STUDY

Traslated by Tim Ennis

STABILITY IN EMPLOYMENT

Francisco Pérez Mackenna

Some of the most and complex and important aspects of labor market institutions are the rules and practices relating to dismissal and redundancy payments. This study contains a discussion of the principles, goals and circumstances that labor legislation should consider on these issues.

According to the author, the provisions governing dismissal and voluntary resignation should respond to the need for fair relations between the parties, reconciling the interests of those who are employed with those of the unemployed, as well as with the needs of a dynamic economy.

In this context, the author suggests maintaining the possibility of dismissal without need to prove specific cause (within a pre-established group), while also proposing the obligation make a severance payment equal to one month's wage per year of service to workers who are fired or who resign voluntarily. Moreover, it is argued that the law should indicate prohibited causes of dismissal, so as to avoid discrimination against certain groups.

FRANCISCO PÉREZ MACKENNA. Commercial Engineer, Catholic University of Chile. MBA, University of Chicago. Professor at the School of Administration at the Catholic University of Chile. President of Citicorp, Chile S.A.

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Introduction

The world of work is a focus of general interest. Political programs have considered various theses and proposals with regard to our labor legislation. Both the union world and that of business normally express their points of view energetically. The Catholic Church also offers a point of view on labor issues with arguments that have even given rise to various encyclicals, and which have become important documents on the topic. The dignity of man, economic development, social justice and equity, property rights and the freedom to carry on an activity are concepts that intermesh when one talks about labor market institutions.

When it comes to questions of employment, everyone wants to express their opinion. In Chile today, the labor force comprises 4.5 million people who are directly affected by concepts like the minimum wage, job tenure, wage increases, unemployment and ultimately anything belonging specifically to the sphere of employment.

There can be no doubt that employment issues involve aspects that are not strictly limited to the economic sphere. For some people the world of work may even be a path to personal sanctification. Others argue that work dignifies man in his condition of being; that through work man participates in the creative work of God. It is also argued that for a human being's personal fulfillment, he or she needs to feel useful, and the psychological consequences of unemployment can be devastating in terms of personal self-esteem. In view of all the above, discussions about labor market issues normally accumulate a heavy emotional and ideological charge, which makes it more difficult to reach agreements in this area. In the lines that follow, I aim to make a contribution to understanding in this field. For reasons of space, the scope of the topic will oblige me to focus only on certain aspects of this complex subject: namely, those related to job tenure. In this sense, these comments are to be seen as reflexions for dialogue and, of course, are far from being the final word on the subject.

The Goals of Labor Legislation

I believe it is essential to begin arguments on labor market issues by explicating the premises on which they are built. These are that we want more jobs rather than fewer; less unemployment rather than more; economic development rather than stagnation. We want adaptability in the eco-

nomy, and within firms, in confronting change. We want to promote the worker as a person, along with better wages and working conditions. We want the different actors in the world of work to bargain on an equal footing; for the weakest to be generally protected by labor market institutions rather than ending up squeezed between powerful groups that exclude them from their sectoral agreements.

Employment and unemployment are two sides of the same coin. For that reason it is important to specify the objectives that should be pursued in policies and provisions regulating the problem of job stability. I believe that the goals mentioned in the previous paragraph are matters of broad agreement.

Firstly, we must try to provide more employment. Secondly, society must be able to develop in a local sense, while also considering the international context. Thirdly, it is important to keep in mind the concept of society's adaptability. Our organizations should be capable of adapting to new requirements (often exogenous — i.e. imposed from outside). A fourth point is that our standards on labor issues must promote the worker. There also needs to be a balance of power for there to be justice in labor relations. Finally, the standards and proposals not only have to respect the weakest but also tend to protect them. From this point of view, when one talks of job stability, one needs to keep in mind that sometimes the negotiations that are carried out tend to cause problems for outsiders: basically those who have been unable to find work and who are unemployed, or those who do not have sufficient training and are excluded for that reason.

Proposals should promote employment and not become impossible hurdles which turn job stability also into a stability of unemployment or under-employment.

Furthermore, from the practical point of view, it is necessary to indicate that whatever the norms on this issue may be, they should facilitate the creation of new sources of work: new firms need to come into existence, existing ones need to increase their requirements for hiring skilled workers. In sum, the need for a larger number of workers should be ever greater.

