Spain´s post-reform labour market legal framework

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The 2012 labour reform aimed to correct two main shortcomings of the Spanish labour market´s legal framework – high labour costs and lack of flexibility. While notable progress has been made to address rising labour costs, legal uncertainty introduced by the reform is preventing firms from taking full advantage of measures to increase flexibility.

The shortcomings of the Spanish labour market´s legal framework are well-known. The framework´s administration-centric view of labour relations is often insensitive to the needs of the productive system, labour productivity, and competitiveness of businesses and the economy as a whole. The result is a rigid framework with consequences not just for job creation/destruction, but also for job quality. The 2012 reform aimed to address this situation, on the one hand by reducing labour cost pressures for firms, and on the other, by increasing internal flexibility in an effort to reduce adjustment through dismissals. Whereas the labour-cost adjustment goals pursued by the reform have been achieved, the impact on increasing flexibility is not as clear cut. Legal guidelines governing modification of working conditions, redundancies on economic grounds, and collective bargaining have greatly curtailed, if not overruled, the most important changes brought by the 2012 reform, further increasing the legal uncertainty companies face.

The shortcomings of the Spanish labour market´s legal framework are well known. There is also ample literature on the consequences for employment, not just in terms of job creation and destruction, but also job quality. The legal framework, which essentially comprises the Workers' Statute, characterized by numerous modifications and implementing regulations, has been largely unaffected by changes in production processes, the economy, companies, and society. It remains anchored in excessive and complex regulation, together with too much intervention by the authorities. The legal framework is therefore a source of rigidity. Moreover, its administration-centric view of labour relations is often times insensitive to the needs of the productive system, labour productivity, or the competitiveness of businesses or the economy.

Similarly, the collective bargaining system also contributes to rigidity and excess burden on productivity and competitiveness. Collective agreements on working conditions have been given regulatory status rather than contractual status, as would have been preferable. Furthermore, they are applicable in general to all the parties within their scope rather than just those represented by the negotiators. Thus, collective agreements tend to constrain, or override, individual employment contracts, making them one of the biggest sources of rigidity in Spain's labour relations. Moreover, given

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that negotiations have predominantly been sectoral (and, more specifically, provincial), business and union organisations have enjoyed excess powers, being able to make key decisions regarding the scope of application of collective agreements, as well as the regulation of labour relations, leaving little discretionary power for individual contracts or for firms.

Apart from being a source of rigidity, collective bargaining has had an inflationary effect on labour costs. An analysis of the evolution of labour costs before and after the crisis reveals that the much advertised wage restraint has never existed, and that wage agreements resulting from collective bargaining have caused a continuous erosion of Spanish firms' competitiveness. This is a consequence, on the one hand, of wage increases being negotiated primarily at the sector level, without taking the specific situations of firms (or labour productivity changes) into account and, on the other, of regulation determining the validity and applicability of collective agreements. Until the recent reforms, employers were legally required to maintain collective agreements in force, even after they had expired, until a new agreement came into effect. This was the so-called "ultra-activity". As a result, negotiations rarely aimed at renewing the content of the agreement to reflect productivity needs, instead revealing a trend towards continually escalating labour costs and efforts to decrease working hours.

In short, in a context of rising labour costs, and regulatory rigidities, employment became the main instrument for adjustment available to firms to adapt to structural changes or simple downturns in the economy. These dynamics in part explain the volatility and high rate of Spain´s unemployment.

Key objectives of the 2012 reform

The reforms passed in recent years, particularly the 2012 reform, aimed to alleviate labour cost pressures on firms´ competitiveness, as well as improve labour relations. The goal was to increase flexibility in labour relations in an effort to reduce reliance on redundancies as firms´ main adjustment mechanism. In other words, the two principal objectives of the reform were: i) a tacit aim of reducing labour costs; and, ii) the openly stated aim of increased discretionary power for employers to increase flexibility and adaptability of labour relations in an effort to reduce dismissals.

The 2012 reform had two major objectives: (i) a tacit understanding to reduce labour costs; and, (ii) a repeatedly expressed aim to increase flexibility of labour relations in an effort to reduce dismissals.

