].

For the most part, legal uncertainty as to what constitutes a fair reason for dismissal or for substantial modification explains the fact that over the last few decades Spanish companies have apparently underused both economic dismissals and unilateral substantial modifications of working conditions. In their stead, they have overused fixed-term employment contracts and unfair individual dismissals (so-called "express dismissals"). The result has been inequitable both to many employees (especially new hires and young people, who experience chronic precariousness) and to some employers (especially the many small companies that provide the vast majority of jobs in the Spanish economy, compelled either to pay relatively high severance costs for labour adjustments or to adopt a low-road strategy through temporary employment). Hence, it is critical to determine whether the 2012 Reform brings legal certainty to this fundamental area of employment practice.

I begin in Section 2 by briefly summarizing how the Spanish legislation has traditionally defined the fair reasons for dismissals and unilateral substantial modification of working conditions. In Section 3, I present the main changes introduced by the 2012 Reform. Section 4 describes the courts' role in interpreting fair reasons for dismissals and modifications, which has been the main source of legal uncertainty. Sections 5 and 6 discuss the main alternatives pursued by firms in their search for legal certainty. Sections 7 and 8 show how the legislature has attempted to provide legal certainty first in 2010 and then in 2012. Finally, I provide some concluding remarks.

II. Legislation dealing with the fair reasons for dismissals and substantial modifications before the 2012 Reform

In the important debate over the optimum balance between labour flexibility and employee security, the dismissal regime and the regulations on unilateral substantial modifications of employment conditions are among the main concerns. According to the Spanish Workers' Statute, employers must have a good cause both for dismissals and for unilateral substantial modifications of employment conditions[2]. This causal requirement entails the employee's right to lodge a claim with a labour court in the case of dismissal or substantial modification to her working conditions. For the employee, this is a reasonable avenue to be pursued, especially in dismissal situations: litigation costs are very low for employees, and the difference between the compensation initially received from the employer and that originating in a judicial declaration of unfair dismissal (plus interim salary[3]) could be large.

The causal requirement established by the law has traditionally been fairly complex. Indeed, it was made up of three distinct elements: a factual component, a causal link, and a functional requisite.

[1] P. Aramendi (2012): "el gran debate que se avecina a partir de ahora radicará en la delimitación de hasta donde llegan los poderes del empresario y hasta dónde éstos van a poder ser fiscalizados judicialmente".

[2] Dismissals on business-related grounds are regulated in articles 51 ("collective dismissals"), 52 and 53 ("individual dismissals") of the Workers' Statute (*Estatuto de los Trabajadores*: Royal Legislative Decree 1/1995). Unilateral substantial modifications of working conditions are regulated in article 41 of the Workers' Statute and, if they affect employment conditions established in a formal, normative collective agreement, in article 82 of the same Statute.

[3] Interim salary may be defined as the employee's salary from the date of termination through the date on which the court's judgment is notified. On average, interim salary could amount to 3 to 6 months of salary.

First, the causal requirement entailed the actual existence of a fact, which could be of an economic, technical, organizational or production (i.e. market-related) nature: a technological change, a decrease in consumer demand, financial losses, etc. Second, the law called for a "causal link" between that fact and the dismissal (or substantial modification), so that the latter could be said to be triggered by the former. Third, the law also demanded the court to apply a "functional test", which was expressed by the law as a purpose requirement: the dismissal must serve the goal of improving the company's situation or outlook.

It was the employer's burden to gather and present before the court compelling evidence of the facts, causal links and purpose requirements that justified the employer's decision of dismissal or substantial modification. Moreover, the employer was expected to put forward convincing arguments, not mere facts, concerning the reasons for the dismissal or the modification. Hence, the employer bore the greatest legal burden, not only of proving that something was true (financial losses, technological change, etc.), but also of persuading the court that the dismissal or the modification was the right decision given an intricate state of affairs. It was the court's function to ascertain the existence and substance of the alleged fair cause, both as a matter of fact and law. Setting aside the difficulties related to proving some facts before a labour court (e.g. proving a decrease in consumer demand by means of the kind of evidence admissible in court), the main problem faced by employers was that the court could determine that the cause did not exist as a matter of law.

Since 1994, the legal wording stated that both dismissals and substantial modifications must be based on economic, technical, organizational or production reasons. Moreover, in order to be legally justified, any dismissal or substantial modification must be the proper measure to be taken in order for the company to get over a negative financial situation or to ensure its own viability or its level of employment. Hence, the legal test was, at a minimum, double in practical terms: there had to be a reason of an economic, technical, organizational or production nature, and there had to be a very clear relationship between the dismissal or the substantial modification of employment conditions and the company's outlook. Thus, the labour courts were required not only to confirm the existence of the fair reason for dismissal or for substantial modification, but also to consider the business rationality of the measure that was being judged, be it in terms of competiveness or in terms of the company's very continued existence. And it could indeed happen that even though the company had proven a sharp and persistent decrease in sales (e.g. -24,55% between 2009 and 2010; -29,68% between 2010 and 2011) and in net income (e.g. -457,18% between 2009 and 2010; -262,37% between 2010 and 2011), these facts were not considered enough to justify the dismissal, since the company had not clearly shown, for instance, in what way the dismissal could help in correcting the negative evolution of the company's situation.[4]

It is obvious that the problematic question was determining the exact legal meaning of these reasons in practice. As expected, one could easily provide a definition, by way of explanation, for each sort of reason. In fact, there were a lot of definitions in the legal literature, with not very much divergence among them. The broad consensus over the definition of these reasons was apparent in the Supreme Court's case law[5], which eventually was codified by the legislature in the 2010 Labour Reform (first by the Royal Decree-Law 10/2010 and subsequently by the Law 35/2010). As a result of this reform (Law 35/2010), the economic, technical, organizational and production reasons for dismissals were defined as follows:

[4] Superior Court of Justice of Galicia, Judgment (*Sentencia*) 1749/2012 of 22 March 2012. A similar judgment is that of the Superior Court of Justice of Castile – La Mancha 250/2012 of 6 March 2012, in which a small company has a decrease in sales (from €171,581 in 2009 to 149,364 in 2010) and still cannot justify the dismissal: the Court argues that the company has not proven that the dismissal is a reasonable measure in order to saveguard employment or enhance its competitiveness.

[5] A good example is the Supreme Court's judgment of 10 May 2006 (appeal 725/2005).

Economic reasons	They exist when the company's economic results reveal a negative financial situation, such as the existence of current or anticipated loss or a persistent decline in revenue that may affect its viability or its ability to maintain employment. To this end, the company must prove the alleged results and substantiate the reasonableness of the decision taken based on them in order to preserve or advance its competitive position in the market.
Technical reasons	They exist when changes to the means or instruments of production are introduced.
Organizational reasons	They exist when changes to work methods are introduced.
Production reasons	They are based on changes in the demand for the goods or services the company intends to sell.

As for the fair reasons for unilateral substantial modifications of working conditions, the law provided that the employer must show an economic, technical, organizational or production reason. When it came to giving details of the meaning of these reasons, the law used to say, before the 2012 Reform, that the employer should demonstrate that by modifying certain working conditions the company's resources would be better managed and the company's future would be brighter, with an enhancement of its competitive position. In practical terms, this legal wording did not help much to clarify what amounted to a fair reason for implementing substantial changes to working conditions. Indeed, it was extremely difficult for any legal practitioner to issue accurate forecasts about judicial decisions on these matters.

III. The main changes introduced by the 2012 labour reform

The 2012 Labour Reform (Law 3/2012) has maintained the fundamental requirement that both dismissals and unilateral substantial modifications of employment conditions be based on a good cause. However, it has attempted to dramatically change the way in which the labour courts must deal with the good cause requirement: first, by giving a more precise definition of the reasons that sustain a fair dismissal; second, by eliminating the part of the causal requirement related to the company's prospects ("reasonableness test"), thus restricting judicial latitude; third, by expanding the causes for substantial modifications; and fourth, by setting up an alternative dispute resolution procedure for modifications affecting conditions established by the vast majority of collective agreements with the status of law[6].

In the first place, the Law 3/2012 maintains the old definitions of economic, technical, organizational or production reasons, except that: (1) economic reasons now comprise not only a persistent decline in revenue, but also a persistent decline "in sales"; (2) the persistent decline in revenue takes into account only "ordinary income", leaving out extraordinary income; (3) a "persistent decline" is deemed to exist where it has lasted at least three consecutive quarters, comparing three given quarters to the same quarters of the previous year; and (4) organizational reasons include the idea of changes in the way the production process is organized.

In the second place, the 2012 Reform eliminates what I have called the "functional test": the courts are no longer called upon to consider whether or not the dismissal serves the goal of improving the company's situation or prospects. As we shall see below, this is a potentially ground-breaking development in our employment relations system.

In the third place, as to the fair reasons for unilateral substantial modifications of working conditions, the law provides that the employer must show an economic, technical, organizational or production reason. It does not provide any definition of these reasons, nor does it require any longer that the employer demonstrate that by modifying certain working conditions the company's resources would be better managed and the company's future would be brighter as a result of the enhancement of its

[6] Most collective agreements in Spain have the status of law: they are binding not as contracts but as mandatory legal provisions. Hence, they are officially published and the labour administration may sanction firms for noncompliance with the applicable collective agreement.

competitive position. The current legal wording has been changed, so that the law now plainly says that fair reasons for unilateral modifications are deemed to exist where they relate to such broad concepts as "competitiveness, productivity, or technical and work organization in the firm".

Finally, the Reform has tried to solve the long-standing problem posed by firms seeking to opt out of industry-wide collective agreements. Though a workplace agreement is initially required, a lack of agreement may eventually be overcome through arbitration: the firm willing to opt out and thus modify certain working conditions regulated by the industry-wide agreement (or even by a company-level agreement) may unilaterally refer the matter to arbitration. This arbitration service will be provided by a public tripartite body called the national advisory committee on collective bargaining ("Comisión Consultiva Nacional de Convenios Colectivos"). Hence, once settled by arbitration, this kind of dispute over modification of working conditions will not be fully reviewable by any labour court, since arbitration decisions may be challenged before a court only on very limited grounds.

It is apparent that the legislature's intent has been to simplify the good cause requirement for redundancies and substantial modifications of employment conditions. The legislature has without doubt eliminated legal wording that required the labour courts to deliberate about such problematic questions as the consequences of dismissals or substantial modifications for the future of the company. However, it is debatable whether the government will attain the desirable goal of legal certainty concerning the fair reasons for economic dismissals and substantial modifications of working conditions.

IV. The courts' role in interpreting the fair reasons for dismissals and modifications

As explained, the labour courts have played a dominant role in defining the practical meaning of the legal reasons for dismissals and modifications. In a system where the definition of most legal concepts and institutions results from a permanent interaction between the legislature and the courts, the latter's role depends on the precision of the language in the statutory descriptions. If the statutory description of the fair reasons for dismissals and modifications is vague, then the courts' power is almost unlimited with respect to its ability to declare the dismissal or the substantial modification of employment conditions as fair or unfair. Indeed, the article defining the fair reasons for dismissals and modifications prior to the 2012 Reform was described by a judge as a veritable "blank check" (Beltrán Aleu, 2006, 152).

Moreover, in practical terms, this enormous power mainly rests with the lower instances of the labour courts. Thus, each first-instance labour court (*Juzgado de lo Social*), where only one judge sits, assumes considerable power. On the one hand, first-instance labour courts have almost complete control over the determination of the facts (here, judges are professional triers of fact) from the admissible evidence (witnesses, experts, documents, etc.) brought before them. On the other hand, the study of judicial cases over the last fifteen years warrants the important conclusion that the various labour courts (*Juzgados*) have applied very different criteria for reviewing dismissals. This holds true as well for litigation on substantial modifications of working conditions. In both areas, it has been extremely difficult to settle uniform case law: by their very nature, the solutions of these cases have hinged on casuistic reasoning rather than on general principles or rules, thus making it difficult for the regional Superior Courts (*Tribunales Superiores de Justicia*), let alone the Supreme Court (*Tribunal Supremo*), to establish harmonized criteria to be followed by the *Juzgados*. These lower courts have been able to maintain differing standards in key aspects of the litigation over the fairness or unfairness of economic dismissals and modifications: e.g., as to the evidence admissible to prove economic, technical, etc. reasons, or as to the assessment of the connection between the dismissal (or modification) and the legal aim of improving the company's negative situation or its future prospects.

It goes without saying that this has resulted in widespread legal uncertainty. This is the basic legal reality that has enormously conditioned labour flexibility in Spain over the last few years. It is scarcely relevant that not all courts have been overprotective of employees,[7] as employers tend to stress

[7] I point out the authoritative opinion of J.M. Goerlich Peset (2005): "The interpretation of a part of the labour courts, induced by their previous experience of judicial review of disciplinary dismissals, has been based on demanding stringent standards of proof of the causes of restructuring, up to the point of requiring something impossible to satisfy" (p. 252, f.n. 53).

the risk of obtaining unfavourable judgments. And unfavourable judgments have meant, at a minimum, significant additional liabilities: e.g. interim salary (sometimes in amounts larger than unfair dismissal compensation). As a result, many employers have made a strategic business decision to simply avoid litigation over these matters. The main three alternatives they have chosen have been overuse of fixed-term employment, overuse of unfair dismissals, and productivity coalitions with employee representatives. This reality is a specific reason, among many other more general reasons, for employers to have taken a negative attitude towards the Labour courts.

V. The search for legal certainty (the individual approach): employer's overuse of fixed-term employment and unfair dismissals.

Legal uncertainty related to dismissals and internal flexibility (substantial modifications of working conditions) has been a major cause of two distinct features of employment relations in Spain: a high rate of fixed-term employment and a disproportionate use of express dismissals as a means of terminating permanent employees without litigation. In turn, both features have reinforced each other, resulting in a distorted labour market, one in which numerical flexibility has tragically pushed out other forms of labour flexibility more favourable to human capital development.

Temporary employment has been the alternative preferred by employers to enhance both numerical and internal flexibility and at the same time avoid litigation. It is a well known fact that among OECD countries Spain stands out for the highest rate of temporary employment. Over the last two decades, this rate has fluctuated between roughly 25 and 35 percent (see Figure 1). Temporary employees are generally more prone to conform and to accept company-imposed changes, and also less inclined to sue during the employment relationship. Moreover, temporary employees are synonymous with numerical flexibility: as is clear from Figure 2, termination of fixed-term contracts has constantly been the most used mode of termination of employment. Indeed, Figure 2 most probably underestimates termination of fixed-term contracts, because the data are derived from applications for contributory unemployment benefits, and only employees who have been insured at least one year are entitled to these benefits (fixed-term employees are less likely to meet this requirement than permanent ones). This mode of termination not only entails a low monetary cost in terms of severance compensation (until 2011, just 8 days' salary per year of work), but also a very low risk of litigation.

Figure 1. Temporary employment rate. (Source of data: Encuesta de Población Activa).

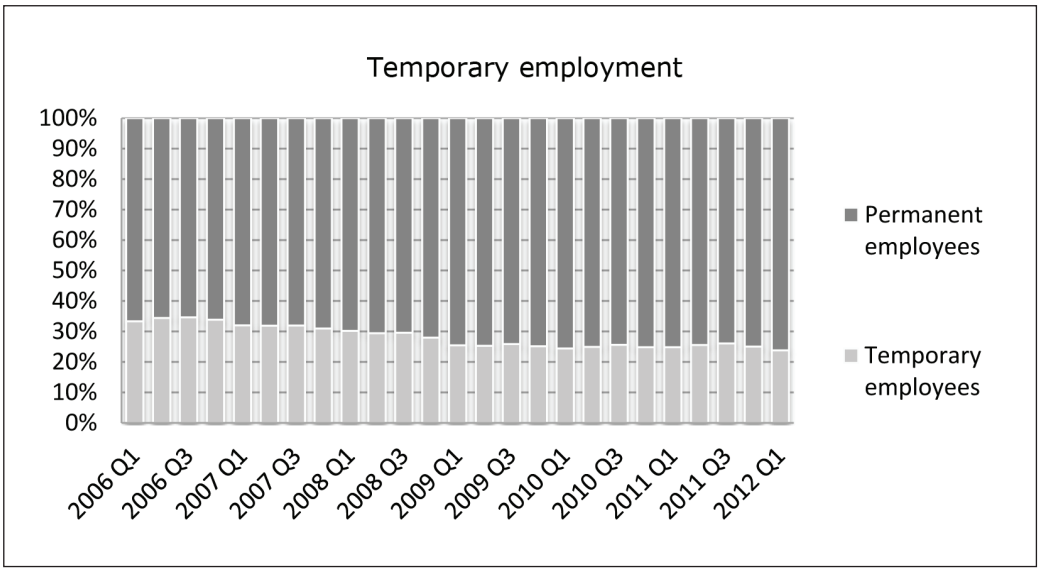
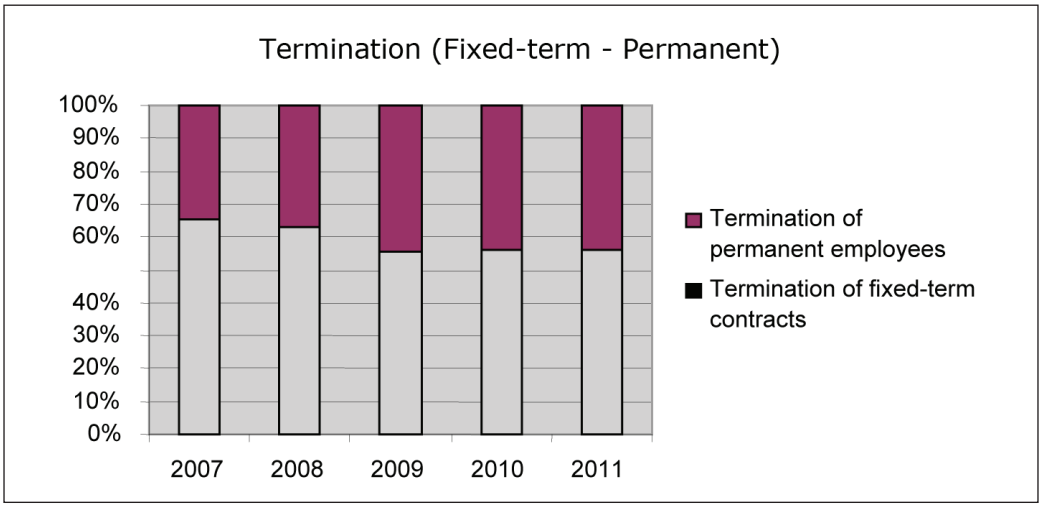


Figure 2. (Source of data: Ministerio de Empleo y Seguridad Social).



For permanent employees, the adjustment solution preferred by companies has been express dismissals, that is to say, instant, summary dismissal (disciplinary dismissal) followed immediately by the employer's admission of its unfair nature and the payment of the resultant severance compensation (45 days' salary per year of employment up to a maximum of 42 months' salary). As is clear from Figure 3, this has been the most common mode of terminating permanent employees, especially before the economic crisis that began in 2008. During the years prior to the 2009 recession, express dismissals accounted for 75 percent of all terminations of permanent employees. Before 2008, individual redundancies (causal dismissals for reasons not inherent to the employee) accounted for less than 10 percent of all terminations of permanent employees: given the thorough scrutiny applied by the labour courts, this sort of dismissal was hardly practical unless the company was in a negative financial situation (losses). Over the last few years (2008-2011), individual redundancies have been on the rise; a plausible explanation for this is the genuine economic crisis of many companies. It is important to note that individual redundancies (unless declared unfair by a labour court) entail a severance compensation of 20 days' salary per year of employment up to a maximum of 12 months' salary (in fact, companies with less than 25 employees receive a subsidy of up to 40 percent of that amount). Hence, the difference between the cost of unfair dismissal and the cost of (fair) redundancy is substantial.

Figure 3. (Source of data: Ministerio de Empleo y Seguridad Social).