Recalling the words of the Holy Father, it should be stated that work is an individual right; not only from the standpoint of sustenance, but also for reasons of personal fulfillment. It is the mechanism through which ordinary human beings collaborate in creation. From that perspective it is not good enough for a society to develop certain subsidy mechanisms as a palliative to unemployment. Although this may partly resolve the problem of sustenance, the fact that people have something to eat does not resolve

the problem of personal fulfillment. Individuals have to feel themselves to be participants in this creative work: "useful" in a real sense. Consequently, it is essential for the economy in general, and our society in particular, to have sufficient dynamism to ensure the creation of more and better jobs for all Chilean people.

Diversity of Arguments

I want to refer to three different approaches, which make it possible to define what is understood by a job from various points of view. These lead to different arguments and are decisive in seeking solutions to the problem of job stability.

The first is the outlook of the firm at the end of the 19th century, according to which labor, capital and raw materials are seen as factors of production. If one accepts this kind of outlook in defining work, one reaches different and more limited conclusions than when one acknowledges in work a more complex role.

The second outlook sees a job as belonging to the worker. According to this, it might even be established that as the owner of the job, the worker can sell it to someone who is unemployed (known in Chile as a *"medio pollo"*). I believe this is a view of what work is that has also grown outdated.

The outlook that is emerging now is based on a more modern view of the firm. The firm is seen as more of a juridical fiction, defined, explicitly and implicitly, for a series of contracts. Some of these contracts are written in documents and others are tacit.

A series of actors participate in this juridical fiction: on the one hand there are entrepreneurs, who usually set up the firm. However, they are not the only ones who define the relation: the workers are also important actors in defining the firm. Other actors who participate in the firm are creditors, consumers or customers, as well as suppliers and the state: ultimately, all elements of society that benefit from this juridical fiction.

To set up a firm, more than having machinery in a production line at one's disposal, or putting up a building, one needs the capacity to reach agreements with different actors. It is possible to form a company on the basis of transforming raw material into a final product; however, one can also create a firm by simply delegating the organization of goods and services to third parties.

From this standpoint, today's firm is more diffuse than fifty or hundred years ago. The tasks of delegation have generated productive units

that are increasingly specialized. Corporate strategy has incorporated the principle of "comparative advantages" into the firm, through concepts such as "strategic coherence", "the company mission", and " let's not forget what has made us famous". Specialization has been facilitated by the availability of markets that are more perfect and integrated every day.

The communications revolution has also played a role in this transformation. Labor market institutions have to respond to this modern conception of the firm, helping to face to the challenges of the world economy. Vertiginous technological progress has made adaptability obligatory. Companies that are not receptive and flexible compromise their survival. To the above one should add a growing trend towards de-standardization of products and jobs[1].

> Through out the industrial era, technology exerted strong pressure towards standardization, not only in products but also in terms of work and the people who do it. Now a new type of technology is emerging which has a diametrically opposite effect. Stated simply: whereas industrial machines are standardized, super-industrial machines are de-standardized[2].

As result of this, the wage has ceased to be the only dimension of compensation. Training, various aspects of motivation, professional fulfillment and spaces to develop the creative spirit are fundamental elements in determining a worker's satisfaction with his job. Today, the firm is a network of relations between different actors rather than a brick building where things are made. Work is different from a factor of production. One cannot say that workers own their jobs, but nor do they have to be considered as a factor of production. They are a group participating in the contract that allows the firm to exist. Moreover, one should keep in mind that although the contract is largely explicit, there are also tacit norms. In times to come the most important thing for the success of firms will not be monetary or economic capital, but human capital.

Entrepreneurial capacity lies in ability to carry out tasks increasing productivity, and this is only possible in a climate of cooperation. The fundamental factor for generating wealth is no longer physical or monetary capital, but human capital. In other words, it has to do with the capacity to create, to develop new ideas. Summarizing this central idea, once it is recognized that workers, entrepreneurs and other actors are part of this

[1] Fernado Coloma, "Reflexiones sobre institucionalidad laboral en el marco de una economía de mercado". *Working Paper*, Catholic University, 1989.