We now examine the regulatory measures introduced to achieve these goals and their results to date. The reform was essentially a modest one, limited to making only specific changes to certain aspects of existing regulation in the areas of labour costs and flexibility. One of the problems in the application of the reform is rooted in the behaviour of the courts, which have often failed to uphold the reform, as the recent regulatory changes introduced are at times at odds with the body of existing regulation. This is particularly apparent in the case of the reform of collective bargaining: attempting to alter only certain aspects of collective bargaining to change the negotiating behaviour of the parties involved, without changing the underlying model for negotiating collective agreements. In addition, technical shortcoming of the reform have also hindered the effectiveness of its application.

Cost adjustment measures

That said, the reform has sought to achieve cost adjustment through various measures. Firstly, by allowing substantial changes to working conditions –including wage cuts– to be agreed by the employer with the employee representatives or unilaterally imposed by the employer. This becomes an option if no agreement can be reached, when economic, technical, organisational or production reasons arise

(however, always with subsequent supervision by the courts, which must confirm that these conditions exist). This measure has allowed firms to cut wages (provided they are above the minimum set in the applicable collective agreement). Secondly, by establishing that company-level agreements on wages take precedence over sector-wide agreements. Company-level negotiation has therefore become an escape route from the rigidity of wages set at the sector level. Thirdly, by opening up the possibility for employers to opt-out of the conditions set in the collective agreement, either at the sector level or the company level. This measures offers firms an alternative route (referred to as an opt-out) to escape regulations that, for certain reasons, have become unsustainable. However, prior negotiations with the employee representatives must be respected and a unilateral decision by the employer is ruled out. If no agreement can be reached, the matter will be subject to arbitration by the National Consultative Committee on Collective Agreements (or the equivalent regional body). Fourthly, and finally, by limiting the time an expired agreement is to remain in effect to one year. This measures facilities the renewal of the expired agreement´s content, avoiding attempts by unions to entrench themselves in the previous agreement as a starting point for new concessions, such as wage increases.

Three years after the reform came into effect, in terms of adjustment to labour costs, we can say that the goals pursued by the reform have clearly been achieved. Wage restraint has become well established in Spain. The adjustment has been significant and is one of the factors enabling businesses to improve competitiveness and boost exports. At the same time, however, paradoxically, employers and employees are facing increases in the cost of associated social contributions. The increase in the contributions ceiling (5% a year in 2013 and 2014), the inclusion of payments in kind in the contributions calculation, and other related measures have partly counteracted the wage restraint efforts made. Furthermore, wage adjustment has had negative social consequences, and from the economic viewpoint, has also been a factor in holding back consumption. However, the scope for additional competitiveness gains based on further labour cost reductions is limited. That said, going forward, future wage increases must be in line with

The 2012 labour-market reform led to a significant adjustment in labour costs, which has improved firms' competitiveness. However, there is probably now little leeway for this wage adjustment to continue.

productivity gains and should not take the form of across-the-board sector-wide wage increases. They should, rather, be limited to the specific scope and circumstances of each individual firm. More forceful regulatory measures may well be necessary for Spain's labour relations to move in this direction.

Flexibility measures

The situation regarding flexibility is much more complex. Here we distinguish between three fundamental aspects of the reform: internal flexibility via changes to working conditions, external flexibility through redundancies on economic grounds, and collective bargaining. Each of these aspects merits separate discussion.

Internal flexibility

Initially, it became easier to make substantial changes to working conditions (either through agreement or unilateral decisions imposed by employers if no agreement could be reached), despite the limited regulatory changes. The courts adopted the legislator's intentions to facilitate firms internal adjustment, provided compliance with formal conditions.[2] Moreover, the requirement to demonstrate economic, technical, organisational

[2] Formal conditions included negotiations with employee representatives and ensuring these representatives were provided with the relevant information.

or production grounds for a decision was less strict than in the case of collective redundancies. It was argued that the causes, or rather their intensity, were not the same in each case, and therefore the evidentiary requirements were also less stringent. Moreover, having demonstrated the grounds, the business's decision to change working conditions accordingly tended to be respected.

However, as the reform was applied with more frequency, this initial acceptance of the greater ease of implementing substantial changes to working conditions was progressively curtailed. To some degree, government regulations played a part. Indeed, Royal Decree 1362/2012, September 17th, 2012, enacting the Regulations of the National Consultative Committee on Collective Agreements, introduced criteria controlling employers' objectives, making it necessary to confirm that the proposed measures were appropriate and proportional, and not merely confirm the existence of the their alleged grounds. This allowed the National High Court (NHC), for example, to again argue for the need to assess the reasonableness and proportionality of the business decision ruled upon by the court.[3]