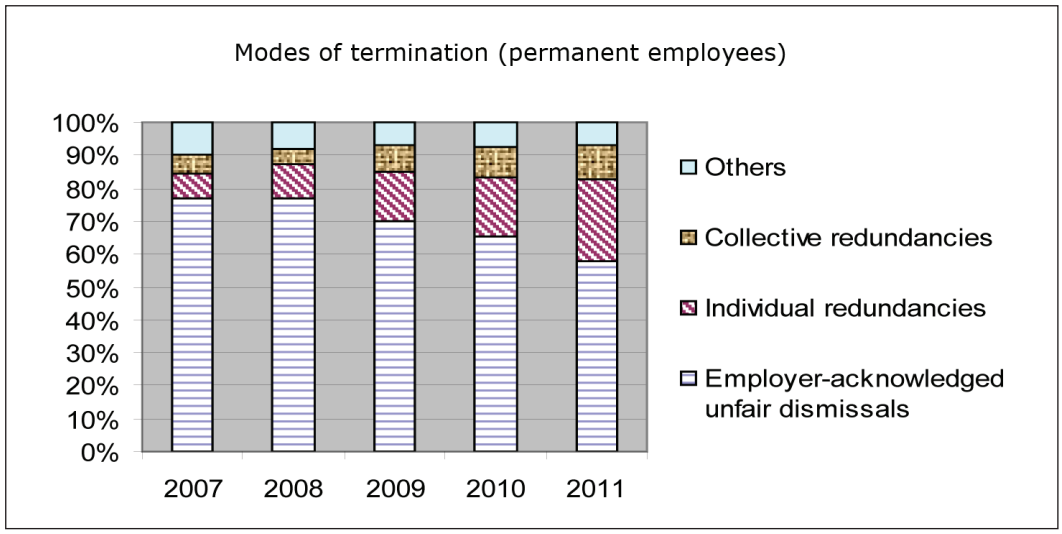
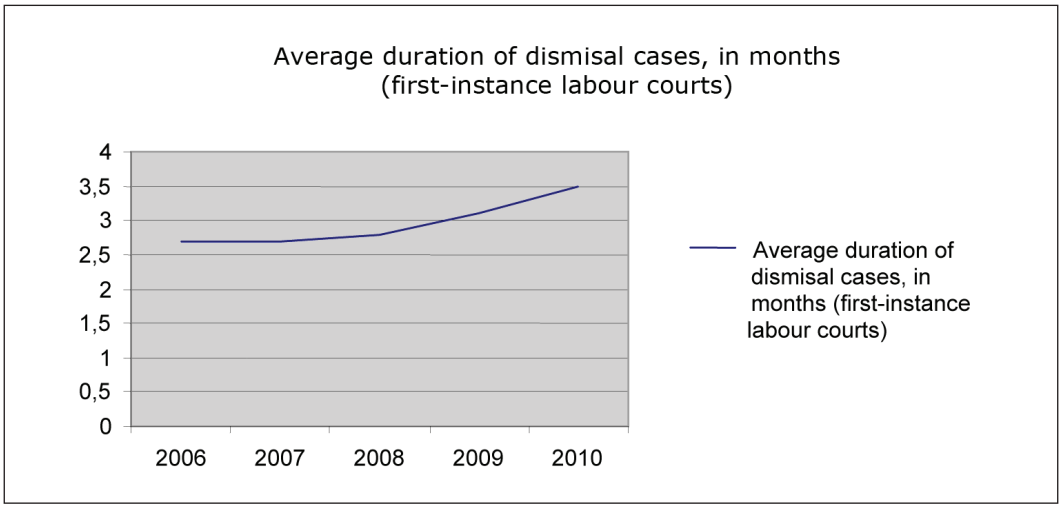


Figure 4. (Source of data: Consejo General del Poder Judicial, La Justicia Dato a Dato, 2010).



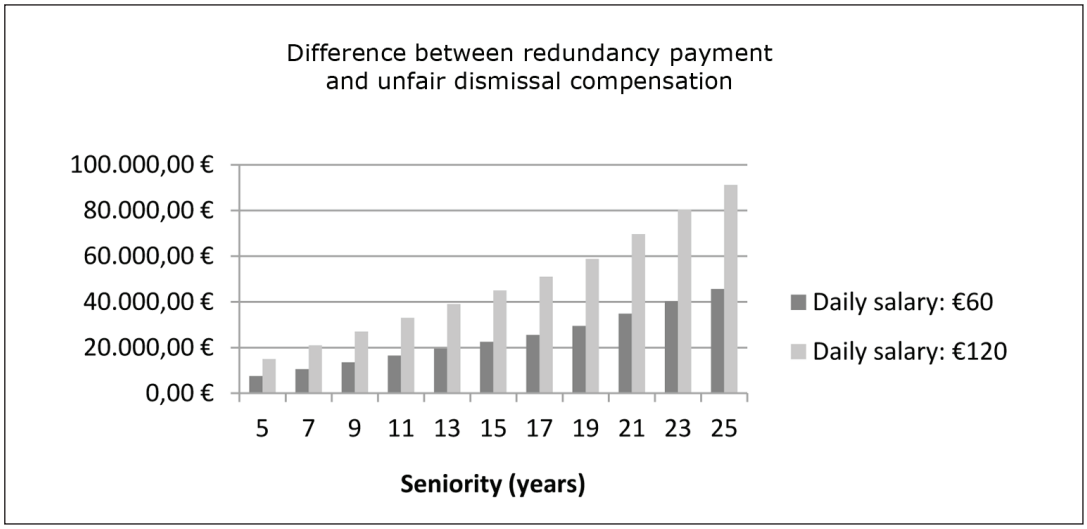
If the severance cost difference is substantial, why would any rational employer acknowledge a dismissal as unfair, instead of trying to maintain in court that the dismissal was objectively based on economic, technical, organizational and production reasons? Since employee access to the labour courts is relatively easy and inexpensive, any company, no matter how large or small, may logically expect that the employee will claim unfair dismissal. The costs associated with the proceedings are interim salary and litigation costs. Interim salary is the salary from the date of dismissal to the date on which the court's judgment is notified (on average three to six months' salary, though it has risen since 2008 due to the judicial overload aggravated by the economic crisis; see Figure 4). As to the litigation costs (lawyer's fees, travel expenses, time spent by different persons, expert witness fees, etc.), they will not be paid by the employee even if the employer wins the case. Accordingly, a company trying to defend the fairness of the dismissal will bear in any event the costs of litigation, and furthermore it may end up paying the full compensation for unfair dismissal as well as interim salary.

In many cases, however, the severance cost difference is more than the litigation costs associated with pursuing a causal dismissal. Take an employee with low seniority (say seven years) and an under-average salary (say €20,000 per annum): the difference between the unfair dismissal compensation (€17,260) and the redundancy payment (€7,671) would clearly exceed the typical cost of litigation in most cases. If the company employs less than 25 employees, that difference would be even larger, since the State ("Fondo de Garantía Salarial") subsidizes up to 40 percent of the redundancy payment (in this example, the subsidy would be €2,755, thus reducing the redundancy payment borne by the employer to €4,916). As you would expect, if you take an employee with more seniority and salary, the difference between unfair dismissal compensation and redundancy payment increases, so that, for instance, for an employee earning daily €120 and with 15 years seniority, that difference would be €45,000 (see Figure 5).

In view of this substantial difference, it would be rational to take the risk of having to pay interim salary as long as there existed a good chance of obtaining a favourable judgment from the labour court. The official statistics show that in 2009 (before the 2010 Labour Reform) 50,000 judgments were favourable to the dismissed employee, and only 13,419 were favourable to the employer[8]. It is obvious that the difficulty of obtaining favourable review of individual redundancies and the uncertainty of the regulation of their fair reasons explain why employers prefer to acknowledge up front that the dismissal is unfair. The risk of having to pay interim salary is alone insufficient to explain this marked preference. Indeed, although the 2012 Labour Reform (in force since 12 February 2012) has eliminated interim salary in most

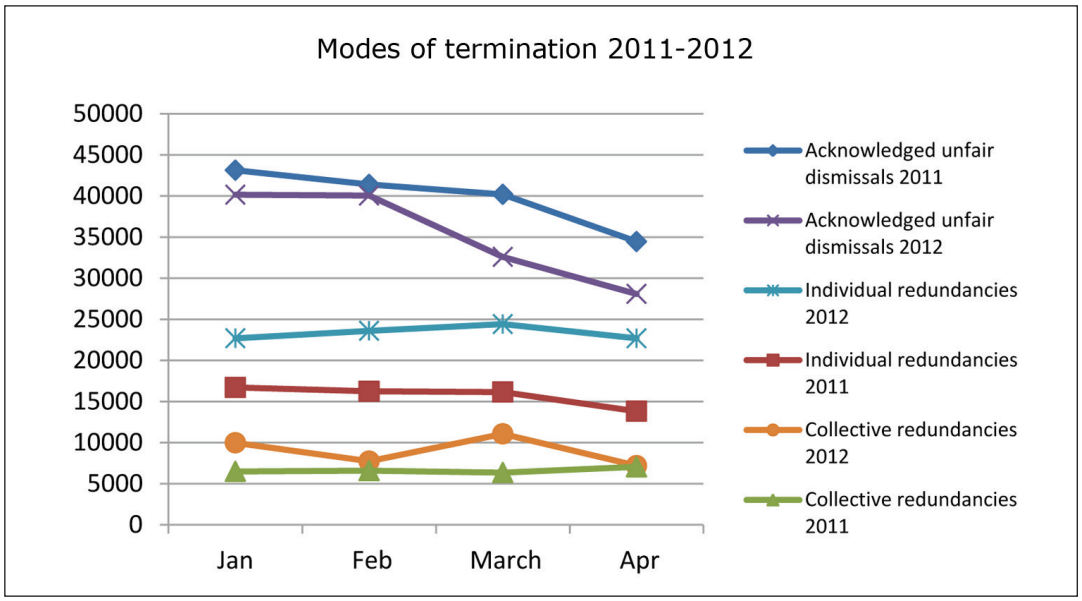
[8] This may have to do with the fact that "judges' decisions tend to be particularly favourable to workers when unemployment is high" (Martin / Scarpetta, 2011, p. 3).

Figure 5.



cases (for dismissals declared unfair by the labour courts), many companies still prefer to acknowledge up front that the dismissal is unfair. The latest statistical data over the period of February to April 2012 show a comparatively slight decline in the number of employees applying for unemployment benefits (regarding the same period of 2011) after having been dismissed with the employer's acknowledgement of unfairness. Admittedly, it is too early to draw any firm conclusions from these data, but our conjecture is that an important explanation for the only slight decline in unfair dismissals may be legal uncertainty over the consequences of the employer's unilateral acknowledgement of unfair dismissal (e.g. tax effects) rather than the employers' confidence in the new legal framework for individual and collective redundancies. The provisional conclusion is that even without the risk of interim salary, a large number of companies prefer unfair dismissals (high severance payment) over redundancies (low severance payment): the data for April, 2012 (which reveal terminations of March and April for the most part, that is to say a period in which there has been no risk of having to pay interim salary) show 28,089 individual dismissals acknowledged as unfair, almost the same number as individual and collective dismissals in total (29,874).

Figure 6. (Source of data: Ministerio de Empleo y Seguridad Social).



It is clear, therefore, that there has been an excessive use of unfair dismissals by Spanish employers. Still, this is not in itself the problem, but rather the symptom of a truly acute underlying problem (Desdentado / De la Puebla 2010: 69): the legal definition of the fair reasons for redundancy (and substantial modifications of employment conditions as well) is "confusing, contradictory and hardly realistic" (Desdentado / De la Puebla, 2010: 74).

VI. The search for legal certainty (the collective approach): fair reasons and productivity coalitions with the employee representatives

The 2010 Labour Reform introduced a new mechanism to reduce the legal uncertainty surrounding the fair reasons for substantial modifications of employment conditions. In cases of collective modifications (defined at that time as any substantial modification affecting working conditions established in workplace agreements or other terms collectively applied within the company, and now defined as any substantial modification affecting at least a given number of employees relative to the firm's workforce size), the law requires the employer to negotiate the projected substantial modification with the employee representatives. If both parties reach an agreement, the law presumes that a fair reason exists for the modification. This presumption of fairness introduced by the 2010 Reform entails that the modification is presumed to be based on a fair reason as long as it has been agreed by the employee representatives. Thus, the party challenging the modification must prove either the abusive nature of the agreement or that it was reached through coercion, deceit or fraud. By any standard, this requirement of proving coercion, fraud or deceit places an extremely heavy a burden on the party wishing to challenge the modification before a labour court.

Accordingly, the new provision brought in by the 2010 Labour Reform encourages "negotiated flexibility", and, at the same time, tactfully redefines the role of the labour courts. The practical outcome is that the labour courts cannot examine the reasons for the substantial modification of employment conditions once they have been agreed by employee representatives. Consequently, the effect is the substitution of the employee representatives for the court: the function of examining and reviewing that the company has a fair reason for bringing about substantial changes in working conditions is performed in the first instance by the employee representatives; if the flexibility measure is agreed, the court's role is negligible. Naturally, if the measure is not agreed, but rather unilaterally imposed by the company without the employee representatives' consent, then the court may eventually examine the reasons alleged by the company and declare the substantial modification void or unjustified.

This mechanism introduced in 2010 has been a valuable tool for promoting "negotiated internal flexibility". It may in fact reinforce a business strategy uncommon among large companies and extremely rare among small employers and medium-sized companies: a long-term strategy based on a continuous process of dialogue between labour and management. However, this mechanism has never been applicable either to individual redundancies or to individual modifications of working conditions. Collective redundancies did not pose the same problems at that time, as they required prior authorization by the labour administration: in practice, the public administration required that the collective dismissal be agreed by employee representatives, and the chances of successfully challenging such administrative decisions before an administrative court were extremely low. Hence, legal uncertainty remains as to the definition of fair reasons for redundancies or for individual modifications as well as for collective modifications not agreed by employee representatives. Both the 2010 and the 2012 Labour Reforms have tried to address this critical and complex issue.

VII. The search for an exact definition of the fair reason: round one (2010).

As explained, the causal requirement established by the law has traditionally featured three elements: a fact, a causal link and a functional test. Under these requirements, the courts' role was not

confined to merely verifying the existence of the fact —a task which in itself entailed a certain degree of autonomy— but extended to deciding whether the dismissals were causally linked to that underlying fact and reasonably appropriate to overcome the company's negative situation. Hence, Spanish companies were required to prove not only the existence of an economic (or technical, etc.) reason for dismissal (or for substantial modifications of employment conditions), but also a close relationship between that reason, the dismissal (or modification) and the effect of the latter on the company's future or outlook (the so-called functional test). In June, 2010 the Royal Decree Law 10/2010 established that the company had to prove just a "minimal" connection between the dismissal and the company's future: provided the economic, technical, etc. reason for dismissal existed in fact, the dismissal would be fair if the employer could show that the dismissal was *minimally* reasonable in order to improve the company's situation or to prevent a future negative evolution. The inclusion of the word "minimally" in the legal text supplied the legal basis to argue that the new enactment's purpose was to lighten judicial enquiry, so that economic dismissals would eventually be subject to less intense judicial scrutiny. However, the word "minimally" was removed from the legal text just a few weeks later: the final version of the 2010 Labour Reform, passed as Law 35/2010 in September, 2010, restored the previous wording: economic dismissals could therefore be subject to intense scrutiny by the labour courts, requiring employers to continue to prove a close relationship between the underlying reason for dismissal and the favourable effect of the dismissal on the company's situation.

While the final version of the 2010 Labour Reform did not reduce the courts' autonomy regarding the functional test, it did provide a new definition of "economic cause". Under the previous wording, economic cause was identified with a financially "negative situation", basically financial losses. In September 2010, two significant amendments were introduced. First, the phrase "negative situation" was redefined as including not only actual losses, but also expected losses. Second, the economic cause was identified not only with a negative situation (losses), but also with a persistent decrease in revenue. Hence, as a result of these innovations, a company generating profits could dismiss employees on economic grounds.

The new definition of the economic cause in September 2010 was extremely controversial but scarcely useful in practice. Indeed, many labour courts derided the very concept of "expected losses" as purely conjectural ("a fact of the future") and opposed the idea of validating redundancies on such speculative facts: for example, the Superior Court of Justice of Madrid affirmed in a recent judgement: "the new wording [that of September, 2010] does not lead to complete certainty as to its interpretation and application by the courts. To begin with, the existence of expected losses is an inconsistency, since what one foresees in the future does not currently exist and thus it is impossible to prove"[9]. As to the concept of a "persistent decrease in revenue", it was too vaguely expressed to be able to create an adequate degree of certainty. In any case, even though a company could come up with compelling evidence pointing to "future losses," the court could always declare the dismissals unfair by arguing that a workforce reduction was not the appropriate response in order to improve the company's prospects. Certainly, there is a glaring inconsistency in deriding a legal concept as conjectural and at the same time defending that the courts should judge and have full authority and ample scope to substitute their judgment as to the best interests of the company for that of the employer. In both instances (how to anticipate losses or how to improve the company's outlook), the judgment does not entail legal reasoning, but pure "business" foresight and anticipation. In sum, this is a question of expectations and probability, which creates an inadequate setting for thorough judicial scrutiny: by contrast, employee representatives are better placed to examine and discuss the business restructuring plan, and therefore should be granted more decisive power.

The amendments introduced both by Decree-Law 10/2010 and Law 35/2010 turned out to be short-lived regulations, and for this reason they cannot be empirically evaluated in an adequate manner. Nevertheless, one thing is clear: the key objective of legal certainty was not attained, with an apparent division within the courts as to how the new legal wording should be construed and applied. This relentless legal uncertainty is the main driver of the amendments made by the latest Labour Reform.

[9] Judgement 228/2012 of 9 March 2012.

VIII. The search for an exact definition of the fair reason: round two (2012).

The 2012 Labour Reform (Law 3/2012) aims directly at the standard of judicial review in redundancy cases. The Reform tries to get to the root of the problem here identified as legal uncertainty regarding the fair reasons for redundancies and substantial modifications of employment conditions. Thus, although it also makes some changes to the definition of economic cause, the major innovation occurs in the technical details of the judicial process: what the Legislator now seeks is a judicial process where the court must focus on the existence of the facts, not on the adequacy of the employer's decision regarding the best course to improve the company's future.

Admittedly, the Reform also makes changes in the definition of economic cause: first, it adds the word "sales" to the phrase "persistent decrease in revenue," so that a persistent decrease in sales is in itself a cause of redundancy, even though there is no decrease in revenue; second, it also adds the word "ordinary" to qualify the revenue which must be taken into account when measuring the decrease; and third it tries to respond to the critical lack of precision of the previous wording by providing a numerical definition of "persistent": from now on, a decrease must be considered persistent if it has lasted three consecutive quarters by comparison with the same period of the previous year.

The exact definition of the facts justifying redundancies or modifications is now significant, since the law clearly requires the labour courts to confine themselves to carrying out a sole function: they must verify the existence of the facts alleged by the company to make employees redundant. It would not be an easy task to find another passage in our employment legislation delivering such an unambiguous message. The explanatory statements of the Law 3/2012 level serious criticisms of a legal framework which allowed the labour courts to substitute their own view (judicial discretion) for the employer's (company discretion) regarding the management of the company, and conclude that from now on it should be clear that the labour courts' sole role is to review the parties' evidence as to the facts that legally justify redundancies.

This intended transformation of the role of the labour courts in redundancy cases is revolutionary in Spain. As with most revolutions, there is a clash of principles and interests here. As expected, workers' unions have mounted vehement opposition to the new legal framework, but some judges have also expressed bitter criticism. Thus, two judges of the Superior Court of Justice of Catalonia have published an article in which they uncover the reasons why the legislature's choice is "unacceptable" (Maragall / Serna, 2012). Furthermore, in a most unusual action, "*Jueces para la Democracia*" (hereinafter JD), one of the three main national associations of Spanish judges, issued a document only a few days after the entry into force of the Decree-Law 3/2012. In the first paragraph of this document[10] JD portrays the new enactment literally as "one of the most important attacks on labour law" since the restoration of democracy, and depicts the reform as "offensive, regressive, reactionary, and utterly unfair." Regarding the more specific issue of the reasons for redundancy, JD considers that "the new regulation intends to limit, once again, the courts' authority to judge the purpose and reasonableness of redundancies by removing the finalistic-cause components." For JD, this entails the breakdown of the requirement for justification of dismissals, which is contrary to the constitutional right to work and to ILO Convention 158. In view of the above, JD proclaims that "our duty as judges who must guarantee workers' fundamental rights is to continue applying labour laws in accordance with constitutional principles and values, and thus to bring to an end the potential abuses that may arise from the considerable powers granted to employers." Their final remark is striking: "We will continue along this line, dismissing the signs of distrust from the legislature apparent in the amendments to the procedural regulation."

The most important constitutional principle concerning judges and courts is the rule of law: as article 117.1 of the Constitution says, judges are "subject only to the rule of law"; and article 117.4 of the Constitution makes clear that judges shall not exercise any powers other than those expressly allocated to them by the law. A court cannot decide not to apply the law even if it considers the law unconstitutional: all it can do is to bring the matter before the Constitutional Court (article 163 of the Constitution). Naturally, the courts must construe any law in accordance with constitutional principles and values, and

[10] http://www.juecesdemocracia.es/txtComunicados/2012/16febrero12.htm [Date of access: 31 May 2012]

they must read any statute so as to conform to fundamental rights. But this interpretive function must be carried out within the limits reasonably allowed by the statutory language. Judicial activism is a positive thing only if not taken to the extreme in which the courts' discretionary powers replace the democratic legislature's will: as expressed by Lord Bingham, "*judicial activism, taken to extremes, can spell the death of the rule of law*" (Lord Bingham, 9).

Indeed, the ILO Convention 158 (1982) —an instrument ratified by only 9 EU states (Spain, France and Portugal among them), and not ratified by important European countries such as Germany, Austria, Denmark, Italy, Belgium, the Netherlands, and the United Kingdom— does not prevent any country from establishing a standard of judicial review as that provided for by Law 3/2012. Article 9.3 of this Convention says: "In cases of termination stated to be for reasons based on the operational requirements of the undertaking, establishment or service, the bodies referred to in Article 8 of this Convention [court, labour tribunal, arbitration committee or arbitrator] shall be empowered to determine whether the termination was indeed for these reasons, *but the extent to which they shall also be empowered to decide whether these reasons are sufficient to justify that termination shall be determined by the methods of implementation referred to in Article 1 of this Convention* [laws, regulations, collective agreements, arbitration awards or court decisions or in such other manner as may be consistent with national practice]." Presently, in a country like Sweden which has ratified the Convention, "the courts *do not examine business assessments made by employers which lead to decisions to reduce their workforce*, unless there is reason to suspect that a given dismissal is due not to business considerations in the sense envisaged by the Employment Protection Act but to reasons which in reality relate to the individual employee concerned" (T. Sigeman, 269). In the same vein, ILO Recommendation 119 (1963) states that the power to examine the reasons given for the termination of employment does not imply that the neutral body should be empowered to intervene in the determination of the size of the work force of the undertaking, establishment or service (5.2).

The real issue is whether the new legislation leaves the interpretation of the fair reason for redundancy to the labour courts' discretion. The new legislation provides that a decrease in sales or ordinary revenue over a period of three consecutive quarters is a fair reason for redundancies. Does this wording leave any margin of interpretation? The answer is clearly in the affirmative: how large the decrease must be is just a doubt among many others raised by the new legal wording. Therefore, the question relating to the existence of a margin of interpretation has to be answered in the affirmative.

Moreover, though the law does not mention the requirement of reasonableness and in fact intends to prohibit courts from substituting their own assessment of the rationality of the dismissals for the employer's assessment, the labour courts may legitimately resort to other legal concepts, such as the general legal ones of abuse of rights (in the sense of the antisocial exercise of one's own rights) and evasion of the law ("*fraude à la loi*", "fraude de ley"). Admittedly, these general legal concepts should be used only in extraordinary circumstances: the case law states that either the abuse of rights or the "fraude" cannot be ordinarily presumed. Nevertheless, our provisional finding must be that it is far from clear that the 2012 Labour Reform will fully achieve its objective of ensuring legal certainty regarding the definition of fair reasons for redundancies.

The intended transformation of the role of the labour courts in redundancy cases goes along with another important legislative decision. As a matter of principle, the labour courts in charge of determining in the first instance all kinds of labour claims are the one-judge courts established in every provincial capital and, additionally, in larger towns and cities (*Juzgados de lo Social*). This has been the general rule for decades, with very few exceptions justified on the grounds that the territorial scope of the claim exceeded that of the province or district (e.g. a union disputing an employer's interpretation of a nation-wide collective agreement must lodge the claim with a court with national jurisdiction). Hence, it is particularly striking that the 2012 Labour Reform provides that *all* collective claims challenging collective dismissals will be lodged not with the one-judge courts (*Juzgados*), but with the higher courts established in every Autonomous Community (Superior Courst of Justice) or with the so-called "Audiencia Nacional," which is a labour court with national jurisdiction. This is a modification of the previous general rule, because even if the collective dismissal occurs in a company with a sole establishment

within the jurisdiction of a "Juzgado," the claim against the company must be lodged with the Superior Court of Justice of the Autonomous Community in which that establishment is located.

There are several plausible explanations as to why the Government has decided to modify the traditional allocation of judicial functions among the different kinds of labour courts. However, since there is no formal statement on this particular subject, we do not have any "official" explanation; hence, we cannot affirm that any of these plausible explanations is the one that has in fact motivated the legal modification.

One plausible explanation is that the Government has tried to avoid different ways of interpreting the law. As of 1 January 2010, there were 331 one-judge labour courts ("Juzgados") in all of Spain. By contrast, there are noticeably fewer higher labour courts with first-instance functions: 21 "regional" labour courts and 1 national labour court. By allocating collective dismissal cases directly to these regional and national courts (skipping the "Juzgados") the Legislator reduces the chances of ending up with different ways of interpreting the law. However, this numerical reduction by itself does not mean that the 22 labour courts will reach the same conclusions about the meaning of the law; indeed, it is a virtual certainty that the 22 labour courts will hold mixed opinions. This means that any decision taken by the 22 labour courts in collective dismissal cases may be appealed to the Supreme Court. By skipping the "Juzgados," the new legislation not only makes possible for the Supreme Court to produce "binding" case law in a relatively short period of time (in 2013 there may already be a few Supreme Court decisions interpreting fair reasons for redundancy), but also makes it possible for the Supreme Court to review *all* collective dismissal cases, as long as the party who has lost in the first instance lodges an appeal. This latter aspect is clearly the most important: if the law had established the Juzgados' jurisdiction over collective dismissal cases, the appeal to the Supreme Court would be extremely difficult in practical terms.

For all the changes introduced to the system of adjudication of collective dismissal cases, the issue of "judicial activism" by the "Juzgados" remains in force for "individual redundancies" or, for that matter, for substantial modifications of employment conditions. Individual employees affected by individual redundancies ("despidos objetivos") may challenge the dismissal before a one-judge labour court. If we take a look at Figures 3 and 6 (above), we can confirm that the incidence of "individual redundancies" is greater than that of "collective redundancies." Moreover, individual redundancies have higher incidence in smaller companies by comparison with larger ones: the legal threshold for a collective dismissal is at least 10 employees (or at least 6 employees if the company is shutting down all its activities); therefore, small companies with less than 25 employees are not likely to use the collective dismissal procedure. The one-judge labour courts may exercise an enormous degree of discretion when examining the fair reason for individual redundancy alleged by the employer; and though their decisions may ordinarily be challenged before the Superior Court of Justice and even reach the Supreme Court (especially through the newly enacted prerogatives of Public Prosecutors regarding appeals in cases involving the interpretation of legal provisions which at the time legal proceedings begin in the first instance have been in force less than five years), first-instance decisions produce immediate effects that may be detrimental to companies, even though the decisions may eventually be overruled by the higher courts.

IX. Conclusion

The traditional Spanish employment relations system concerning firm adjustment may be described as uncertain, unbalanced and individualistic. Legal uncertainty over fair reasons for redundancies and substantial modifications of employment conditions remains even after the 2012 Labour Reform. The system continues to be unbalanced, both from the perspective of employers and from that of employees. Small employers can hardly manage to gather the paperwork and other kind of evidence needed at trial to prove a dismissal case or a unilateral substantial modification of employment conditions (e.g. a decrease in sales). Temporary employees, who in practice face hyper flexible employment conditions and employment at will, compensate smaller employers for this rigidity. These are well-known facts among specialists and practitioners. A less commented part of this story is the individualistic approach

to employment protection. The collective protection that unions and other employee representatives (works councils, etc.) can provide (social plan, labour market services, etc.) covers a small fraction of the workforce: thus, for most employees the only protection is a lump sum payment followed, if the individual has worked a sufficient amount of time, by unemployment benefits. The protection that the courts can provide is strictly limited: unless the dismissal is void because of discrimination, harassment, retaliation, or some other reasons, the court can only raise the amount of the lump sum payment from 20 days' salary per year of work to 45 (or 33) days' salary per year of work.

It is possible to think of a better use for these financial resources. The innovation introduced by the 2010 Labour Reform restricting the ability of the labour courts to invalidate the substantial modifications of employment conditions agreed with the employee representatives should be extended to collective dismissals. Thus, the law would provide a strong incentive to building "productivity coalitions" by companies and employee representatives (Dubin, 2012). The result would be an increase not only in procedural simplicity but also in fairness: those companies that invest in employee participation and conclude agreements for substantial modifications or redundancies should not have to prove their business reasons before a court. Furthermore, the collective and bilateral administration of the employment adjustment process can design more efficient ways of compensating employees who end up losing their employment. A large fraction of the redundancies and dismissals related to productivity reasons have taken place without any collective involvement on the part of employees. This happens at the cost of paying high severance compensation (it used to be 45 days' salary per year of work, but for contracts entered into after 12 February 2012 it will be 33 days' salary per year of work) to individuals who are left unemployed and largely on their own in search of new employment opportunities.

Over the last few decades, it has been quite difficult to justify or get approval for dismissals based on business-related reasons (entailing a severance payment of 20 days' salary per year of work up to a maximum of one year's salary). At the same time, it has been extremely easy to dismiss employees through the so-called "express dismissal procedure" (with much higher cost: 45 days' salary per year of work up to a maximum of 42 months' salary). This historical experience led to the reasonable conclusion that termination costs in Spain were far above the European average, which in turn has paved the way for a reduction in unfair dismissal compensation. Moreover, legal uncertainty as to the construction of the fair reasons for dismissals and substantial modifications has encouraged firms to seek alternative, distinctly sub-optimal paths to flexibility (eg. temporary employment).

Even though express dismissals have been a prevailing trait of our employment relations system, Spain ranks second (after Germany) among OECD countries in terms of contested dismissal cases (Venn, 2009, 33). Over the past few decades, the employment courts have had a leading role in determining the possibilities and costs for employers of adjusting employment to actual business needs. Thus, the high rate of individual dismissals acknowledged as unfair by employers (express dismissals), along with an OECD-leading rate of fixed-term employment, have been the by-products of a legal system unable to adequately deal with workforce restructuring. Setting aside the long-standing problem of a dual labour market, the high rate of individual unfair dismissals has led to at least two negative consequences. First, employers have faced huge costs of restructuring, disproportionately high for small companies: instead of severance payments of 20 days' salary per year of work, they have faced unfair dismissal compensation of 45 days' salary per year of work. These huge costs, in turn, have often resulted in decisions to postpone restructuring or simply no restructuring at all. Second, employees unfairly dismissed on an individual basis have lacked union representation, collective control of employer decisions, and also the kinds of social measures that typically go along with collective dismissals (retraining, outplacement, etc.).

It is clear that the Legislator's intent in 2012 is to discontinue the practice of express dismissals and to make firms use individual and collective redundancy procedures for all business-related dismissals. But this objective is contradicted by the simultaneous decision to reduce compensation for unfair dismissals. Moreover, the new legal framework is likely to lead to more litigation. On the one hand, firms no longer have the clear incentive to avoid litigation they used to have in the past (saving interim salary). On the other hand, after the new law, severance compensation for unfair dismissals is not exempt from taxation unless the dismissal is agreed after the employee has filed a lawsuit. The same conclusion

(more judicialization) may be reached regarding collective dismissals. Until the Decree-Law 3/2012, collective dismissals required authorisation by the labour authority. In practice, the labour authority typically issued the authorisation in order to approve the prior agreement reached by the employer and the employee representatives; it was generally quite difficult to obtain administrative authorisation without such prior collective agreement. Generally, the agreement was concluded at the cost of offering employees at least the unfair dismissal severance compensation. Overall, the system was expensive but reliable: if there was agreement, the labour authority granted the authorisation, which, in turn, was almost impossible to challenge before an administrative court. Now, however, as the 2012 Reform has abrogated administrative authorisation, collective dismissals may be challenged before a labour court. The employer continues to be required to negotiate in good faith with employee representatives before announcing its decision: if the employer and the employee representatives conclude an agreement, the employer's decision to dismiss based on the terms of the agreement is still subject to possible (and likely) lawsuits both from the individual employees affected and from any unions which did not sign the agreement. As expected, both individual and collective lawsuits are possible (and likely) where the employer, after fruitless negotiations with the employee representatives, unilaterally makes the decision to dismiss a number of workers. Though the legislature provides a technical mechanism ensuring that all these possible collective and individual lawsuits against a collective dismissal receive a unitary response from the labour courts, the basic problem still lies in the uncertainty surrounding the interpretation of the fair reasons for dismissal.

Thus, it seems that much of the game surrounding dismissals and modifications will continue to be played out in the labour courts. If this interpretation is correct, then the 2012 Reform may fail in its attempt to reduce legal uncertainty. But this may be inevitable if along with a more flexible legal design of employment adjustment measures the legislature does not try to strengthen social dialogue at the workplace level.

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Coalitions Against Change: The (Real) Politics of Labor Market Reform in Spain[1]

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Abstract: Conventional wisdom attributes the persistence of labor market rigidities in Spain to the power of insiders, typically identified as unions and permanent workers whose interests they supposedly represent. In this article, I take issue with this definition of the insiders, showing that in fact the robustness of existing labor market institutions in the face of long-standing problems of precariousness and unemployment can only be explained if the definition of "insiders" is expanded to include a far larger group of cross-class actors.

Key Words: social partners, labor market institutions, authoritarian legacies, Spain, labor market reform, social dialogue.

I. Introduction

The labor market reforms introduced in February 2012 and confirmed in July 2012 by the conservative Popular Party government under the leadership of Mariano Rajoy may well prove to be the most radical changes in the regulation of the Spanish labor market since the timid introduction of collective bargaining by the Francoist dictatorship in 1958.[2] The legalization of independent labor unions and the introduction of effective constitutional protections for workers' rights with the Transition to democracy in 1977 shifted the balance of power in the workplace. However, much of the Francoist institutional legacy with respect to collective bargaining and the content (if not the substance) of individual worker rights remained largely in place. The latest labor market reforms, by contrast, include measures that are likely to first, transform the structure, logic and reach of the current collective bargaining system and second, radically reduce the historic protections enjoyed by permanent workers that have contributed to persistently high rates of precarious employment.

The law sharply reduces the costs of dismissal for permanent workers and greatly expands employers' abilities to reorganize work, reassign workers and reduce salaries. It also introduces a one-year training contract (for firms with less than 50 employees) during which time workers can be fired at any moment at no cost. Judicial and Labor Inspection Corps oversight of management decisions concerning both internal flexibility and layoffs has been reduced in ways that are wholly unprecedented, sparking claims of inconstitutionality from certain quarters of the judiciary and perhaps reinforcing the very un-

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[2] Royal Decree Law 3/2012, 10 February and Law 3/2012, 6 July.

certainty surrounding judicial rulings that the reforms seek to reduce.[3] The reform also seeks to promote a radical decentralization of collective bargaining and the rapid readjustment of the contents of collective agreements: it inverts the historic privileging of sectoral over firm-level collective bargaining agreements and puts an end to the ultraactivity rules that left in place indefinitely any collective bargaining clause unless both sides agreed to its revision or elimination. Finally, the reform seeks to promote more effective labor market intermediation by requiring employers to provide training to workers whose jobs have been changed significantly, by obligating 20 hours of paid training leave for workers with at least one year's seniority and by removing remaining restrictions on private labor market intermediaries.

Given the depths of the current economic crisis in Spain and the growing chorus of demands for significant labor market reforms from key actors at home and abroad, it is hardly surprising that a newly arriving center-right government with an absolute majority would make comprehensive labor market reform a pillar of its agenda. More suprising, given historically poor labor market performance and a relatively weak labor movement, is the fact that change has taken so long. This is the puzzle motivating this article: why has labor market reform long proved so difficult in Spain?

Across the "Bismarckian" welfare states of continental Europe, historically low activity rates among women and significant unemployment problems dating back to the 1970s have been corrected over the last two decades through a variety of largely incremental reforms, structural economic changes and strategic shifts in employer strategies that have been collectively labeled processes of "dualization."[4] In many of these countries, one important element in the explanation for better —if generally much more unequal— labor market performance has been the declining influence of the social partners over workplace outcomes. In Spain, however, the social partners' influence (albeit in many ways limited) over workplace outcomes has remained largely constant until now, despite the fact that the main labor unions and employer associations are far less able to coordinate actions across organizational levels than their counterparts in most other Bismarkian political economies.[5]

Spanish labor market reform efforts since the return to democracy have centered around a process of "flexibility on the margins" that has encouraged employers to achieve competitive adjustment through an enormous expansion in temporary employment that has failed to alter a decades long pattern of employment boom and bust (Toharia y Malo 2000). The evidence that Spanish employers adjust via employment levels rather than wages or working hours is incontrovertible. Official unemployment figures rose from 8.3% in the fourth quarter of 2006 to 22.85% in the fourth quarter of 2011,[6] while temporary employment rates dropped in corresponding fashion, from 34% of the active population in 2006 just before the crisis began to "only" 24.9% in 2010.[7] Inevitably, then, as the world's capital markets turned bearish on the solvency of both public and private sector debt in Spain, labor market reform was considered by many observers to be just as essential as retrenchment in public spending.[8]

Conventional explanations for the longevity of the Francoist institutional legacies point a finger at labor market insiders. The literature broadly identifies the insiders in Spain as workers with permanent contracts who enjoy significant protections from either dismissal or the unilateral introduction by employers of major changes in their working conditions. The dominant unions, so the argument continues, have strong institutional incentives to defend the interests of these insiders. These widely repeated claims significantly overstate the protections enjoyed by permanent workers in Spain and the ability of the major unions to defend labor market institutions that they supposedly alone support. In so doing, they almost entirely ignore other collective actors and employers who have had every bit as large a stake in the current labor relations system.

[3] Comunicado de JpD ante la Reforma Laboral (Statement by Judges for Democracy regarding the Labor Reform), 16 Feb. 2012. Downloaded 28 Feb. at http://www.juecesdemocracia.es/txtComunicados/2012/16febrero12.htm. My discussions with employer-side lawyers suggest that this concern may well limit changes in employers' behavior, particularly in larger firms likely to be held to a higher standard than their smaller counterparts.

[4] For an excellent overview of these processes, see Patrick Emmenegger et al., eds. (2011).

[5] For comparative data, see Traxler, F. (2003).

[6] Encuesta de Población Activa, www.ine.es

[7] Eurostat Labour Force Survey.

[8] See *inter alia,* Wölfl, A. and J.S. Mora-Sanguinetti (2011) and International Monetary Fund (2011).

In this article, I will develop a more nuanced definition of labor market insiders in Spain and define the key power resources that have enabled them to maintain and even strengthen their control over critical institutions in the face of the worst labor market crisis in Spain since the era of the democratic Transition. I argue that reform in Spain has been so slow in coming because the cross-class coalition that favors the current regulatory framework has remained far more cohesive than the forces that continued to defend Bismarckian frameworks of labor market regulation in many other countries. The robustness of this coalition has rested on four critical foundations. First, its members broadly share a belief that Spain's labor market problems, serious as they are, have less to do with the regulations themselves than with the ways they are applied —by the labor administration, by the social partners and by employers and workers themselves. Second, the complexity of Spanish labor market regulation has enabled the coalition's members to define themselves as a privileged epistemic community uniquely capable of managing the labor market in an orderly fashion. Third, the symbolic importance of social dialogue has made politicians reluctant to challenge the privileged position that the members of this coalition have adjudicated for themselves. Finally, those firms best positioned to organize challenges to the existing regulatory framework have, in fact, been able to pursue successful competitive adjustment; in other words, the Spanish regulatory regime has long been far more flexible than is conventionally understood.

The article will proceed as follows. Section II offers my definition of the insiders in the Spanish labor market while Section III provides an analysis of the ways and extent to which Spanish firms have been able to pursue competitiveness adjustment in the face of such supposedly rigid labor market institutions. Section IV defines the major institutions of the Spanish labor market and the incentives that bind together the insider coalition in support of these institutions. Section V seeks to resolve the paradox that animates this article —the persistence of these institutional rigidities despite the weakness of the main producer organizations—, that is, how the dominant coalition has managed to impose its preferences until now. It is followed by a brief conclusion.

II. The Vanguard of the Status Quo

The classic explanation for why Spanish labor market reforms have taken the form they have —flexibility on the margins— is twofold. First, because the unions' median member is a permanent worker, they are reluctant to accept legislative changes that prejudice their core constituency. Second, while affiliation rates in Spain are quite low, unions have organizational links to a far larger number workers through two key institutions: on the one hand, through formally independent but generally union-linked worker representatives on works councils in most medium- and large-sized firms; on the other, through high rates of worker coverage for the automatically extended sectoral collective bargaining agreements negotiated in the overwhelming majority of cases by the two dominant unions. Because union seats at sectoral bargaining units are distributed based on the number of delegates they obtain on works councils, unions have strong institutional incentives to defend the interests of works council voters, not only in sectoral bargaining but also in political negotiations regarding the future of labor market regulation and social policy (Dolado et al., 2010).

Thus, the argument goes, the key median supporter of Spanish unions is not necessarily an affiliate, but rather a voter in the shopfloor elections —in other words, Spanish unionism is electoral rather than organizational unionism. While ties to the electorate may be weaker than those of a more conventional union organization with its members, the unions do possess a substantial capacity to mobilize this broader "electorate" against legislative initiatives contrary to their members' interests, as demonstrated by their recourse to the general strike and relatively high levels of labor conflict, especially around the negotiation of collective bargaining agreements (Rigby and Marco Aledo, 2001).

This, at least, is the conventional story, one in which labor market rigidity in Spain is almost entirely attributed to unions' successful defense of labor market insiders' interests. However, this argument significantly overstates the capacity of Spanish unions to resist legislative changes in labor market rules. While some general strikes have led to the withdrawal of proposed reforms, others have not. Indeed, even when legislative initiatives have been revised in the wake of a general strike, many of the changes

disputed by unions have remained in place.[9] Critically, Spanish general strikes have always been one-day affairs —nothing like the weeks-long public sector strikes that form a critical piece of the French labor conflict repertoire. Spanish governments may at times prefer to modify legislation to avoid mass demonstrations, but unions have proven singularly incapable of successfully resisting legislative change to which governments are strongly committed.

The conventional wisdom also grossly understates the ability of employers to achieve the labor market flexibility they desire through unilateral action and, in some cases, negotiated settlement. As I shall show in the next section, the Spanish labor market is far less rigid than is conventionally depicted. In fact, the relaxation of restrictions on external flexibility dating back to 1984 has enabled many employers to achieve high levels of both external and internal flexibility through a manipulation of contracting categories.

The fact that real levels of flexibility in the Spanish labor market are far higher than is often recognized, does not, however, prevent employer associations and their allies from joining the long-standing chorus of international agencies demanding substantial labor market reforms. Even heterodox critics who endorse many of the claims made here about the effective levels of flexibility in the Spanish labor market, would agree that the inefficiencies and inequities created by a model of competitive adjustment through employment levels cries out for reforms to reduce repeated cycles of intensive creation of precarious employment followed by equally intensive job destruction (for example, Navarro et al., 2011 and Fishman, 2012).