This "reabsorption" of the changes introduced by the reform into the old interpretative patterns was consecrated at the highest level by the Sentence of the Constitutional Court of January 22nd, 2015. Curiously, while endorsing the constitutionality of the reform, this ruling does so on the basis of consideration that the reform has had very little impact, if any at all. The Constitutional Court seemed to be saying that the reform is constitutional because, basically, it has left the regulatory situation unchanged. In relation, in particular, to internal adjustment measures, the Constitutional Court held that employers' authority to make changes to working conditions *regulated* under Article 41 of the Workers' Statute is a regulated rather than a *discretionary power.* This is to avoid *misuse* by employers of the authority they have been granted. Thus, Article 41 has to be interpreted in the light of the regulations on collective redundancies (Article 51), suspension of contracts (Article 47), and opting-out of collective agreements (Article 82.3). In all these cases, the grounds are the same, and the court's oversight of the corresponding measures by the employer must be full and effective.

Under these circumstances, if judicial doctrine takes this approach, one of the most significant changes brought by the reform will be severely constrained, and it will significantly increase firms' insecurity with respect to the possibilities of internal flexibility it allegedly sought to increase.

Legal obstacles have significantly limited the changes made to internal flexibility, thus creating greater uncertainty among firms as regards its possible application.

External flexibility

The same logic applies to external flexibility. If the legislator's intention was to rationalise the functioning of redundancies on economic grounds, allowing relevant decisions to be taken by employers, while demanding compliance with certain formal requirements, we believe the reform has fallen short of its objective. The uncertainties are greater than in the past and the situations arising are more difficult to manage. This is a consequence of the reform's approach (and its technical shortcomings).

The legislator sought to bring the situation of redundancies on economic grounds in Spain closer to that of other European countries and in line with the European community's approach. Thus, the requirement for prior authorisation for dismissals from the authorities was eliminated and

[3] Sentence of the NHC of March 11th, 2013, referring to a specific case of dismissal but applying a doctrine to be used as a precedent for cases of modification of working conditions.

the employer was given freedom over the decision to be taken. But, in the wake of the Community directive, a period of consultations with employee representatives was imposed, and employers' duties to provide information to enable or facilitate these consultations was regulated in detail. The European approach of giving employers the power to decide on workforce adjustments configures this decision in a highly proceduralised or formalised way, putting the emphasis on the formal requirements, in particular respect for genuine (informed) negotiations with employee representatives.

Alongside these changes, rather than respecting the employer's decision once the negotiation process has taken place and the established requirements have been complied with, the ultimate ruling remains entirely under the court's control. The courts not only seek to confirm that the formal requirements have been met, but also look at the substance of the case to verify whether the economic, technical, organisational or production grounds claimed by the employer have in fact arisen, and whether these grounds warrant the measures taken. This is in contrast to the preamble to the law, which states that court intervention should to be limited to verifying the facts asserted by the employer, not judging the business decision's appropriateness or scope.

This situation gives rise to two basic issues: the first is that complying with the formalities has turned into a labyrinth employers are finding hard to navigate. The courts have been extremely strict in this regard, and many of the collective redundancies ruled to be null and void by the courts have been excluded on the grounds that they have failed to comply with formal requirements. The legal uncertainty on this point has become extreme.

The second issue derives from the legislator's illusory goal of achieving an objective formulation on which to base redundancies on economic grounds. The way the legal text is drafted is a long way from objective (the basic justification being a negative economic situation, which is by no means a precise concept.) And legal guidelines, after an initial stage in which they stressed the legal changes adopted and the legislator's wish to avoid court judgment of business management decisions, have reintroduced appropriateness criteria (the alleged grounds) for the business decision, its reasonableness, and its proportionality. With these criteria, we again have courts appraising business management decisions and moving away from the idea that, once the grounds have been confirmed, the decision based on them should be taken by the employer.

The Constitutional Court's ruling alluded to above is also relevant here. The Constitutional Court maintains that, in relation to collective redundancies, the reform *neither blurs the grounds for dismissal nor introduces greater discretion for employers,* but simply eliminates the room for uncertainty in the interpretation and application of the rule. It neither gives more leeway for the employer's discretion nor eliminates the causal element from the dismissal, but defines these grounds more objectively and with more certainty, by avoiding rulings over the appropriateness and forward-looking assessments. As regards judicial oversight, the Constitutional Court says that the judge is to assess whether real and realistic grounds exist making it just, *i.e.* reasonable, that the employer decide to terminate the employment relationship.