If unions' effective abilities to resist legislative reforms are far more limited than is often claimed, how is it that labor market reform efforts in Spain have not been more extensive? Quite simply, the web of actors committed to maintaining much of the extant regulatory framework goes far beyond the main union organizations and the labor market insiders they supposedly represent. These actors share not only a readily identifiable set of common interests in the status quo regulatory framework, but also two further elements that are critical to the maintainance of their unity and their ability to repel efforts to build alternative coalitions: a set of common beliefs that strengthen unity within a coalition of actors who are constantly managing major differences among themselves and a credible claim to exercise an an almost exclusive monopoly on the professional expertise required to manage critical regulatory aspects of both collective and individual employment relations —contracting and separations, job classifications, the structure of compensation and the workweek, and, critically, the resolution of conflicts regarding the application of rules derived from both legislation and collective bargaining. Moreover, as detailed in the next section, leading Spanish firms that would be best positioned to press for comprehensive labor market reforms have largely been able to adjust, reducing their incentives to invest their political capital in pressures for reform.

III. The Economic Consequences of Spanish Labor Market Regulations

Handwringing about labor market rigidities aside, many industrial firms in Spain have proven to be quite capable of meeting world-class productivity standards, with autos (including a large domestic auto parts industry), chemicals and machine tools demonstrating particularly robust performance.[10] These employers would of course prefer to pay lower severance for long-term employees than is *de facto* required; many would also prefer not to have to negotiate internal flexibility with works councils and union sections. The critical point, however, is that these firms have consistently achieved world-class productivity standards in highly competitive businesses.

Why are Spanish aggregate productivity numbers so low, then? First, low value-added sectors like tourism, construction and commerce have long constituted a relatively large part of the Spanish

[9] The 14 December 1988 general strike declared by the two majority unions pushed the Socialist government to withdraw its proposal for a low-cost y outh employment contract. However, strikes on 28 May 1992 against a reduction in pensions and on 27 january 1994 against a far more ambitious set of labor market reforms than in 1988 had only limited impact on the final legislation; the same fate befell the general strike held on 29 September 2010. Even the much heralded withdrawal of the Aznar government's 2002 reform proposal after a general strike on 20 June 2002 was in fact only a partial trimming back of the government's proposal.

[10] For autos, see Guillén (2000), for machine tools, Kohler and Woodard (1997). See also Antrás, (2010a, 2010b and 2011).

economy. Second, Spanish firms frequently have an especially short-term focus. During years of economic bonanza, they record higher profit taking and reinvest far less in research and development than most of their European counterparts. Third, service sector, utility, and construction firms are overrepresented among the largest domestic firms and have a long-consolidated competitive advantage in winning public sector contracts or gaining regulatory approval for comparatively high tariff rates. They have successfully managed their relationships with central, regional and local administrations in ways that have effectively shuttered their markets from international competition. Such strategies have obviously minimized pressures for labor productivity-enhancing innovations. Fourth, the SME sector occupies a comparatively high proportion of employment, and many of these firms suffer from limited managerial skills and compete largely on price. It is precisely these politically weak SMEs whose productivity is most compromised by the current regulatory framework (OECD, 2010).

A final, obvious, source of low aggregate productivity is the explosion of temporary employment after the 1984 labor market reform. Given the historic cost-based strategies of smaller (and many not so small) Spanish firms, it is not suprising that precarious employment emerged as a pivotal element in many companies' human capital strategies. The relative inexperience of temporary workers negatively impacts their productivity. Moreover, as a considerable body of research demonstrates, temporary employment undermines incentives to investments in training by both employers and workers (Wölfl and Mora-Sanguinetti, 2011).

Bigger employers in Spain are by and large able either to adjust or to pass on the costs of low productivity to their customers.[11] This fact provides us with a first approximation towards an explanation for the absence of more thoroughgoing labor market reforms: for large firms, the extant regulatory framework is workable. The story for many —if not most— smaller firms is quite different. For these firms, easy recourse to temporary employment reduces incentives to abandon traditional, cost-based competitive strategies. At the same time, smaller firms where there are frequently no worker representatives or union links must resort to informal and often outright illegal practices in order to obtain the flexibility they seek with respect to wages, working hours and job assignments. They are also burdened by the same layoff costs for permanent workers and rules governing sickness, disability and maternity leave as those facing larger firms. These complications make many SMEs extraordinarily reticent to add permanent staff, effectively discouraging them from building competitive strategies around investments in human capital.[12]

Two aspects of Spanish labor market regulations have been particularly onerous for the firms that fall into this latter category: the relative scarcity of exemptions from labor market legislation for smaller firms and the automatic application of sectoral collective bargaining agreements to all firms within the geographical footprint of the agreement (with little margin for opting out of agreements). Both of these elements have been significantly altered by the latest labor market reform, perhaps marking a radical transformation of the Spanish labor relations model. Given the enormous productivity costs imposed by the absence of significant reforms until now, the remainder of this article will discuss why the many firms and sectors that have been especially disadvantaged by the extant regulatory framework have proven so powerless to achieve more thoroughgoing reform, and offer some final conclusions on the politics underlying the latest regulatory changes.

IV. The Politics of Labor Market Regulation in Spain

The collective actors charged with setting and administering labor market and labor relations rules in Spain have long enjoyed an extraordinary degree of autonomy from both political authority and other economic actors. This autonomy derives not from exceptional organizational strength but rather from their common interest in and ability to defend a near-total monopoly over a key set of highly institutionalized functions whose origins can be traced back to the peculiarities of the Spanish transition

[11] My research reveals that large firms that relied on individual or small group side-payments to obtain flexibility while marginalizing worker representatives during flush economic times have also run into difficulties in the present environment. I will return to this point later. See Dubin, 2012.

[12] Roundtables with small-business administrators, spring 2011.

to democracy. The dominant unions and employer associations in Spain negotiate sectoral collective bargaining agreements that are automatically applied to almost 90% of Spanish workers. In exchange for their services, the main producer organizations long held a virtual monopoly over public funds for on-going training in the workplace and significant public subsidies to support their operations. They are also the only organizations recognized by the State to engage in bipartite or tripartite negotiations with respect to both labor market and social policies. These same organizations, along with a large number of SME advisors and law firms, interpret labor market rules on behalf of employers and workers (whether derived from legislation or collective bargaining agreements) and serve as representatives in the highly judicialized conflict-resolution process.[13] For both workers and their employers in firms without a significant union presence, these intermediaries provide an authoritative definition of the rules governing the workplace.

Collective Bargaining Institutions

Most workers in Spain are covered by a sectoral collective bargaining agreement. Most of these agreements are provincial, giving rise to literally thousands of bargaining units.[14] As I discussed above, unions gain access to negotiate sectoral agreements based on the number of delegates they obtain in works council elections. An employer organization is considered representative at the sectoral level when its represents at least 10% of the employers in the sector who employ at least the same percentage of workers within the geographical territory of the bargaining unit.[15] However, absent a correlate of the works council elections for employers, there is no clear test of an employer associations' real representativeness. In practice, in those sectors with a relatively strong culture of employer organization, this is rarely a controversial matter. In others, however, significant disputes may arise regarding the legitimacy of the employer association.

These complex criteria and the problems associated with them reflect the highly unusual origins of the current structure of collective bargaining. At the beginning of the Francoist dictatorship, independent unions and collective bargaining were prohibited, with wages and working conditions set by the Ministry of Labor. Both workers and employers were required to join the vertical syndicates of the Spanish Syndical Organization (Organización Sindical Española, OSE); however, for many years the OSE provided only social services and relatively ineffective legal representation for workers in the case of disputes. In 1958, the regime introduced limited collective bargaining. Larger firms could bargain over a narrow range of issues (wages and little else) with workplace representatives in the *jurados*, precursors to the current works councils (*comités de empresa*). At the same time, sectoral agreements could be reached within the vertical syndicate itself, with the organization's bureaucrats representing both parties.[16]

When the vertical syndicates were dissolved during the transition to democracy, they left a legacy of thousands of sectoral collective bargaining units without bargaining agents. In the context of severe economic crisis and high levels of worker conflict, finding interlocutors to renegotiate these agreements was a key political priority. Recognition of the most representative union organizations through works

[13] In 2009, there were 348,106 conflicts resolved by the Spanish labor courts. However, contrary to the claim repeated incessantly in the Spanish media from left to right in recent times that this is the number of "collective" conflicts, the actual number of collective conflicts resolved in the courts was only 2,263 (which amounts to about 40% of the total number of agreements in force).

[14] In 2006, there were more than 5000 collective bargaining agreements in force in Spain. Firm-level agreements were of course the most numerous, but only affected 9.25% of workers, while the 900-odd provincial (sectorial) agreements affected 55.5% of all workers. 27.4% of workers were covered by one of the 60-some national agreements. See Márquez Sánchez, 2008.

[15] Workers' Statute, art. 87.3. Note that this criterion allows an association of small firms in a given territory to exclude from the bargaining table a single large employer that provides more than 50% of all employment in the region or province. The 2011 reform changes these criteria to make an association representative when its members employ at least 15% of all workers in the unit. This change was a response to pressures by large firms in certain sectors excluded from the provincial bargaining table by associations of SMEs seeking to impose costs on their larger competitors in the form of wages and working conditions that the smaller firms would simply not enforce. Interviews with human resource directors of large firms, members of executive committee CEOE, Spring 2011.

[16] In a limited number of cases, worker representatives connected to the democratic opposition were successful in infiltrating lower levels of sectoral bargaining, a strategy that was largely repressed after 1968. See Amsden, 1974.

council election results provided a relatively transparent heuristic at a time when no objective data existed on membership in the many fledging unions.[17]

The identification of employer representatives followed an altogether different script. Except in a few sectors in regions characterized by intense industrial conflict during the waning years of the dictatorship, most of the employer representatives for sectoral agreements were not truly independent associations of leading employers but rather small law firms created by former employees of the vertical syndicates who previously had been responsible for negotiating these agreements. In a minority of cases, these opportunistic former bureaucrats would end up building effective forums for the coordination and aggregation of employers' preferences. In many others, however, these new employer associations' activities would be largely limited to resisting as best they could unions' demands for higher wages and fewer working hours and copying into their sectoral agreements, often word-for-word, changes in legislation or agreements reached by the peak inter-sectoral organizations.[18] Indeed, in sectors where employers' associational activities were (and generally still are) particularly weak, sectoral (provincial) collective bargaining agreements are often negotiated by territorial rather than sectoral organizations; in these cases, those representing employers at the negotiating table often have no experience in the sector.

Collective Bargaining Agreements as Law

One important consequence of the structure of collective bargaining in Spain is that, for all but the largest employers or the exceptional entrepreneur who saw a business opportunity in taking over the regional employer association in his or her sector,[19] sectoral collective agreements are virtually indistinguishable from labor legislation. This gap between employers and their putative representatives is reinforced by the institutional mechanisms through which collective bargaining agreements are communicated and applied. On a largely symbolic level, all sectoral and most firm-level collective bargaining agreements have the status of laws rather than private contracts and, as such, are published in the official state bulletin announcing legislative changes, regulations and public tenders. This practice, an artefact of the dictatorship, may well reinforce the impression that those negotiating sectoral agreements are officially-sanctioned technocrats setting rules to which all but a few especially influential firms must conform. As the president of the Economic and Social Council from 1992 to 2001 explained, "It's surprising that employers and unions legislate. However, this situation is unlikely to change over the short term because *many people make a living from collective bargaining*."[20]

The second factor distancing employers from the process of collective bargaining is the way in which collective agreements are applied. The management of labor relations in Spain is a narrow professional specialization. Most large firms, whether they have a firm-level agreement or apply a sectoral accord, have dedicated labor relations staff responsible for managing discussions with worker representatives in the firm and overseeing the application of collective agreements. Until at least the mid-1990s, human resource policies in Spain were generally managed by "personnel directors" (*directores de personal*) rather than specialists in human resources. Most of these directors were trained as lawyers or "social graduates" (formerly a three-year technical degree program and now a four-year university degree focused almost exclusively on employment law and labor relations); in either case, it was extremely unusual for these managers to have any significant training in human resource management (Guillén, 1994 and Consejo General de Colegios Oficiales Graduados, 2011). To the extent that human capital played a role in firms' strategic thinking at all, their concerns were almost entirely restricted to minimizing labor costs

[17] The 10% figure was arrived at by the governing center-right UCD as a way to ensure that both the Socialist party linked UGT and the then-stronger Communist party linked CC.OO. would both be recognized as most representative organizations, ensuring a divided union movement and, hence, a weaker Left opposition in parliament. See Fishman, 1982.

[18] This can be easily confirmed by even the most cursory review of sectoral agreements.

[19] A typical employer association at the provincial level will charge annual dues of some 20-30 Euros/employee. Given the extremely limited services offered, staffing is minimal at best, meaning these associations can be extremely lucrative for their promoters. Personal communication, senior labor relations manager, participant in multiple collective bargaining units across Spain.

[20] Comments of Federico Duran. *Expansión*, July 21, 2006. The italics are mine.

and increasing flexibility, particularly through the use of temporary contracts to minimize the number of workers eligible for the seniority rights spelled out in the law and in collective bargaining.

Today, human resource directors in most larger firms are not labor relations experts; however the divide between labor relations and human resource concerns remains largely in place. During the years of economic resurgence from the mid-1990s through late 2007, there was often little integration of the existing labor relations function into the new concerns of the human resources department —the structure and content of employee development, incentive compensation for key personnel, and the like. Indeed, my research suggests that human resource directors often express little interest in labor relations questions, considering collective bargaining and works council relations to be a largely technical matter setting limits on salaries, hours and working conditions (Dubin, 2012). Business education in Spain reinforces this limited coordination between human resource and labor relations specialists. Given the density of the regulatory framework governing employment in Spain, there is an almost shocking lack of attention paid to labor relations and labor law in general business education (MBAs and the like).[21] The historical consolidation of both the labor relations profession —social graduates, labor lawyers, union negotiators, labor inspectors, judges and their staffs in the labor courts— and the degree programs managed by these same professionals prior to the creation of human resource education and the correlary profession in Spain goes some way toward explaining this bicephalic structure of human capital management.[22] This profound division within the world of human capital management has only been deepened by the fact that Spanish MBA programs, first developed in concert with leading U.S. universities during the 1960s, provide human resources management training that mimicks the American curriculum's indifference to labor relations (Puig, 2003).

In smaller firms (to the extent that the human resources position exists at all), a similar division of labor exists. In fact, the separation between the labor relations function and human resource management in smaller firms is often even starker than in their larger counterparts: firms delegate labor relations functions to small business administrators (*asesorías* or *gestorías*) that are a prominent feature of the commercial infraestructure in even the smallest Spanish town.[23] Interviews with these intermediaries reveal that they are the only direct link between sectoral collective bargaining agents and most small firms.[24] The unanimous view of the advisors interviewed is that their clients do not make any distinction between employment law and collective bargaining agreements; both are simply viewed as external constraints on their freedom to manage.

The Consequences of Distance

The significant distance between the negotiators of most sectoral collective bargaining units and the employers and workers they claim to represent conditions the contents of bargaining. Although the range of topics open to collective bargaining (i.e., no longer legally mandated) was expanded substantially in 1994 (contracts, hours, job categories, probationary period, etc.), many sectoral agreements continue to include little more than a list of job classifications and the salaries associated with each category, the total hours to be worked, a list of sanctionable worker actions with their associated penalties and the occasional direct transcription of legal changes or agreements reached by the national level social partners.[25]

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[21] Specialists in labor relations almost never teach Human Resource classes at the major business schools and labor relations are almost entirely absent from the content of theses classes. Labor relations specialists are generally trained in separate, specialized programs.

[22] The publicly sanctioned, self-regulating professional association —the College of Social Graduates— was created in 1956. General business education programs in Spain were not really launched until the early 1960s. Consejo General…, 2011.

[23] There are almost 50,000 firms of this type in Spain. Escobar, 2011.

[24] Two roundtables carried out during early 2011 in the context of the project cited in fn 1 and many more informal conversations.

[25] The 2011 reform may well augment this distance in regions with little associative activity, as it permits the national employer association to negotiate sectoral, provincial agreements on behalf of local employers when there is no local association that can certify a membership level of at least 10%.

Even in sectoral negotiations led by employer associations that are relatively responsive to the firms they represent, it is extremely rare for the employer side to present unions with a platform of key demands. The so-called "employer offensive" widely documented in collective bargaining across Europe has been conspicuously absent in most sectors in Spain.[26] The leaders of employer associations have precious little to gain from engaging in dialogue with their members, as automatic extension of collective bargaining agreements guarantees their income. Closer examination of the details of the bargains they conclude might well threaten their positions of leadership and even give rise to challenges from newly created organizations. The limited dialogue between most sectoral employer associations and the employers on whose behalf they bargain places an obvious limit on the associations' abilities to aggregate interests and develop cohesive bargaining positions; the typical association's almost purely defensive negotiating strategy is a logical consequence of the dynamics of this relationship.

Union Disincentives to Organizing

Union representatives at the sectoral bargaining table often face similar incentives to minimize dialogue with their base. Most union bargaining agents are partially or fully "liberated" from their full-time positions in other organizations (firms, the public administration, private educational institutions, etc.). The term derives from the fact that works council representatives are entitled to dedicate a certain number of work hours to council and union business. Because these hours can be distributed irregularly among the members of the council, one or more works council representatives in larger firms often dedicate all of their time to union business. These *liberados* form the backbone of the full-time union staff; many negotiate sectoral collective bargaining agreements, and they may often do so for sectors about which they know quite little.

While union officials may claim to be committed to increasing affiliation rates, the reality is more complicated. The activities of works council representatives face far less scrutiny in firms where union affiliation is low (or non-existent) than in those where worker organization is significant; as a result, union elections in these low-affiliation sectors are rarely competitive affairs. Given the importance of works council elections to sectoral union officials' accountability, limited contestability at the firm level also implies less pressure on sectoral union officials (especially at the provincial or regional level).[27] In sum, in many sectors the low interest-aggregation equilibrium described with respect to employers also applies to the union side of the equation. Not surprisingly, the collective bargaining agreements in these sectors are largely limited to the most basic issues outlined above, as no party at the negotiating table has strong incentives to press for significant changes.

Conflict Resolution

During the Francoist era, workers' (individual) rights could only be defended legally by labor inspectors or through the specialized labor courts that were significantly expanded from the earliest days of the dictatorship.[28] Despite the significant reach of the opposition labor movement during the final years of the dictatorship, these courts were the only real recourse available to the overwhelming majority of Spanish workers before the transition to democracy.[29] When limited collective bargaining rights were reintroduced in the late 1950s, the agreements reached were considered to be laws. Not surprisingly, the juridification of employment relations quickly expanded to include collective as well as

[26] The absence of employer-side sectoral negotiating platforms was commented by numerous labor relations and human resource directors in our study.

[27] These dynamics do not apply in traditionally unionized sectors of the economy (although they may certainly exist at the provincial level in such sectors when there is little economic activity in the sector in that area).

[28] The fascist Falange that was most powerful within the Francoist regime at its very beginnings, was the main force behind the creation of the Mussolini-inspired *Fuero de Trabajo* (Workers' Charter) in 1938 while the Civil War was still far from decided. They were also the main proponents of the expansion of the Magistraturas de Trabajo, or Labor Courts. See Babiano Mora, 1998, Chapter II.

[29] Even today, 25 years after the name of the courts was changed to *Juzgados de lo Social*, many Spaniards continue to speak about going to "Magistratura" to defend their employment rights.

individual rights. The highly juridicized culture of employment relations consolidated under the Franco regime continues to cast a long shadow over contemporary dynamics.

For my purposes here, several points related to the management of collective relations are particularly relevant. Despite their claims to the contrary, the representative unions and employer associations demonstrate that they often view the labor courts as the most effective way to resolve their conflicts. Since 1989, these organizations have developed bipartite institutions for conflict resolution at the national (1995) and Autonomous Community levels. However, their greater confidence in the courts can be measured by comparing the relative utilization of these institutions for extrajudicial conflict resolution with the labor courts. At the national level, where the courts have far less jurisdiction than the bipartite institution (SIMA), in a typical year the national court resolves dozens of times the number of conflicts solved through arbitration in the SIMA (in 2010, the ratio was 273:3) (CGPJ, 2011 and Fundación SIMA, 2011).[30] The extraordinary level of juridification in contemporary Spanish labor relations can be seen in the fact that the approximately 5000 collective agreement in force currently generate more than 2000 court disputes in a given year.

In my discussions with legal representatives of all the major producer organizations, they have repeatedly expressed their confidence in the ability of the courts to resolve juridical disputes regarding the interpretation of their collective bargaining agreements. Ironically, this confidence has created a culture in which bargaining agents frequently leave the language of their agreements purposefully ambiguous because they find it easier to delegate the resolution of their conflicts to the courts. This confidence in the courts and the subsequent obscurantist language that it encourages reinforce the autonomy of the bargaining agents from their bases; if they themselves cannot easily interpret their own agreements, it is extraordinarily difficult for others to contest the positions they adopt and, thus, to dispute their authority. Perhaps not surprisingly, the minutes of the negotiations of sectoral agreements are not public documents; in a telling detail, however, they are frequently used by the bargaining agents themselves as they attempt to resolve their differences in the labor courts.[31]

V. From Incentives to Resources: The Politics of the Status Quo

Figures regarding the exact number of bargaining agents for sectoral collective agreements and those involved in the administration of the legal framework of labor relations in Spain are impossible to come by; however, several experts consulted suggest that the number of those involved in collective bargaining alone is likely to exceed 10,000. These actors comprise a cross-class coalition in favor of the existing structure, process and, in many respects, contents of collective bargaining. While common interest alone does not provide actors with the organizational and political resources necessary to impose their preferences on others, these bargaining agents have managed —at least until the most recent labor market reform— to defend the status quo against all challengers.

The above discussion has already described a number of the most critical resources deployed by these bargaining agents in the defense of their interests. First, their accountability to those employers or workers on whose behalf they negotiate is often quite limited. The rules governing representation at the sectoral bargaining level and the automatic extension of collective bargaining agreements to all firms reduce incentives for building closer ties with most employers and workers and, as a result, for the development of innovative content. Collective bargaining agreements that assume (albeit implicitly) continuity in forms of work organization and employment relations in general and, therefore, focus on a limited range of issues like the size of overall salary increases and total working hours avoid raising the stakes of bargaining in ways that might encourage more organized opposition to the privileged position currently enjoyed by so many of these bargaining agents.

Second, the incumbent players dominating the current labor market institutions can make plausible claims to possessing a near monopoly on the expertise required to manage the labor relations sys-

[30] My thanks to Francisco Gómez-Abelleira for drawing my attention to this issue.

[31] Personal communication with multiple officials from employer associations and unions.

tem and the administrative structure of individual rights. Both the collective bargaining system and the mechanisms for resolving both individual and collective differences between employers and workers often revolve around interpretations of the law and its limits, while differences among the negotiating parties are commonly resolved through the courts. The weaker the links between the bargaining agents and the parties they represent, the more likely the parties are to resolve their differences through battles over legal minutae. The juridification of conflicts and dispute resolution thus provides a strong competitive advantage to worker and employer representatives in the most poorly organized sectors.

If the above factors are sufficient to explain why the problems the current framework of labor relations generates for SMEs have not been addressed, the same is not true for larger firms. However, as I have discussed, larger firms are generally able to put in place the human resource policies they need to maintain their competitiveness. While they may well complain about the costs of layoffs or difficulties in achieving internal flexibility, the reality is that those firms most exposed to international competition have largely been able to maintain world-class standards of labor productivity.[32] The large firms that complain about the labor relations framework and who tend to voice neoliberal criticisms regarding the rigidities of the Spanish labor market are not those competing in world markets but rather those firms whose dominant position in domestic product markets has allowed them to manage labor "ideologically" rather than pragmatically and to pass on to their suppliers and customers the costs of their resistance to institutional incentives for collectively managed labor adjustment. Only with the arrival of the current crisis and the subsequent pressures on their margins have their complaints been transformed into more active advocacy of significant legal reforms (Dubin, 2012).

Finally, the authority of the main social partners has long been reinforced by their rhetorical claims to a supposed right to manage the labor relations system without political interference. The rhetorical cornerstone of this "autonomy" is the social partners' claim that labor market reforms should only be pursued through social dialogue. The current crisis has precipited the repeated collapse of social dialogue and enboldened both Socialist and Popular governments to pursue major labor market reforms unilaterally. The deployment of social dialogue as a rhetorical tool to defend institutional prerogatives has apparently collapsed under the weight of a crisis that has enabled outsiders to successfully press their demands for a wholesale restructuring of the rules governing the Spanish labor market. The rapidity with which Spanish labor market regulation has been transformed can be understood more clearly when we see how little social dialogue has accomplished for anyone but its protagonists.

Social Dialogue as Power Resource

Social dialogue is defined by both unions and CEOE as an exercise in self-management, what they refer to as "autonomy" from the government. They deploy this term to denounce efforts by politicians that are assumed to encroach on issues that only *they* have the right to manage. The organizations take pains to assert their autonomy symbolically. For example, CEOE invited the Secretary Generals of both CC.OO. and UGT, but not a single politician, to the ceremony celebrating the retirement of its long-time president, José María Cuevas.[33] Similarly, they deploy the term to reject government policies they dislike as initiatives treading on the "social partners" exclusive responsibilities. Queried about the consequences of the PP's 2002 labor market decree reforms, the Secretary General of UGT responds,

> I lament that the government's position has contaminated social dialogue between the unions and the employer association. Together we're going to try to preserve this space. The government has acceded to one of the employers' longtime demands [lower layoff costs], but I'm confident they are not very content with the how or the when [just prior to the renegotiation of the national collective bargaining guidelines accord].[34]

[32] See fn 10.

[33] El País, June 6, 2007. Given the frequent meetings and signing ceremonies between Cuevas and senior politicians, along with the attendence of all three organizations' leaders at major political ceremonies, the failure to invite politicans to the event was clearly designed to send a message to the political class.

[34] ABC.com June 17, 2002 interview with Cándido Méndez, Secretary General, UGT.

If social dialogue means the rejection of global pacts and a commitment to protecting core values through a process in which organizational autonomy is safeguarded, it stands to reason that the process may collapse at any time. This institutional vulnerability has long been addressed by frequent assertions that social dialogue is a continual and enormously valuable process *regardless* of the results achieved. CEOE's next president, Gerardo Díaz Ferrán, declared in his inaugural speech that social dialogue with the unions and the government would be one of his main priorities because "things must be permanently renewed."[35] One rhetorical strategy to deflect from the scarcity of social dialogue's results is the claim that it contributes to social peace and sets a standard of civic culture for both politicians and society at large. According to the then Secretary General of CC.OO., José María Fidalgo, social dialogue provides "social cohesion" simply by bringing the parties together.[36] More expansively, Cuevas of CEOE declared at the signing ceremony for the 2006 reform that, "With this responsible exercise in collaboration we aim to offer a certain example for Spanish society at a moment in which attitudes of compromise, understanding, agreement or consensus are lacking. We are the *commando of calmness* [comando del sosiego]."[37]

Events that took place over the summer and fall of 2001 provide important perspective on these comments. The government had participated actively in the development, with the participation of both CEOE and the dominant unions, of two quite radical reforms of the structure and content of collective bargaining —the Bentolilla proposal (developed by a team of highly respected, mainstream labor economists) and the Plan Durán (developed by a prominent legal scholar and employer-side defense attorney). In addition to these two proposals sponsored by the Ministry of Economy, the Ministry of Labor developing three further proposals over the months of negotiations in an effort to bring CEOE and the main unions closer together.

Why did the PP not pursue a legislative solution in the face of union resistance to some of these proposals? After all, the PP enjoyed an absolute majority after the 2000 elections, so these efforts to promote a radical decentralization of collective bargaining, to put an end to the legal status of collective bargaining agreements and to do away with ultraactivity could easily have been legislated. The answer lies in the fact that CEOE was also opposed to many of the changes that the Ministry of Economy was so anxious to put in place, particularly eliminating the legal status of collective bargaining agreements and the decentralization of bargaining. The entire effort was abandoned when both CEOE and the unions turned on the government for attempting to "interfere" in an issue that they viewed as their exclusive domain.[38]

Asked his opinion of the new 2006 labor market reform, the former president of the Social and Economic Council and promoter of the Plan Durán declared his disappointment that the accord failed to introduce much-needed changes in the labor market, only to conclude that, "…the critical thing is that the tradition of social dialogue has been maintained."[39] This same position was voiced by senior officials of the Labor Ministry in the course of negotiations leading up to the 2006 reform: "It doesn't have to be a grand reform…but whatever measures we approve will be based on a consensus with the social partners."[40] This claimed reluctance to pursue reforms without consensus surfaced again as Ministry of Labor officials for the Zapatero government responded to disputes among the social partners regarding a new calculation for increases in the minimum wage: "We would not wish the process of social dialogue to become undone for this. We'll leave it to the end of the Legislature."[41]

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[35] El País, February 15, 2007.

[36] *ABC*, October 11, 2005.

[37] *Expansión*. February 7, 2007.

[38] For a summary of these negotiations, see García-Perrote, Ignacio. 2008. "La reforma de regulación legal de la negociación colectiva: estructura y contenido," in Various Authors. *La reforma del sistema de negociación colectiva y el análisis de las cláusulas de revisión salarial* (Madrid: MTIN); 27-56. Note that, by contrast, in France, when the Right is in power, Medef does not defend in nearly so strident terms the importance of the social partners' autonomy from the government. See Pélissier et al. 2008. *Droit du travail* (Paris: Dalloz), p. 27.

[39] Interview with Federico Durán, May 6, 2006, *Expansión*. It should be noted that Expansión is the largest circulation Spanish business daily and has a liberal ("free" market) editorial line sympathetic to Durán's call for far more profound labor market reforms. The Social and Economic Council is an advisory board composed of representatives from the government, the most representative unions and CEOE, and representatives of consumer groups. It is charged with analyzing economic and social policy and the development of labor relations; it also emits opinions on relevant legislative projects.

[40] *ABC*. October 11, 2005.

[41] *El País* November 11, 2006.

The grandiloquent claims of social dialogue's proponents suggest a widespread commitment to strengthening an institution that is of vital importance for the Spanish political economy. It therefore bears repeating that the only significant reforms in the regulation of the labor market since the Transition to democracy have been imposed through legislation.[42] More perplexing still, the proponents of social dialogue have invested the institution with expectations that are fundamentally incompatible.

For CEOE, social dialogue is an institution that can contribute to the realization of their fundamental goal of a more flexible, less regulated workplace in which government intervention ceases to be an obstacle in an ever-changing marketplace.[43] For the unions, social dialogue is an institution that can contribute to their core objectives of increasing cohesion and equality across social classes and supporting firms' efforts to compete on quality rather than price.[44] To understand what these goals mean in practice, we need to examine specific issues that have generated disputes within the process of social dialogue.

For the unions, social dialogue is a process through which they can negotiate an increased presence at the firm level throughout the economy. They consider this presence essential for building an economy in which greater flexibility is granted employers in exchange for a substantive employer commitment to decent jobs. To this end, they had proposed to CEOE the creation of union workplace safety delegates that would be assigned to a given territory with the mission of advising workers at smaller firms without dedicated safety delegates. The unions suggested that the government legislate the obligatory assignment of a specific number of delegates for each sectoral collective bargaining unit, arguing that "…the employers [i.e., bargaining agents from sectoral employer associations belonging to CEOE] will refuse to negotiate this innovation." CEOE was radically opposed to this move, explaining that, "in reality, the unions are trying to take one step forward toward greater involvement in questions of firm management."[45]

In the event, the unions managed to gain employer association support for territorial safety delegates in just one sectoral collective bargaining agreement —the construction sector in the province of Asturias. The possibility of a territorial delegate was recognized in the national chemicals agreement, but only when the lead firm or firms within a complex collaborative arrangement were in agreement. Meanwhile, several Autonomous Community governments sought to promote these delegates, but the legal status of these efforts is unclear.[46]

Similarly, the unions, with the support of the Socialist government, sought to reduce firms' abilities to sweat labor by treating as subcontractors individuals who are in reality employees. The unions proposed that independent contractors who earn more than 75% of their income from a single client (and have no employees of their own) be able to pursue disputes with their "employer" through the labor law courts rather than those dedicated to commercial law. A shift in jurisdiction would have meant a faster resolution of cases and free legal counsel for the subcontractor. Moreover, the labor courts would likely be far more receptive to the subcontractors' demands than the mercantile courts. For CEOE, the proposal would have created serious problems for employers' "juridical security."[47]

Underlying this dispute wass the more vexing issue of which organizations have standing to speak for subcontractors, traditionally "represented" by an association within CEOE. This arrangement had been challenged by federations linked to the unions that demanded not only a change of jurisdiction for dispute resolution but also unemployment compensation, early retirement privileges and an independent seat on the Economic and Social Council.[48] In other words, the unions not only sought to keep firms from reducing worker rights through outsourcing to dependent contractors, but also to increase their uni-

[42] The one true exception to this rule, the Moncloa Pacts of 1977, were an extraparliamentary pact among the major parties from which both the main unions and CEOE were excluded.

[43] Editorial by new president of CEOE. *ABC*, July 28, 2007.

[44] CCOO.es and UGT.es. See final programs from their respective last conventions.

[45] *Expansión*. November 24, 2006.

[46] I thank Patricia Nieto for her comments on these developments.

[47] *Expansión.* September 26, 2006.

[48] Ibid.

verse of potential members. Meanwhile, CEOE was hard-pressed to accept changes that would restrict employer rights in this field when the proposed changes would not only have reduced employer discretion but also would have challenged the very existence of an association affiliated to the organization.

That these seemingly irreconcilable disputes about jurisdiction were allowed to intrude on the agenda of social dialogue calls into question claims that it is a process designed to promote consensus. Indeed, the Zapatero government eventually adopted much of the unions' position on this issue in the Law 20/2007, 11 July, the Statute of the autonomous worker. Critically for the argument developed here, the changes were imposed wholly through the legislative process as the process of social dialogue was unable to move the issue forward.

A similar dispute raged over proposed revisions to the Law for Public Contracting. The unions, with the support of experts from the Economic and Social Council, proposed that the law prohibit firms that win public contracts from subcontracting any of the awarded contract to firms that in turn subcontract. There is a clearly established link between these subcontracting chains and a myriad of worker abuses and workplace accidents that representatives of CEOE have recognized and affirmed in public settings such as the Economic and Social Council. Yet, while supposedly committed to addressing these problems through social dialogue, CEOE bitterly opposed the proposal, arguing that it would create "juridical insecurity" and failed to take into account the evolving structure of firm organization.[49]

These episodes illustrate the profound and wholly incompatible objectives that CEOE and the majority unions hope to realize through social dialogue. For the unions, social dialogue is an opportunity to gain employer buy-in for new institutional arrangements that will strengthen their ability to regulate the workplace, whether workers are union affiliates or not. For CEOE, social dialogue is yet another forum through which the "discretion" of employers to manage as they see fit can be protected and, if possible, reinforced; any proposal that gives unions an opportunity to check employer strategies, whether through a greater presence in the firm or through the promotion of new legal restrictions agreed in social dialogue is, quite simply, a non-starter. Despite public rhetoric recognizing that many Spanish firms need to be prodded away from their reliance on precarious employment and low-cost production, CEOE's primordial commitment to its members is that it will safeguard at all times employer discretion against governmental and labor incursions.[50] Critically, however, as we have seen, this does not mean that CEOE's leaders want to do away with the institutions of collective bargaining, as these institutions are critical to the survival of the organization.

Social dialogue has been presented as a vehicle for both preserving the national market and maintaining social peace. To the extent that leading business and government elites believe that social dialogue promotes these goals, they will be loathe to challenge the institution. While the economic consequences of social dialogue are surprisingly limited and the degree of consensus regarding its objectives superficial, the unions and CEOE—along with governments of both the Right and Left— have long found in social dialogue an institutional cushion shielding them from important changes in their external environment. Unable to agree about how to regulate the labor market, much less identify joint preferences with respect to welfare retrenchment, social dialogue has served as a flexible barrier that has enabled the social partners to resist efforts to encroach upon their authority and institutional privileges.

Conclusion

The Spanish social partners and successive governments have repeatedly attempted to reform a labor market that clearly suffers from numerous structural problems often linked to the formal rules governing employment relations. The substance of these reforms, particularly those agreed to by the social partners, have historically been quite limited. These limitations raise an important political question: how is it that the existing institutional framework has not been more successfully challenged by the

[49] *Expansión.* February 21, 2006.

[50] Employer discretion has been a central employer trope since the Transition to Democracy.

many employers and citizens who are clearly prejudiced by the current arrangements? The traditional answer to this question lays blame largely at the doorstep of unions and the insiders they represent.

In this article, I have shown that this answer is inadequate. In particular, the persistence of an extraordinarily complex structure of collective bargaining that has encouraged adjustment through employment levels rather than through internal flexibility has only been possible because it has been ably defended against multiple challenges by a robust, cross-class coalition of employer organizations, labor relations specialists (both within and outside the public administration), unionists and permanent workers with long tenure.

The labor market reforms imposed by the Socialist party in 2010 and 2011 over the angry opposition of the dominant unions and CEOE would likely have reinforced the dynamics that I have described in this article. On the one hand, those employers who were able to reach collective agreements with shopfloor representatives would have been able to pursue ever less expensive dismissals as they sought to respond to the shocks of the current crisis and market insecurities. Such solutions appeared to continue to be out of reach of the smaller and less sophisticated firms that have long been prejudiced by the current regulatory framework; in other words, the Socialists' reforms appeared to once again reinforce the divide between a minority of firms that is able to adjust well to new challenges and those whose competitive prospects are handicapped by labor market regulations.

Consider the critical and highly contentious issue of multi-level bargaining. The 2011 reform of collective bargaining permitted firm-level agreements to take precedence over sectoral accords absent the existence of a sectoral agreement at the national or Autonomous Community level that specifically reserved certain themes for that level. In such significant sectors as metalworking, construction and chemicals, the majority producer organizations managed to sign new sectoral agreements in record time during the fall of 2011 to avoid just such an outcome.

Similarly, the 2010 reform strengthened incentives to collectively negotiated adjustment by limiting the ability of individual workers to challenge collectively negotiated agreements in the courts. Once again, this reform in reality deepened the chasm between sophisticated and unsophisticated firms (and between larger and smaller ones) by providing the former with a major tool for imposing rapid and minimally consensual adjustment that is largely unavailable to those firms lacking access to the counsel of experienced labor relations professionals.

At the same time, the 2010 reform facilitated the constitution of ad hoc committees to negotiate collective solutions in the absence of formal workplace representatives, apparently providing a shortcut to internal adjustment for firms that have long been denied this option. The dominant unions opposed this element of the reform more than any other (CC.OO. and UGT, 2011). My analysis makes clear that this opposition was rooted in the challenge of these committees to two of the unions' core power resources —the unions' control over the content of collective bargaining and their role as intermediaries between workers and the highly judicialized system of conflict resolution. However, I believe that the unions' fears were largely overstated. On the one hand, if the employers targeted by this reform —those I have identified as *outsiders* in the current labor relations system— were to have taken advantage of this new possibility, the unions might well have found themselves forced to dedicate far greater resources to organizing long-excluded workers, something that would likely to have been good for both the unions and Spanish workers as a whole. On the other, it is highly unlikely that this reform would have led to a substantial transformation in the ways in which these outsider firms adjust in the face of competitive challenges.

One of the central resources of the dominant actors at the center of the Spanish labor relations system is, as I have documented throughout this article, their virtual monopoly over an extraordinarily complex regulatory apparatus that is rooted in highly legalistic rituals and legitimated in part by the rhetorical commitment of the political class to the institutions of social dialogue. The ever-changing patchwork of labor market reforms is so complex that only a small number of experts are able to readily interpret and take advantage of the opportunities that the law objectively offers to employers. The resulting veil of ignorance in which most employers and workers operate has long reinforced the power of the labor market insiders. At its root, the very process through which various actors have tried to transform the Spanish system of labor relations over the last 25 years has been one of its most important sources of stability.

This stability is challenged as never before by the 2012 labor market reform. A series of threats to the leadership of CEOE from within and without,[51] the ascendency of neoliberal ideology within important segments the Popular Party and the Spanish managerial class, and of course the depths of the current labor market crisis in Spain and international pressures for wholesale labor market reforms as a solution to financial crisis have all served to delegitimize the existing system of labor market regulation.

However, the incumbent beneficiaries of the system of labor market regulation as it existed before this latest reform will not go down without a fight. Judges and employer-side lawyers have suggested that larger firms that take an expansive view of their new powers do so at considerable risk. Meanwhile, it will take some time to see whether smaller firms are able to negotiate their own collective agreements. Many experts believe that firms will continue to prefer to adjust through levels of employment rather than internal reorganization: such an outcome would be truly disastrous for the Spanish people and, perhaps, the future of Europe.

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[51] Leaders of several territorial associations within CEOE (particularly the powerful CEIM in Madrid) whose membership is dominated by SMEs appear to believe that their power within the organization will be strengthened if sectoral bargaining is largely eliminated.

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Liberalization within Diversity: Welfare and Labour Market Reforms in Italy and the UK*

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Abstract: Are advanced democracies converging on a liberalized economic model, revolving around increasing penetration of markets and the decline of egalitarian institutions? The literature has tended to polarize between proponents of convergence and scholars who emphasize of the resilience of the distinct models of welfare capitalism. This article argues that although there is no strong evidence of convergence, the distribution of income in advanced democracies is becoming more unequal, suggesting significant change in a liberalizing direction. The article develops this argument by charting changes to the political economy of labour in two large European democracies: Italy and the United Kingdom. Despite belonging to entirely distinct 'families' of welfare capitalism, they have both undergone extensive changes to their political economy in the past three decades. We find that Italy and the UK were very different political economies in the 1970s, and remain very different today, but they have both undertaken reforms which have weakened egalitarian institutions and led to dramatic increases in poverty and inequality. This suggests that a focus on the diversity of institutional legacies and the distinct reform paths that we observe in advanced democracies should not distract from the conclusion that market-focused economic reforms in very different institutional contexts can still lead to the same outcome: the privatization of economic risk and increased income inequality.

Key Words: Welfare capitalism, inequality, Italy, United Kingdom, Economic reform.