Collective bargaining

Finally, as regards collective bargaining, despite the changes made to the role of company-level agreements, in terms of the possibilities of opting out of the agreed conditions, and in terms of the limitation on the "ultra-activity" of collective agreements, in general terms, it is safe to say that little has changed. Collective agreements remain a major source of rigidity in Spain's labour relations. They continue to have the aberrant regulatory character mentioned above.

Being generally applicable (reaching beyond the parties the negotiators effectively represent), their negotiations remain marked by the tendency to conserve existing conditions, with minimal drive for innovation. Experience shows that efforts to change collective bargaining without changing the regulatory framework underpinning it, as in the case of the latest reform, are unlikely to succeed. And while it is true that numerous opt-outs from collectively agreed conditions have taken place, their quantitative importance, in terms of the number of workers affected, is scant. It is also true that the possibilities opened up for businesses to negotiate have promoted agreements to tailor the conditions agreed upon sector-wide to the business level. However, collective bargaining has not changed substantially and the limitation on the "ultra-activity" of collective agreements to a year has not worked. The lack of ambition of the legislator, the technical errors in the statutory rules and the interpretation of many judges, obstinately refusing to accept that workers might lose the coverage of a collective agreement, has led to a situation in which the regulation has barely had any impact on the reality.

On the one hand, judges have interpreted that the pact against the end of "ultra-activity" may be an agreement prior to the reform. A substantial percentage of collective agreements mirrored the preceding legal regulation. Given that the interpretation of this regulation includes an understood agreement not to limit "ultra-activity," the practical impact of the regulatory change has been severely limited from the outset.

What is more, judicial doctrine has gone further[4] by interpreting the regulatory change to mean that an expired collective agreement ceases to be applicable after a year (by legislative mandate), but must nevertheless continue to be applied. This is either because it is understood that the conditions of the collective agreement have been incorporated in the individual employment contracts, or because there was a tacit agreement between the employer and employees for the collective agreement to continue to apply in its entirety.

In this context, if the reform´s intention was to modernise Spain's labour relations, making them more sensitive to changes in productivity and competitiveness needs of firms and the economy, a thorough overhaul of the regulatory and negotiations framework is needed.

Conclusion

Thus, as regards internal flexibility, the set of regulations contained in Article 41 of the Workers'

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Statute needs to be reviewed. The grounds for internal flexibility cannot be the same as those required for dismissal, and discretionary powers of businesses cannot be conceived of as being regulated as if they were administrative measures. Firms must be given leeway for discretion (but not arbitrariness) in their business management, as firms cannot be managed as if all possible organisational and productive changes can been foreseen by law and regulated.

Legal certainty urgently needs to be restored to collective redundancies. Compliance with formal requirements must be subject to approval by the authorities, as it is in France, with the possibility of rectification of any errors or non-compliances, without subsequent judicial oversight. Judicial oversight should be limited to legal aspects of dismissals, leaving economic conflicts and conflicting interests aside. This does not undermine the right to effective legal protection. The work of the courts should focus

[4] See the ruling of the Supreme Court of December 22nd, 2014.

on individual claims against dismissal, eliminating the nullity of a collective dismissal, which creates more problems than it solves, and leads to almost unmanageable situations. Nullity of dismissal should not be used in the case of collective redundancies. And much less so if possibilities of

Court oversight of redundancies should be limited to legal aspects, leaving economic conflicts or conflicting interests aside. The work of the courts should focus on individual claims and it should not be possible to rule collective redundancies null and void.

collective enforcement of the ruling for nullity of the collective dismissal are opened up, as the legislator has done.

Finally, in relation to collective bargaining, re-establishing the contractual nature of the collective agreement would be a significant step, as would limiting its application to the parties represented in negotiations. Together with this, in any case, legislation should give company-level agreements more prevalence to avoid creative interpretations by the courts. The consequences of the loss of validity and applicability of the agreement should under no circumstances be that the expired agreement should remain in force in its entirety.

In sum, the 2012 labour reform has made progress to address some of the relevant shortcomings of the Spanish labour market´s legal framework. For instance, there has been notable progress on reducing competitiveness pressures on business and the economy through moderation of Spain´s rising labour cost dynamics. At the same time, however, legislative changes applied to key areas affecting labour relations, such as internal flexibility, external flexibility, and collective bargaining, have introduced greater uncertainty into Spain´s legal framework, necessitating further advances in these areas for employers to be able to benefit from the reform´s intended effects.