I. Introduction

Are advanced democracies converging on a liberalized economic model, revolving around increasing penetration of markets and the decline of egalitarian institutions (Baccaro and Howell 2011)? An extensive literature has examined institutional change in the advanced industrialized economies, examining the impact of Europeanization, globalization and other structural economic changes on the different models of welfare capitalism found in the OECD countries. This debate has tended to polarize between proponents of convergence, who argue that common pressures push advanced democracies to adopt similar policies and institutions, and scholars who emphasize the resilience of the distinct models of welfare capitalism that evolved in the industrial age, although some recent scholarship seeks to bridge this divide. At the same time, there is increasingly firm evidence that the distribution of income

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in advanced democracies is becoming more unequal, sparking a lively debate on how inequality can be measured and explained (OECD 2011).

This article seeks to contribute to this literature by examining changes to the political economy of labour in two large European democracies: Italy and the United Kingdom. Though infrequently compared by political economists, Italy and the UK offer a useful vantage point for observing the nature and consequences of institutional change in the advanced democracies. Despite belonging to entirely distinct "families" of welfare capitalism, they have both undergone extensive changes to their political economy in the past three decades. Whilst these changes have differed in many ways, the result in both cases has been a steady shift from being relatively egalitarian societies to having the highest levels of income inequality in Western Europe. By charting these changes, we aim to offer insights into the nature and implications of institutional change in the advanced democracies. We find that Italy and the UK were very different political economies in the 1970s, and remain very different today, but they have both undertaken reforms which have weakened egalitarian institutions and led to dramatic increases in poverty and inequality. This suggests that a focus on the diversity of institutional legacies and the distinct reform paths that we observe in advanced democracies should not distract from the conclusion that market-focused economic reforms in very different institutional contexts can still lead to the same outcome: the privatization of economic risk and increased income inequality.

II. Convergence, Divergence and Institutional Change in Western Europe

Over the past two decades an extensive literature has examined the impact of the twin forces of Europeanization and globalization on the distinctive institutions of welfare capitalism found in Western Europe. Proponents of the "convergence" thesis argue that a variety of forces external to the nation state push advanced democracies to adopt a more similar set of institutional arrangements. Opponents of this view stress the myriad forces of institutional *di*vergence amongst advanced states, suggesting that this divergence is robust to outside pressures, and that continued diversity is the most likely outcome. These different approaches are generally founded on distinct theoretical premises, and make recognizably different empirical predictions about the state of the world. A range of empirical studies has attempted, using quantitative techniques such as regression or factor analysis, to gauge the extent of convergence. Conversely, the divergence school often bases its arguments on more detailed qualitative empirical analysis of single cases, or small n comparisons, which usually show the difficulties involved in institutional change and the persistence of national differences, stressing a lack of significant change over time.

Theories of convergence focus on two main exogenous factors: globalization and Europeanization. Globalization exposes advanced countries to ever greater competition, undermining national economic institutions that protect society from the downside of markets and unleashing a "race to the bottom" as governments abandon generous welfare states and strict regulatory regimes (Marquand 1994, Strange 1996, Bouget 2003). In labour markets, this means a generalised push towards dismantling employment protection regimes, which are seen as inimical to "competitiveness" and efficient clearing of job markets (Siebert 1997), and reducing income protection entitlements (Layard, Nickell and Jackman 1991, OECD 1994). Although the direst predictions of the damage to welfare regimes proved overblown (Garrett 1998, Drezner 2001, Swank 2002), there is cumulative evidence that the last two-three decades have seen a strong trend towards liberalization reforms in advanced economies (Baccaro and Howell 2011).

European integration acts as a force for convergence both through its explicit regulatory requirements and through the increasing economic openness constituted by the single European market (Ferrera and Gualmini 2004, Hay 2006, Hay and Wincott 2012). Europeanization also takes other forms beyond regulation and competition (Radaelli 2000, Zeitlin *et al*. 2005, Graziano and Vink 2008, Exadaktylos and Radaelli 2010); for example, the adoption of European level initiatives in employment policy in the framework of the Open Method of Coordination (OMC) gives member states an incentive to evaluate policy according to shared criteria (Lodge 2002, Hopkin and Wincott 2006). Here, rather than a simple deregulation of labour markets, proponents of convergence see the likely outcome as a common move

towards a more flexible but protected labour force on the "flexicurity" model (Sapir 2006). The main policy template of interest here is the European Employment Strategy (Ashiagbor 2005), which drew on "best practice" in mostly Northern European countries to propose labour market reforms combining liberalization and flexibility with social cohesion and social investment (Morel, Palier and Palme 2011).

In spite of all these powerful forces for convergence, economic policies and institutions remain stubbornly diverse amongst advanced democracies. Two main approaches can be invoked to explain this diversity. Paul Pierson's "New Politics" of the welfare state (2001) stressed the resilience of institutions, which lock in particular patterns of behaviour and generate protective coalitions, undermining reform attempts. Even though the forces of convergence may be "irresistible", the welfare state is an "immovable object" (Pierson 1998), so radical changes in response to the pressures for convergence —such as reductions in employment protection and the dismantling of corporatist institutions— are unlikely. Second, the "Varieties of Capitalism" approach (Hall and Soskice 2001, Hancké, Rhodes and Thatcher 2007) stresses that divergence is also functional, since different kinds of production regimes can be equally efficient in responding to external economic pressures. Globalization should not lead to convergence around a liberal market model, because Coordinated Market Economies (CMEs) can resolve coordination problems just as effectively as Liberal Market Economies (LMEs). In labour markets, this implies that established levels of employment protection and wage protection will tend to complement other features of the political economy (bolstering skill formation and wage moderation, for example), making radical change unlikely because "actors (…) face incentives to preserve the existing system of coordination" (Hancké, Rhodes and Thatcher 2007: 12). For instance, coordinated labour markets are complementary to other economic institutions and contribute to economic performance.

These logics of institutional persistence are powerful and important, but existing models are under serious pressure to reform as shown by recent research which rejects the idea of welfare states as "frozen landscapes" in which the only interesting questions revolve around retrenchment and restraint (Hemerijck 2008). This kind of approach offers a more dynamic view of European welfare state change, focusing on patterns of welfare "recalibration" (Ferrera, Hemerijck and Rhodes 2003), which are constrained by institutional legacies, but which can still result in substantial change. Even apparent institutional stability and continuity can mask radical change, when existing institutions are "displaced" by new ones, allowed to "drift" in the face of new challenges, or "converted" to new functions (Hacker 2004: 246-8, Streeck and Thelen 2005: 18-30, also Hacker 2002, Thelen 2003, 2006). Moreover, distinct national patterns of institutional change may still produce convergent results, as countries choose different routes to adopting increasingly market-oriented arrangements (Streeck 2009, Baccaro and Howell 2011).

There is plenty of evidence that European welfare states have undergone significant change in the 1990s and 2000s, revising old policy programmes and introducing new ones, blending and experimenting old instruments and paradigms with innovative policy contents, emulating and borrowing ideas from other national experiences or from supranational agendas. The economic and social challenges of this period (the demographic revolution, the entry of the women in the labour market, the openness of markets and de-industrialization) and the related appearance of new social risks, particularly affecting the weakest categories of the labour market (Taylor-Gooby 2004, Armingeon and Bonoli 2006, Palier and Martin 2008), have had a destabilizing effect on national welfare states. Pressures to adopt the Anglo-American model as a "one best prescription" (Mukand and Rodrik 2005) on the one hand, and the influence of EU directives on the other, have interacted with national institutional legacies in a variety of ways, creating a confusing picture.

The diversity of policy prescriptions – from Anglo-American liberalism to Nordic social investment strategies —and the complexity of diverse national traditions, make a simplistic theory of convergence untenable. Even if we accept the importance of international economic and political pressures, the institutional legacies and differentially organized social interests of national polities will refract, or even absorb, these pressures in significant ways. However, what we also know is that even before the financial crisis of the late 2000s, welfare and labour politics were conditioned by a climate of "permanent austerity" (Pierson 1996), and the strains imposed on the labour force by globalization and tertiarization. The variety of institutional options available to European welfare states may be much greater

than early convergence theorists believed, but the outcomes have nevertheless been remarkably similar (OECD 2011). This suggests that beneath the complex and diverse nature of the policy process in different countries, powerful political and economic forces are pushing in a common direction (Baccaro and Howell 2011). The result is not institutional convergence, but it does reflect a common "direction of travel". Moreover, the process of liberalization inevitably involves some measures which seek to mitigate the social costs of pro-market reforms, although these measures appear insufficient to contrast the broad thrust of market incursions into social life. So liberalization may be the common underlying trend, but it is not a uniform process. In sum, this pattern of labour and welfare policy in European political economies can be described as "liberalization within diversity".

The rest of this article will present some evidence for this interpretation, by comparing welfare and labour reforms in Italy and the UK. The selection of cases allows us to assess the "liberalization within diversity" thesis. On the one hand, Italy and the UK exhibit two very different forms of welfare capitalism, the former a Southern European variant of the "Bismarckian" or "conservative" welfare regime, the latter the clearest European exemplar of a liberal welfare regime. On the other, however, both countries have undergone processes of institutional change in their welfare regimes, which have not brought convergence, but which have resulted in increasingly similar outcomes for citizens. The article proceeds as follows: the next section compares the development of labour markets and social indicators in the two countries, charting the liberalizing trends in Italy and the UK, the following sections examine in greater depth the reform processes in the UK and Italy in turn, and the final section concludes.

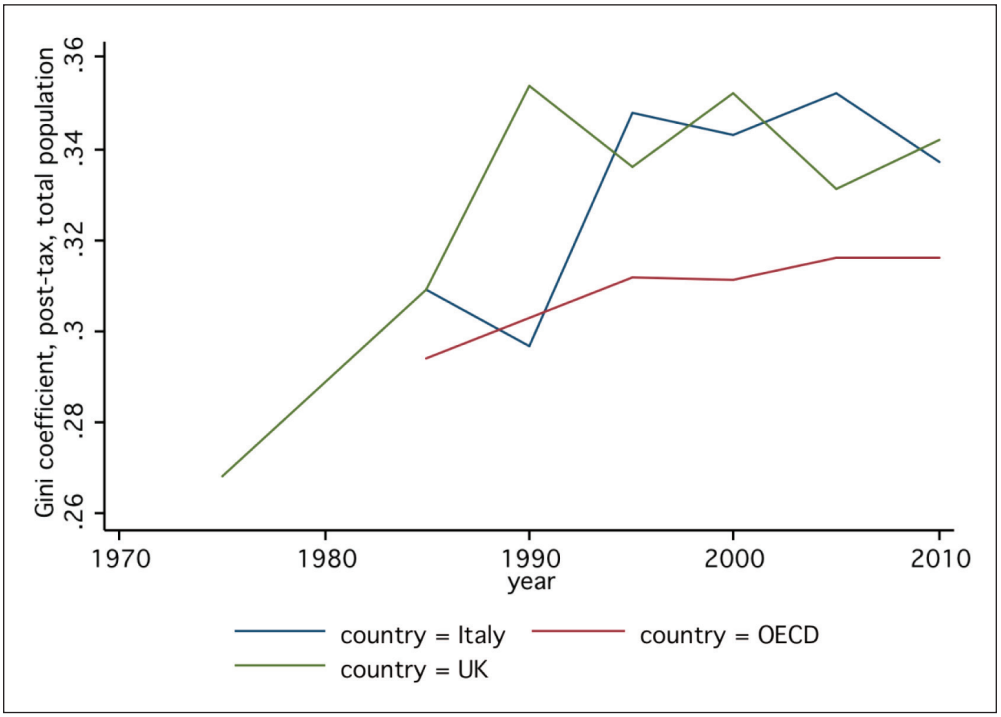
III. Liberalization Within Diversity: Bismarck, Beveridge and the Market

It is well known that Italy and the UK belong to two very different welfare regimes. In the welfare states literature, Italy is a classically "Esping-Andersen's" system of social protection, the UK a "Beveridgean" model; or to use Esping-Andersen's "Three Worlds" typology (1990), the former is a "continental conservative" welfare regime (for Ferrera 1996, a "Southern European" regime), whilst the UK is a "liberal" welfare regime. For the Varieties of Capitalism literature (Hall and Soskice 2001), Italy is mostly considered part of the group of "mixed market economies" (MMEs) (Hancké, Rhodes and Thatcher 2007), with some features of the Northern European social market model, but also a distinctive "statist" inclination, through the use of regulation and state-owned enterprises to coordinate economic activity (Hopkin 2006, Schmidt 2009). Britain is the most prominent European exemplar of the "liberal market economy" (LME), characterized by competitive relationships between firms and deregulated markets, although in the past it had some features of an unstable coordinated market economy. Moreover, the policymaking context is also very different in the two cases: Italy has historically shown a degree of corporatist policy-making and unstable and divided governments, whereas in the UK trade unions have been largely excluded from policy processes, and governments are strong and cohesive (Lijphart 1999).

In spite of these differences, the two countries share a clear trend toward higher levels of poverty and inequality since the 1970s, as we can see in Figure 1. The Gini coefficient of post-tax income inequality for all households grew from somewhere around 0.30 in the early 1980s to around 0.34-0.35 in the late 2000s in both countries, with the biggest increases coming during the 1980s and early 1990s, and inequality stabilizing after then. Poverty rates also show substantial increases in the same period, as can be observed in Figures 2 and 3. Britain and Italy are not unique in experiencing pressures on their social cohesion in this period, and there is a well-known set of broader economic and social trends that explain the challenge to the more egalitarian post-war order in western democracies (see for example Streeck and Thelen 2005, Glyn 2006). But the distributional effects of the new economic order have been more powerful in these two cases than in the majority of OECD countries, which make them a valuable source of insights into the processes of change facing advanced capitalism since the 1970s.

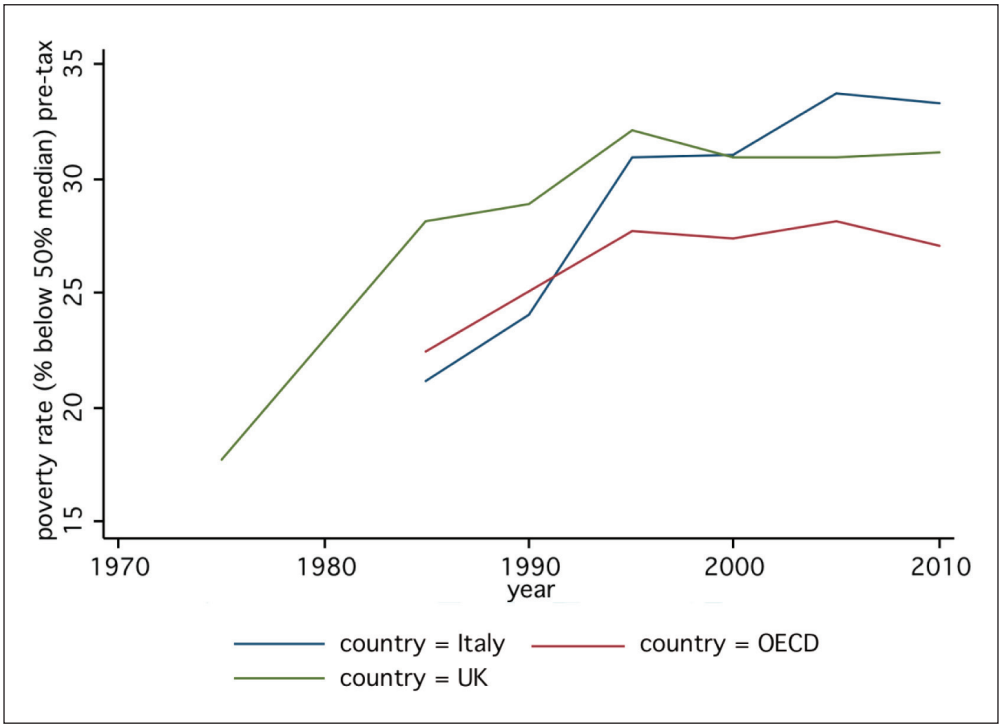
What makes the comparison of Britain and Italy particularly fruitful is that this growing inequality reflects neither their joint convergence on the free market liberal model, nor indeed a simple destruction of their welfare and labour market institutions. Instead, the story is more complex. First, the liberaliza-

Figure 1. Gini Coefficient of Post-tax Household Income mid-1970s to late-2000s, Italy, UK and OECD Average.



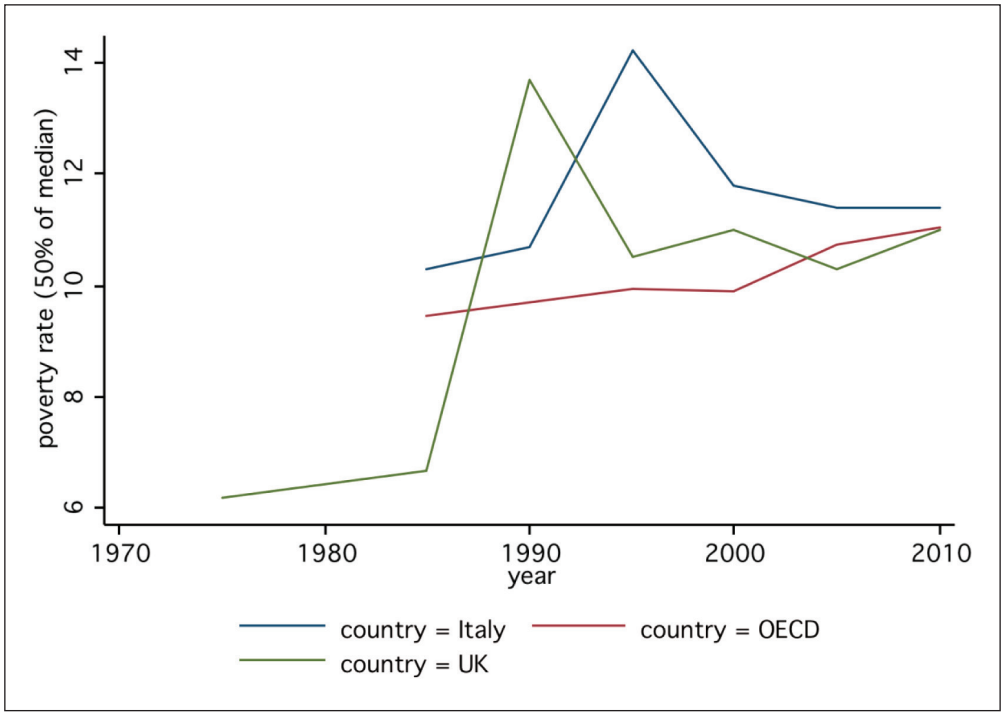
Source, OECD, 2012.

Figure 2. Pre-tax Poverty Rate (% on less than 50% median income) mid-1970s to late-2000s, Italy, UK and OECD Average.



Source, OECD, 2012.

Figure 3. Post-tax Poverty Rate (% on less than 50% median income) mid-1970s to late-2000s, Italy, UK and OECD Average.

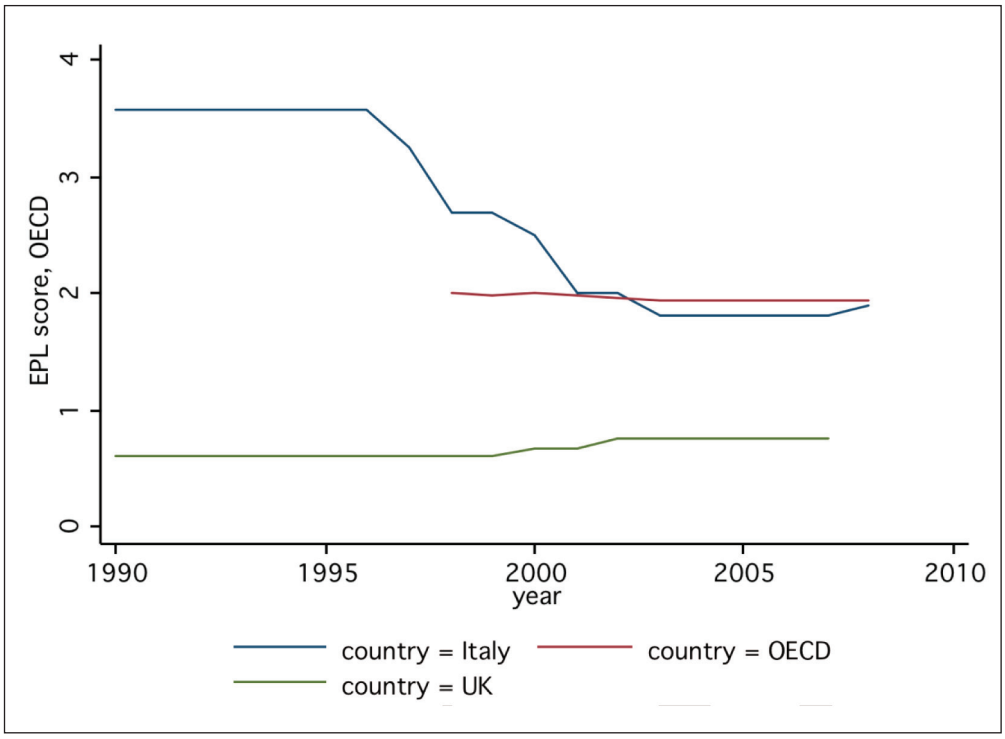


Source, OECD, 2012.

tion of the labour market has taken a different path in the two cases, given their very different starting points. Italy, with a more regulated labour market in the post-war era, has embarked on the privatization and decentralization of its job centres, the introduction of a wide range of flexible employment contracts and of specific programmes for the activation of the outsiders (the young and the women), and the incorporation of more conditional logics into the allocation of unemployment support. In the UK, in contrast, labour market protections have always been weaker, and recent reforms have introduced a statutory minimum wage, enhanced trade union participation in the workplace, and improved the rights of temporary workers, so that before the financial crisis some observers claimed to see a shift to an "Anglo-Social" welfare model (Hopkin and Wincott 2006). The changes to labour market regulation are shown in Figure 4, which charts the two countries' measures on the OECD Employment Protection Legislation (EPL) variable over the past two decades. It can be seen that Britain had very low levels of formal labour regulation all the way through, whilst Italy has liberalized, converging on the OECD average, but remains relatively protected by comparison to the UK.

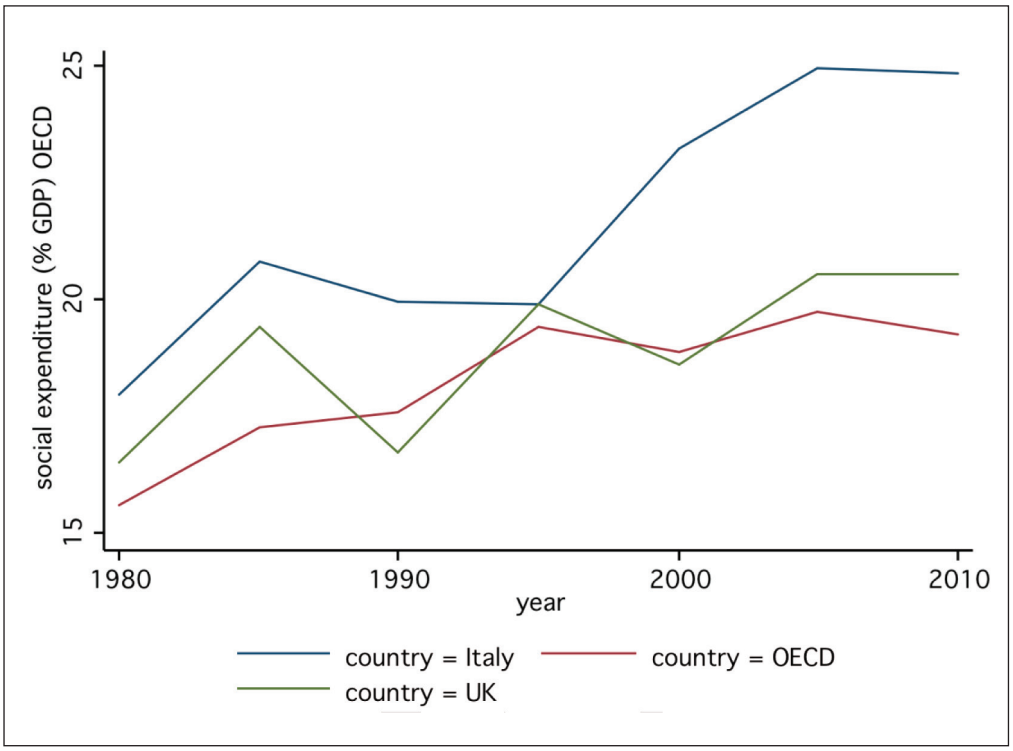
The push towards more liberal arrangements in labour markets has coincided with significant changes to welfare policies in both countries. On the one hand, policy drift has brought an increase in social spending, in part associated with the aging of the population, which has had particularly powerful effects in Italy, which has both less favourable demographics and more public pension provision than in the UK. Figure 5 shows that social expenditure on the whole has seen an upward rise in the period under study, particularly so in Italy, where state pensions outlays have reached 15% of GDP in the late 2000s. But the increase in social spending also reflects in part a response to the increased poverty that has resulted from the growing inequalities in the labour market, persistently high unemployment, and "new social risks" associated with changing patterns of family formation and life expectancy. The significant differences in poverty rates before and after taxes and benefits (Figures 2 and 3) in both countries shows that this social spending has had a powerful impact, but has not come close to arresting the trend towards higher inequality and poverty.

Figure 4. Employment Protection Index, Italy, the UK and OECD, 1998-2008.



Source, Online OECD employment database, 2009.

Figure 5. Social Expenditure (% GDP), Italy, the UK and OECD, 1980-2007.



Source, OECD, 2012.

The emergence of widespread acute poverty and high unemployment as new social risks in Italy destabilized the traditional labour market and welfare regime, and elites have responded with a structural recalibration of existing institutions and policies, largely in a liberalizing direction. In the UK meanwhile, the liberalizing reforms of the 1980s were followed in the 1990s by strong pressures to redesign the British welfare regime along more "social" lines, apparently emulating a more "European" social model. The reforms undertaken before the crisis in both countries were consistent with the policy advice of the European Employment Strategy (EES), which has advocated the adoption of both a degree of labour market liberalization and the development of a work-oriented "flexicurity" model of social protection. However these moves did not go far enough to bring either Italy or the UK particularly close to the Nordic "flexicurity" model which inspired the EES.

These two cases provide some leverage for assessing most recent theoretical hypotheses on welfare state reorganization, looking beyond the "usual suspects" to less studied, and even less frequently compared, countries. Italy and the United Kingdom are valuable cases because they exhibit very divergent institutional traditions, yet have both introduced policies which challenge their existing institutional logics. These policies have certainly moved them in a liberalizing direction, and the egalitarian institutions which upheld the post-war settlement have been severely weakened. At the same time, liberalization has been accompanied by measures, albeit largely insufficient, which respond to the social costs of freer markets. The research design is an example of selecting on the dependent variable, but this choice is justified by the usefulness of seeing how advanced democracies with different institutional histories can follow quite different routes toward a similar outcome: a more marketized economy and greater inequality. The next two sections chart the processes of policy change in the two cases in turn.

IV. Liberalization in a Liberal Market Economy: Welfare and Work from Thatcherism to New Labour

Esping-Andersen (1990) identified Britain as a "liberal welfare regime" on the basis of 1980 data, but most observers agree that it was the Thatcher governments of the 1980s that transformed the UK labour market into the "flexible" deregulated model we are familiar with today. A series of legislative interventions focused on recalibrating the balance of power in British industrial relations, by removing trade union legal immunities, requiring formal balloting of memberships before strike action could be taken, outlawing "closed shop" arrangements, and restricting the scope for union strategies such as secondary action and picketing (Paterson and Simpson 1993, Wood 2001). Interestingly, the Thatcher reforms did not bring about a particularly dramatic reduction in employment protection legislation, which was already at the lower end of the scale: British workers had relied on trade union strength, rather than legislative restrictions, to provide job security. As well as curbing union power, the Conservative government also dismantled the wages councils and the minimum wage, freeing up wage determination from institutional restraints, and the authorities encouraged —and refused to regulate— the growing use of temporary and part-time employment contracts. The end result was that in the early 1990s the OECD's *Job Study* (1994) identified Britain, along with the US, as models of labour market flexibility and pressed other European countries to follow its deregulatory path.

The other plank of the Thatcherite labour market model was to "roll back" the welfare state, by reducing unemployment benefits and cutting taxes, with the aim of incentivizing swift re-entry to the job market for those made unemployed. This policy was initially unsuccessful in reducing unemployment, and the persistently large numbers of claimants (and threat of social disorder) undermined attempts to reduce welfare transfers. Here again, the thrust of policy was to restrict welfare state growth, rather than reduce net provision, although de-indexing of benefits did contribute to a decline in replacement rates and the regressive direction of tax cuts increased real wage dispersion. Various reforms sought to enhance activation, by tying receipt of welfare benefits to efforts to re-enter the labour market, most notably the Jobseekers Act of 1995, which introduced a number of job search requirements for the unemployed. This implied a definitive move away from the insurance principle in unemployment support,

and a more rigid definition of active attempts to find work in allocating unemployment benefits (the Jobseekers' Allowance) (Clasen 2005: 81). This built on the paring back of National Insurance as an effective supplementary tier of protection, which meant that most unemployed were already in receipt of means-tested benefits by the mid-1990s.

There is some evidence to suggest that these policies were not as successful in job creation as the OECD initially claimed (Howell, Baker, Glyn and Schmitt 2007), but by the mid-1990s, the UK had low unemployment compared to the other large European economies, and relatively high employment (but also high levels of sickness benefit claimants, who do not figure in the unemployment statistics). However the British case also suggested a sharp trade-off between employment performance and social justice, as Britain experienced a dramatic increase in income inequality through the 1980s and the early 1990s (Jenkins 1996). The model emerging out of two decades of marketizing reforms fit closely with the logic of the liberal market economy (LME) type in the Varieties of Capitalism approach: low employment protection combined with limited welfare provision to generate a flexible labour market with wide wage dispersion and limited employer commitment to building collaborate relationships with employees. This model facilitated rapid firm adaptation to market change, and particularly suited the politically influential financial sector. However this was achieved at the price of exacerbating inequalities and the insecurity of a large part of the workforce, key concerns of the Labour party, which won election in 1997.

The election of the Labour government marked a change of approach of the area of welfare and labour market policy and represents an important test of the theories of institutional change outlined earlier. Labour was committed to tackling poverty and "social exclusion", but was reluctant to upset employer interests (Hay 1997) and therefore committed itself to retaining many of the Thatcherite reforms, including those affecting trade unions. Its "third way" approach in effect embraced the logic of institutional persistence: Blair and Brown promised a "fair and flexible labour market", and won election on the commitment that the UK law would remain "the most restrictive on trade unions in the western world" (Taylor 2005: 293). There were pragmatic reasons for adopting this position: to win power, Labour had to offer something to its traditional constituency, hard hit by Thatcherite policies, but also reassure the middle class groups which had supported the Conservatives in the 1980s (Heath and Curtice 2004), as well as heading off opposition from business elites. This set of circumstances set high barriers to formal revision of institutional arrangements, and incentivized working within the existing paradigm.

The Blair government also adopted a more pro-European tone than past British governments, including a commitment to the Social Chapter of the Maastricht Treaty rejected by the Conservatives. But Europe was not a convenient source of cover for Labour, which faced a different dilemma to many other European governments: after Britain's exit from the ERM, unemployment had fallen rapidly compared with neighbouring countries, but poverty and inequality were much worse than in most of the rest of Western Europe. To this extent, the EES —which focused more on job creation than on anti-poverty measures— did not match Britain's specific labour market concerns, and European pressures are not a plausible explanation of Labour policies in this area (Hopkin and van Wijnbergen 2011).

In practice, Labour aspired to resolve the poverty problem in part by encouraging and subsidizing greater participation in the labour market, so that the poor could improve their situation through paid work rather than increased government transfers. As Gordon Brown himself clearly stated, "the best form of welfare is work" (1999, cited in Sloam 2007). Labour's welfare and labour market strategy consisted of a series of inter-related measures. The first move was in the area of active labour market policy: the "New Deal", initially aimed at the young, and later extended to a variety of categories of the long-term unemployed. Claimants (those claiming benefits for 6 months, if under 25, and 18 out of the last 21 months, if older) are automatically enrolled on a "Gateway" period giving extensive job search assistance, involving training in job search and interview skills. Those failing to find work after this first stage were offered a choice of education, paid voluntary work or subsidized paid work. Withdrawal of benefit was possible if no such choice was made. The judicious combination of inducements and penalties aimed to enhance employment and social cohesion without impeding the flexible and deregulated operation of the UK labour market.

This constituted a major step in the direction of increasingly active, rather than passive, labour market policy in the UK, and there is some evidence that it made an impact (van Reenen 2003, Hirsch and Millar 2004). Subsequent reforms sought to enhance the activation potential of the services for the unemployed: in 2002, the existing Job Centres (where the unemployed registered for work opportunities) and Benefits Offices (where unemployment benefits were claimed) were merged into a new agency, Jobcentre Plus, aimed at intensifying support for job seeking. Various pilot schemes have involved private employment agencies being contracted by the government to place unemployed workers. These measures moved beyond simply deregulatory liberalization, focusing instead on creating institutions that would make the labour market clear more effectively.

Activation was quickly complemented with other measures to enhance incentives for excluded groups to enter the labour market. The most important was the introduction of "tax credits", which subsidized the income of low paid workers according to certain criteria to ensure a higher minimum income for families. These credits (Working Families Tax Credit and Child Tax Credit) were paid to families with children in order to overcome the "poverty trap" resulting from low-skilled workers being unable to earn enough in the labour market to compensate for the loss of social benefits on achieving employment. Complementary to these measures were moves to provide more widely available and affordable childcare facilities —in which Britain lagged badly behind most of the EU in the mid-1990— in order to encourage unemployed lone parents to take up paid employment. Finally, the introduction of a national statutory minimum wage in 1998 contributed to the increased attractiveness of employment for workers at the low-wage end of the labour market. Other regulatory measures include extensions of maternity rights, rights to request flexible working times (Employment Act 2002), an enhancement of protection against unfair dismissal and a right to union recognition in all workplaces (Employment Relations Act 1999).

In other words, Labour increased the regulatory burden on employers, and deployed a range of fiscal and welfare measures to enhance labour market opportunities for the unemployed and low paid workers. All of this amounted to a departure from the straightforward liberal logic of labour market and welfare policies in the 1980s and early 1990s. However this does not imply a reversal of the broad push towards liberalization observed by Baccaro and Howell (2011). These policies, despite making important changes to the labour market regime in the UK and having non-negligible distributive consequences, remain consistent with the broad institutional arrangements of the LME entrenched under Margaret Thatcher. The Labour government's policy ideas followed the logic of LMEs: low taxes, flexible labour markets, and weak trade unions. As well as the "flexicurity" ideas of the EES, the Labour welfare strategy also drew on experiences from the archetypal LME, the United States, where "welfare to work" measures developed under Clinton (Dolowitz 2003) sought to make welfare provision consistent with the logic of a liberalized labour market. The well established activation measures in Scandinavia were introduced to policymakers by Labour party economics advisors such as Richard Layard, but they were not deployed with equivalent expenditures. This kind of policy response fitted in with the "third way" (Giddens 1998) approach adopted by Tony Blair, and could be built on top of the existing welfare regime architecture without challenge the liberal paradigm.

In this way the UK moved away from the dominant model of the early 1990s (articulated in the OECD's 1994 *Jobs Study*), adding activation and further regulation, albeit with a "light touch" (Davies and Freedland 2007): Britain remains at the low end of the EPL scale and Labour ministers could still boast that Britain had "the most flexible labour market in Europe" (Nolan 2004). Labour chose to encourage rather than undermine the creation of "atypical" employment, as part of the "employment-friendly" welfare strategy, although there was a further extension of temporary worker's rights agreed with the trade unions in the 2004 Warwick agreement.

It is therefore not too much of a simplification to see current labour market arrangements in Britain as consistent with the logic of the LME model. Labour have maintained the flexible labour market and limited trade union involvement inherited from the Conservatives, and have sought to ameliorate the condition of the lowest paid workers and the unemployed through labour market activation and in-work social transfers. This policy mix was consistent with European-level initiatives, but European pressures probably did not take the Blair government very far from the goals it had set for itself in any case. The

high levels of labour mobility, part-time and temporary work, poverty and income inequality remaining after three legislatures of Labour government suggest that the LME logic was not fundamentally challenged by its reforms. The liberalization of the labour market under Thatcher was been complemented by state interventions which seek to enhance both social inclusion *and* labour market flexibility; for example by adapting the Jobseekers" Allowance to a more activation-oriented function, or the use of tax credits to enhance employment incentives without fundamentally altering the nature of the employment contract. This leaves Britain with a liberalized political economy, and a welfare state which works with the grain of the flexibile and mobile labour market, providing a safety net without challenging the growth of inequality.

V. Liberalization in a Statist Political Economy: Rigidity and Reform in Italy

Just as recent patterns of labour and welfare policy in UK have been tied to distinct periods of Conservative and then Labour government, the process of policy change in the Italian labour market has also been closely intertwined with the dynamics of political power. After the institutional turmoil at the basis of the transition from the "First" to the "Second" Republic in the early 1990s, including an electoral reform introducing a strong plurality component to the election of the Chamber of Deputies, in 1996 Romano Prodi's Olive Tree (*Ulivo*) coalition formed the first government in post-war Italy to include ministers from the former communist left (*Democratici di sinistra*). Prodi's government also rested on the parliamentary support of the radical left party *Rifondazione Comunista*. These developments have dual significance. First, the introduction of a majoritarian dynamic in party competition implied greater scope for policy change than in the deeply consensus-oriented politics of the "First Republic". Second, the entry of the left into government would be expected to lead to policy changes in the area of welfare and labour markets. Prodi's majority drew on two different traditions: a reformist left mixing social democratic and Christian democratic inspiration, and the left of communist identity, represented by the party of *Rifondazione Comunista* and by the biggest Italian union (CGIL - *Confederazione Generale Italiana dei Lavoratori*, with almost 6 million members in 2008), hostile to liberalizing and deregulatory reforms.

The pressure for reform responded in part to political dynamics, in particular the end of the dominance of Christian Democracy in 1992-4, and its replacement on the centre-right of the party system by political forces far less sympathetic to worker protections, notably Berlusconi's *Forza Italia* and the Northern League. But reforms were also a response to objective deficiencies in the existing "conservative/corporatist" model, which was based on strong legal protection of the jobs of core workers, an emphasis on passive rather than active labour market measures, and a welfare system which tended to protect already protected workers, creating insider-outsider tensions and hindering labour market adjustments (Esping-Andersen 1990, 1996). The Italian political economy that had developed by the early 1980s was characterized by a high degree of state interventionism, heavily regulated labour and product markets, and serious budgetary imbalances (Padoa-Schioppa Kostoris 1993, Locke 1995). The financial crisis of the early 1990s, in which Italy came close to debt default and had to exit from the European Exchange Rate Mechanism, was a trigger for a series of reforms. Although these reforms covered a range of areas, including the budgetary process, the organization of local and central government, and the financial sector, our attention here is focused on the labour market and welfare provision.

The first major labour market intervention of the Prodi government was the so-called "Treu package" (Law 196/1997 named the Labour Minister), which for the first time in Italy legalized temporary agency work (*lavoro in affitto*), previously a state monopoly. The legislation was a compromise between the commitment of the Olive Tree coalition to dismantle labour market rigidities and the demands of the communist left to tame flexibility with boundaries and restrictions in order to limit worker insecurity. Temporary work was allowed only for medium -and high-level qualifications in the industrial sector, and agencies could only operate within strict bureaucratic rules and conditions. However these restrictions

were gradually relaxed in the following years, as temporary agencies and contracts became widespread, allowing temporary work for all qualifications and economic sectors (including in the public administration). By 2008 there were 142,000 temporary workers, i.e. 0.6% of total employment; not a very high share but qualitatively important given its concentration in the industrial regions of the North (Bertolini, Berton and Pacelli 2009).

Another important measure towards labour market liberalization was legislative decree no. 469/1997, which radically reformed employment exchanges after 50 years of state monopoly. The provision combined the re-scaling of placement competencies with the legalization of private employment agencies and a new "activation" approach. Placement competencies were decentralized at the provincial level, private agencies (to be added to the agencies for temporary work) were allowed to act alongside state employment offices, and an attempt was made to introduce a "Scandinavian" approach to welfare-to-work and activation. This involved the introduction of conditionality rules and specific "client-agreements" (*patto di servizio*), according to which the office was committed to getting the unemployed back into the labour market as soon as possible, provided that the latter did not reject any offers of work or training.

These two liberalizing reforms – the dismantling of state's monopoly on placement and the introduction of private labour market agencies on the one side and the decentralization and reorganization of public placement offices on the other – can be considered more than incremental change. A new logic of labour market regulation through the "assimilation" (Streeck and Thelen 2005) of Northern European practices (such as activation, coaching and tutoring, public-private competition, decentralization and localisation) implied a challenge to the logic of the existing hegemonic paradigm, based around high levels of employment protection and low labour mobility. The reforms sought to align the Italian employment services with the experience of the other European countries, in particular the Scandinavian countries and the United Kingdom (the 1996 Job Jobseekers' Allowance proving particularly influential). They marked a move away from the rather bureaucratic logic of the post-war arrangements — where employers were formally required to hire workers from employment agencies according to strict rank orders— towards a more flexible, market-oriented model.

However, there were difficulties and delays in implementing this new logic, not least of which was the difficulty in transforming the "old guard" of employment exchange bureaucrats into a more proactive service, and the relative scarcity of funds for the new service: spending on active labour market policy in Italy grew from 0.2% to 0.5% of GDP between 1995-2000, but this figure still placed Italy at the low end of the scale amongst advanced democracies (although slightly higher than in Britain; Rueda 2007: 75). Another constraint on reform was the Prodi government's commitment to negotiating changes with the trade unions through "social concertation" (Rhodes 2001, Ferrera and Gualmini 2004, Baccaro and Simoni 2008): the introduction of temporary work was anticipated in the "Pact for Work" signed by Prodi with the unions in September 1996, together with other innovative measures on long-life training and local development. But the unions were concerned to ensure that reforms did not undermine the protected position of their core membership, mostly older tenured workers in large firms.

Trilateral agreements were facilitated by the "emergency" situation created by the risk of Italy's budgetary problems keeping it out of the first wave of EMU. When this urgency began to subside, concerted action became a much less powerful tool for negotiating reform, and the last social pact signed by all the three most representative Italian unions with the centre-left government (Corregir D'Alema's 'Christmas Pact' of December 1998) had largely symbolic contents and did not result in any structural reform. In particular, the project of enhancing labour market flexibility by reducing employment protection, promoted by many labour economists and policy advisors, did not prosper, hindering the mobility effects of the Treu reforms (Tompson 2009: 260). The Italian trade unions, though much weaker than in the 1960s and 1970s, retained sufficient strength in this period to place limits on the liberalization agenda.

When in 2001 Berlusconi formed a centre-right government with a large parliamentary majority, the season of concerted action ended and labour market reform became more conflictual. In October 2001 a White Paper (*libro bianco*) on labour market modernization was published, including the general framework of the reform going from the revision of labour law to the review of the whole range of active

and passive labour policies. The document drew openly on the newly developed European Employment Strategy. New forms of flexible labour contracts and a further privatization of placement services were announced in order to encourage the creation of new jobs, together with the revision of social shock absorbers, addressed to correct the dualism between the insiders and outsiders.

In March 2003, some of the contents of the White Paper were included in a delegation law (no. 30), which became known as the Biagi law, named after the Law Professor involved in its drafting who had been murdered by Red Brigade terrorists. In terms of labour contracts, the law introduced new contractual forms and revised others: new instruments of temporal flexibility included job-on-call, work vouchers, job sharing and staff leasing. Project work (*collaborazioni a progetto*) and occasional work (*contratti occasionali*) were already widespread in Italy (since 1995), but they were amended and refined, including with some improvements in the social rights of employees. In the field of placement, the law widened the number of private actors who could deal with the matching of labour market demand and supply, from universities to single consultants, introducing free competition between public and private agencies. The Biagi law sparked intense political debate, partly unleashed by the government's simultaneous proposal to repeal Article 18 of the Workers' Statute (*Statuto del Lavoro*), which would remove workers' rights to reinstatement as compensation for unfair dismissal. While the CGIL and the communist RC strongly opposed the reform for its "savage liberalization", the DS and the *Margherita* (the two main parties of the Olive-tree), as well as the more centrist trade unions CISL and UIL, adopted a more conciliatory position, arguing that the number of flexible labour contracts was too high and that some of them (though it was not clear which ones) should be abolished.

The main element of discontinuity introduced by the Berlusconi government concerned the relationships between the government and the social partners; instead of trilateral concerted action, the White Paper introduced the concept of "social dialogue", which implied a weaker role for the social partners, and the possibility for the government to unilaterally decide in case of disagreement. Divisions among the three main national trade unions did not take long to emerge, with the CGIL expressing clear opposition, and the CISL and UIL adopting a more strategic and at times pro-government profile: the "Pact for Italy" of July 2002 and the later agreement on collective bargaining made with the third Berlusconi government in January 2009 were not signed by the CGIL. At the same time as the centre-right encouraged divisions within the trade union movement, it also won strong support from the peak national business association, Confindustria, and of employers in general who welcomed the reduction of burdens and constraints for companies. Confindustria in this period was under a new leadership, more favourable to the concerns of small and medium-sized enterprises, who embraced labour market deregulation. Large firms, more comfortable with the existing labour market regime, were less supportive of this strategy.

However, in its content the Biagi law in many respects showed a high degree of continuity with the previous reforms of the Olive Tree government. The Treu package already introduced a greater degree of flexibility (above all concerning employment contracts), and the Biagi law extended this, although through a less consensual process. The flexibility paradigm was imposed on top of the existing, more protectionist, labour market regime. The main features of this regime —a high degree of employment protection for core workers, and limited unemployment coverage— remained intact, hampering the effective operation of the flexibility reforms. The reforms probably had some employment-generating effects: in the period 1996-2001 the yearly job growth was 223,000; 145,000 in the period 2002-2005 and 660,000 between 2006 and 2007 (Bertolini, Berton and Pacelli 2009), and in the same period the unemployment rate declined from 10,6% to 5,9% in 2007 (ISTAT, various years). However, it is not so clear that the reforms benefited the younger workers it was designed to ease into the labour market: the activity rate of population aged 15-24 decreased from 38.8% in 1995 to 32.5% in 2006, considerably lower than the EU average (Simoni 2010: 17).

Labour market liberalization in Italy has run up against a number of institutional constraints that have hindered its progress. The first is that the trade union movement, though much weakened, remains strong in the public sector and in large firms where workers benefit most from labour protection legislation. This has created an "insider-outsider" dynamic (Rueda 2007, Palier and Thelen 2008, Emmenegger, Hausermann, Palier and Seeleib-Kaiser 2011) which incentivizes governments to liberalize "at the

margin" whilst leaving protectionist institutions intact for the core workforce. Italy's fiscal position makes it difficult to overcome resistance to liberalization, since there is no real fiscal room for manoeuvre to allow for extensions to unemployment compensation, which could ease the passage of reforms.

The financial crisis from 2008 on did lead the Berlusconi government to introduce €8 billion of "supplementary social shock absorbers" (*ammortizzatori sociali in deroga*) for the unemployed workers excluded from traditional unemployment compensation (temporary workers, the self-employed, and those working in companies with less than 15 employees). But this measure, which also drew on the European Social Fund, applied only to 2009-2010 and a full structural reform of unemployment compensation was again postponed, despite bipartisan support for new arrangements. The other major social policy innovation of the crisis period —the so-called "social card" introduced in 2008— cannot be considered a "structural" or "radical" policy intervention, amounting to just €40 per month for one year, addressed to the poorest elderly and families (with 1.3 million beneficiaries).

In sum, liberalizing reforms spurred a transformative change in Italy, which gave the country a more markedly Anglo-Saxon profile; but this selective liberalization was designed to work alongside the dualistic Bismarckian model of welfare provision and labour regulation. The goal of deregulation of the labour market was shared by both the political coalitions, but reformers dodged the thorny but crucial issue of reforming social expenditure, without which a liberalized labour market could not properly function. Differentials in social protection thus widened and are the basis of the growing inequalities discussed earlier. Italy has therefore combined liberalization with the maintenance of parts of the pre-existing model, which suffered from a lack of effective institutions to encourage competition and efficiency or protect social cohesion. The result is some distance away from being a liberal model like the UK or US, but the broad thrust of policy change has been a liberalizing direction, and the failure to progress on the provision of universal income replacement policy ensures that inequality and poverty remain high.

VI. Conclusion: Liberalization and Diversity

This article has provided an account of innovations and reforms in labour and welfare policy in Italy and the UK in the last 30 years, two national cases rarely examined together in comparative welfare studies. We have shown that the dominant trend in both countries has been towards greater liberalization of the labour market, which helps explain the increasingly unequal distribution of income in the same period. This supports the "common neoliberal trajectory" thesis of Baccaro and Howell (2011).

However, these moves in a liberalizing direction do not amount to convergence on a neoliberal model, for two reasons. First, the very different institutional legacies of Italy and the UK continue to shape the way labour markets and the welfare state work, and interact with liberalizing measures in different ways. Second, at least to some extent the Italian and British models of liberalization have some elements in common with the "flexicurity" agenda of the European Employment Strategy, stressing the concepts of "conditionality" and "activation" to deal with problems of social exclusion, poverty and employability. The picture is therefore more nuanced than a simple focus on neoliberalism would permit. However, our account shows that the "flexibility" trend has been stronger than the "security" trend, and that policy change has cumulatively moved both Italy and the UK toward a more liberal and less egalitarian model of labour relations and welfare.

In Italy the firm belief in the flexibility recipe, considered as an effective answer to low unemployment and competitiveness, has pushed the political agenda in a liberal direction (with the support of trade unions during centre-left governments, and through unilateral policy making during centre-right governments which nurtured union divisions). But the instability inside the government coalitions, especially for the centre-left, the lack of fiscal room for manoeuvre, and entrenched opposition from the unions, have hindered any effort to go ahead with the reform of employment protection and unemployment compensation to extend flexibility to the core workforce. Ad hoc and temporary interventions were introduced for limited categories of outsiders but these innovations have not modified the functioning, the eligibility rules and the coverage of the old system. The bipartisan support for liberalization has al-

lowed for a layering of liberal institutions on top of a Bismarckian and corporatist framework, a highly institutionalised dualistic system of social protection dating from the 1950s and 1960s. Flexibility "at the margin" has increased the inequalities between insiders and outsiders, and dismantled the Italian model of employment protection for many younger workers.

In the UK, two decades of radical reforms under the Conservative party weakened trade unions and collective bargaining, leaving in place a residual welfare state and a mobile, flexible and increasingly polarized labour market, characterized by high levels of wage inequality. The Labour governments led by Blair and Brown made important changes to this model through strategies of partial re-coupling with the trade unions and of social policymaking aimed at correcting the most rooted inequalities among categories and to stimulate participation into the labour market. The Beveridgean universalistic system was amended by new rules for fighting social exclusion, like tax credits, statutory minimum wage and more rights for the workers in the workplaces. But evidence on wage and income inequality and poverty suggests that the fundamental logic of the labour market and social protection inherited from the Thatcher years has been revised but not overturned. The financial crisis since 2008 has placed heavy pressure on the more distributive institutions introduced by Labour, and current policy under the Conservative-Liberal Democrat government moves firmly in a neoliberal direction.

The two countries have thus both undertaken important labour market reforms in the recent period, which have led to them liberalizing labour markets and introducing stronger elements of conditionality in the welfare regime. However we do present some evidence – particularly in the Italian case – that policy change was not solely in a neoliberal direction. The Biagi law, in particular, drew openly on the European Employment Strategy, and the role of European Monetary Union in hastening fiscal policy change in Italy is well documented (Dyson and Featherstone 1996, Ferrera and Gualmini 2004). Britain did not face the same kind of fiscal pressures, but UK policymakers did draw on the repertoire of policies in the EES, in part because the New Labour government under Blair lobbied hard to push for the "uploading" of policies consistent with his "third way" thinking (Hopkin and van Wijnbergen 2011). Timid moves towards "activation" —the active labour market policies successfully pioneered by the Nordic countries— were made in both countries, but lacking the necessary supporting institutions, the result was some distance away from the "flexicurity" model advocated by European policymakers. Moreover, once Italy had achieved entry into the first phase of EMU and Blair's difficulties over Iraq undermined his own European policy agenda, the symbolic appeal of supranational prescriptions such as the EES became much less powerful. So European pressures to adopt labour market reforms that would attenuate liberalization with strong measures of social compensation had only limited impact.

In our view then, the dominant picture is one of continued liberalization in labour markets and welfare institutions, but the persistence of diversity stemming from the two countries' very different histories. Convergence around a pure neoliberal model is unlikely, because of the well-known inertia and stickiness of institutions governing labour and welfare, and the political appeal of more socially progressive policies. But where changes have taken place, these changes have tended to imply liberalization and greater role for markets, whilst reforms adopted to attenuate the social consequences of liberalization have had less powerful effects. The timing of liberalization and the "fit" of market reforms with existing institutions may differ, but the outcome remains that Italy and the UK have progressively dismantled the most egalitarian elements of their post-war settlements, and left in place an increasingly liberal model of welfare and work.

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NOTES ON SPANISH LABOUR AND EMPLOYMENT REGULATIONS

Notes on Spanish Labour and Employment Regulations: Termination With and Without Cause Under the Workers' Statute

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1. Ruling on terminations of employment and related effects

Once an employer has taken the decision to terminate employment, the employee has the right to dispute this decision before a court of law whereby judges will be responsible for ruling on this same. Rulings on termination of employment are regulated in articles 55 and 56 of the Statute for Workers and in articles 108-110 of Law 36/2011 of the Social Jurisdiction. With the aim of correcting important flaws in the laws governing dismissals, this matter has recently been modified by the Royal Decree-Law 3/2012, of February 10th, and finally by Law 3/2012, of July 6 th, regarding urgent measures for labour market reform.

In Spain, there are three types of rulings on termination of employment: with cause, without cause or void. At the same time there are three types of dismissal: disciplinary, objective and collective. Disciplinary termination (art.54 of ET) is based on a serious and deliberate breach committed by the employee. On the other hand, objective dismissal (art.52 of the ET) is determined by reasons which are objective as opposed to subjective (these last being characteristic of disciplinary termination) and may include breaches of the provision which are neither malicious nor culpable but which are still to the detriment of the employer. Collective dismissal (art.51 ET) constitutes a mechanism for restructuring companies for reasons which are economic, technical, organizational or related to production.

In the first place, a ruling of termination with cause applies when the breach- alleged by the employer in the letter of termination- has been demonstrated. If the termination is disciplinary then the employee is not entitled to compensation but he is entitled to claim unemployment benefits. Only when an objective termination is declared with cause is there compensation of 20 days salary for each year of service, distributed pro rata over months for periods of less than one year and with a maximum of twelve monthly payments.

In the second place, termination without cause is defined as that in which the breach alleged by the employer in the termination letter has not been demonstrated or as that which does not comply with the formal requirements as established in the Workers' Statute. Once the judge has ruled that the decision to terminate employment is without cause, the employer is left with the choice of re-employing the employee or paying compensation. That said, when the employee who has been dismissed is a workers representative than then rule is inverted and it is the employee who chooses between compensation or re-employment. If the party making the decision remains silent then, in both cases, the legal response is reemployment.

In the third place, void dismissal is that which involves a breach of the employee's fundamental rights or a breach of the right to reconcile family life and work (as recognized under the law). When a termination of employment is declared null the employer must reinstate the employee with back pay.

2. Objectives of 2012 labour reform

Practical experience has revealed important flaws in the laws governing the termination of employment. On one hand, proceedings were at times deliberately delayed by the claimant because of

wages which could be generated from the moment employment was terminated until the court's judgement was handed down (and then added to the legal compensation). This so-called interim salary* pay was paid by the employer when termination was declared null or without cause. In some cases, however, the 2012 labour reform abolishes such interim salary alleging that the length of time taken by a judicial process cannot be used as grounds to compensate the harm caused by loss of employment. Furthermore, the employee may claim unemployment benefits from the very moment that the decision to terminate employment is made effective. Interim salary may only be paid if the party terminated without cause is a legal representative of the workers or a union delegate or, beyond cases described, if the employer opts to re-employ the claimant.

On the other hand, the so-called "express dismissal" consisted of termination with legal cause, acknowledgement of unfair dismissal and payment of compensation. This was clearly a move away from legal processes and altered the nature of the motives for termination of employment. In the setting of the economic crisis, it became clear that the main way of terminating permanent contracts was indeed via "express dismissal", far surpassing the number of collective and objective dismissals. In order to avoid the legal process, employers generally preferred to pay compensation for termination of employment which was higher (45 days) than specified in the law for termination with cause (20 days or nothing in disciplinary termination). These were the reasons why the labour reform eliminated "express dismissal".

Lastly, strong segmentation in the labour market between temporary employees and employees with a permanent contract has meant a reduction in the costs of terminating the employment of permanent employees. After the 2012 labour reform, severance pay for termination without cause is 33 days wages for each year of service, distributed pro rata over months for periods of less than a year, up to a maximum of twenty four monthly payments (previously it was 45 days' wages for each year of service, with smaller periods of time distributed pro rata over months, with a maximum of forty two monthly payments).

2.1. Related problems

The application of the 2012 labour reform has led to serious doubts as to whether interim salary is to be paid in those dismissal procedures begun prior to February 12, 2012 but which are resolved by the courts after this date (which is the date the reform was passed into law). Several decisions have been handed down in this matter that have found both for and against.

With regard to these terminations of employment, the 2012 Labour Reform has established a transitory rule regarding severance pay for termination without cause for those contracts drawn up prior to the law being passed. Thus, compensation is to be calculated on the basis of 45 days' wages for each year of service for the period of time worked prior to the aforesaid date the law was passed and on the basis of 33 days wages for each year of service for the period of time worked afterwards.

The amount to be compensated may not be greater than 720 days' wages, unless compensation for the period prior to the passing of the Royal Decree-Law is calculated to have a greater number of days. In such cases, this will be the maximum amount of compensation to be applied, and on no account may be greater than 42 monthly payments.

2.2. How to calculate compensations for termination of employment a hypothetical case

An employee was hired as an administrative assistant on July 1st in 1998 by the company "Informática S.A" by means of an ordinary permanent contract.

On March 20st 2012, he was notified by the company that he is to be subject of a disciplinary termination. In the termination letter it is alleged that he has repeatedly removed computer equipment over a period of time.

* Interim salary may be defined as the employee's salary from the date of termination through the date on which the court's judgement is notified.

In a ruling made available to the employee on September 10 in 2012, the judge rules that the termination is without cause on the grounds that, during the hearing, the employer was unable to prove that the employee behaved in a way that led to the termination of employment.

Including the corresponding portion of bonus payments, the employee's monthly salary is 1,500 euros.

Solution

As established by article 56 of the Workers' Statute, according to the draft provided by the 2012 Labour Reform, a disciplinary termination without cause means that the employee would be entitled to receive compensation of the amount of 33 days wages for each year of service, with a maximum of 24 monthly payments. At the same time, and applying the aforementioned transitory rule, two types of calculations must be made:

1st Step: compensation corresponding to the period July 1, 1998 to February 11 ,2012
(13 years, 7 months and 11 days of service) would mean:

156 + 8 (whatever the number of days worked since the last full month, the apportionment to be made for months, as if he had worked the whole month)= 164 months

12 months ..... 45 days of compensation
164 months x
X= 45x164/12=615 days of compensation

This adds to a total of 615 days of compensation

Daily wages that are to act as a unit of measure for calculating the compensation:

(1.500 x 12) / 365 = 49.32 euros

Amount of compensation until February 11, 2012:
49.32 euros x 615 days = 30,331.8 euros

2nd Step: Compensation corresponding to the period February 12 to March 20, 2012
(1 month and 9 days of service)

12 months ..... 33 days
2 months x
X= 33x2/12= 5.5 days of compensation

49.32 euros x 5.5 days = 271.26 euros

3rd Step: Total amount of compensation:

30,195.67 euros + 271.26 euros= 30,466.93 euros

The hypothetical situation described above proposes to add up the interim salary (wages which are generated from the moment of implementing the termination-March 20, 2012-until notification of the court's judgement-September 10, 2012) for terminations of employment implemented prior to the

work reform. However, if the employment had been terminated subsequent to the work reform then in no circumstances would interim salary be paid when the company had decided to pay compensation.

In sum, it is clear that the 2012 labour reform has considerably reduced the cost of termination of employment, not only for employees hired from the date the new rule was made effective but also for those hired beforehand.

RECENT PUBLICATIONS

García-Perrote, Ignacio; Mercader Uguina, Jesús R. (dir.). *La regulación del Mercado Laboral*. Valladolid: Lex Nova, 2012. 506 p.

La regulación del Mercado Laboral (The Labour Market Regulation) is one of our latest books and it has been extremely well-received by experts and general readers alike. This research, directed by professors Ignacio García-Perrote and Jesús R. Mercader, analyzes the different areas targeted by the recent labour market reform. An important group of researchers who come from our group, "Labour Law, Economic Changes and New Society", took part in this work, focusing their analysis on the main instruments that Law 3/2012 uses to resolve the main rigidities of the Spanish labour market. The result is a complete guide on the important changes that this new rule incorporates into the Spanish legal system, analyzed from a multidisciplinary point of view.

This book can be divided into six main areas of analysis. Firstly, it focuses on measures adopted to transform the Spanish contractual system. In this sense, the reform modifies the contracts for learning and apprenticeship, which is directed at improving qualifications of young people; it reforms part-time contracts, in order to permit the use of extra hours; and it creates two new types of contracts: a telework contract and a contract for entrepreneurs. The latter has been criticized because of its long probation period, one year, twice that of the longest period established in the current legislation, which has been considered as a kind of reduction in severance pay.

Secondly, the authors analyze the actions the Law 3/2012 adopts in order to promote employment policies. The most important actions are the modification of the employment subsidies program, temporary employment firms being allowed to act as private employment agencies, and the fostering of permanent and vocational worker training.

Third, the reader will find chapters dedicated to explaining the changes adopted regarding internal flexibility. On the one hand, the reform makes it easier for the employer to modify working conditions, including working hours and salary, an area explained as one of the main instruments for developing internal flexibility in the Spanish labour market. On the other hand, there are some negatives effect related to these changes that are also analyzed. Specifically, there is a chapter focusing on the effects of the reform on personal and family life as a consequence of the changes in articles concerning the work day, temporary invalidity, work permits and holidays.

Fourth, the book deals with what is likely the main target of the Law 3/2012: the reduction of labour costs in order to promote employment and reduce the duality of the Spanish labor market. The reduction of compensation for dismissals for permanent contracts, narrowing the gap between the costs of temporary and permanent work; clarification as to when dismissal for economic reasons can be used; and its effects on public and financial sector, are all explained in three different chapters.

In the collective bargaining area, the book pays special attention to the pre-eminence of agreements reached at the firm level and the limited validity of agreements in the absence of a new one once they have expired (ultraactivity). Furthermore, it also describes the main innovations in labour relation conflict resolution procedures linked to collective bargaining.

Finally, the reader will find answers to some specific technical problems that labour reform brings about in Procedural Labour Law and in the Social Security system.

In conclusion, *La regulación del Mercado Laboral* is a complete research into the principal effects of one of the most important reforms of the Spanish labour market in the last three decades. Its multidisciplinary point of view offers the reader a complex analysis of the dramatic changes that this reform is likely to bring about in the Spanish labour market.

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AUTHOR GUIDELINES

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Mercader Uguina, J.R. (2011), Lecciones de Derecho del Trabajo (Valencia: Tirant lo Blanch).

Sánchez Pego, F.J. (2010), "La dirección del proceso laboral tras la reforma", Justicia Laboral, 42, 13-32.

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