[2] A. Toffler, *The Flexible Firm*, quoted by Fernando Coloma, op. cit.

juridical fiction that we call the firm, one can infer that labor relations allow people to gain their sustenance and contribute to the progress of the country, while also allowing them to develop as people. Labor relations are not confined to the payment of a wage. Yet, nor are they restricted to compliance with a work timetable or with a minimum performance as defined in the labor contract. Workers and entrepreneurs expect more from each other. Only in this way can the two of them win the struggle against poverty and mediocrity. The modern world has opened up to competition, so work well done, and constructive labor relations, are crucial for development.

Job Stability

The next question is how to achieve a balance between the need for a dynamic economy and the need for fair relations between the parties.

Of course, the unemployment problem needs to be resolved not only through subsidies but also through the genuine creation of sources of productive and useful work, where people participate in creative tasks. However, as has been said already, one should not forget that the firm is a complex juridical entity, where although workers are not the owners of their jobs, neither are they mere factors of production comparable to raw material. There is a relationship that goes beyond the purely contractual, that has to do with what are often implicit considerations in labor relations.

The worker needs to have his important and fundamental role in the firm recognized, and it also needs to be understood that relations are long-term. When the worker joins a firm, his contribution is not exhausted in the working day. Yet, the need to have an economy that adapts to change, one that contributes to creating jobs and does not replace labor with physical capital (which in the end detracts from employment possibilities), imposes a significant constraint on the challenge we face regarding job stability.

Without doubt, the most important variables for job stability are not the legal aspects. They relate to macroeconomic stability and the conditions of development in our country. These are variables that are going to be decisive in defining job stability, not only at the level of workers, but also entrepreneurs and the entire economy. There are very important factors on which I believe it is possible to agree: the importance of macroeconomic stability, the importance of growth, of saving, of stability in the rules of the game, the importance of investment. All of these are crucial for job stability.

Now that this reflection has been made, I will basically refer to certain aspects that relate to micro-relations at the level of the firm. For

there to be stability in employment, on the one hand there has to be job creation —an interest in hiring and creating new jobs, and in keeping workers on. On the other hand, there also has to be a capacity for adaptation in facing different situations, such as the individual who thought he had found a job-creating opportunity, but after carrying out much of the investment he realizes that because of changes in conditions, or a mistake, the opportunity begins to dissolve. These are two fundamental elements.

When, for some reason, it is impossible to compete on acceptable terms, or pay adequate wages because the environment in which the firm or the productive units is operating does not generate sufficient revenue, there should be the possibility of backtracking without losing everything.

Mechanisms have to be sought to enable both things to be compensated: that, on the one hand, the adventure of creating firms and jobs should not be an impossible burden to carry when the going gets harder. On the other hand, there should be a awareness that adaptability is not frivolous, but responsible; that it involves people whose long-term, often implicit, contracts have to be respected. All of this should be achieved within a framework of reduced conflict, an element which is important to introduce.

This question leads us to the issue of redundancy pay —of the obligation existing between workers and entrepreneurs regarding the possibility, often inevitable, that a worker may be laid off or lose his job.

Norms of Dismissal

Dismissal norms have not always been the same in Chile. In the past, the law established what is known as job tenure. Law Nº 16.455, April 6th, 1966, established that an employer could not terminate a labor contract without stating one of the three causes justified by the legislation. However, in practice it was possible to fire a worker by invoking any cause, provided the employer paid one month per year of service as severance pay.

Along with easily understood causes, others were included such as: (a) acts affecting workers' health; (b) a loss of professional aptitude, or (c) whatever the needs of the firm's operations dictate.

In this respect, Rodrigo Alamos argues:

> The passing of Law Nº 16.455 gave rise to a proliferation of legal actions for unjustified firing. In addition to dismissals for reasons that are difficult to prove, claims were made against those citing

> inefficiency, and what is more serious, those caused by changes in the conditions of technology and demand.
> The rulings in such cases established that except in the case of easy proof, all other lay-off was deemed unjustified; even the cause relating to the needs of the firm's operation, ended up as an dead letter[3].

According to, Pablo Huneeus, the director of SENDE during the Frei-Montalva government, accumulated experience showed that the tenure law:

a) did not favor the fired worker, because 68% of them abandoned their claims against unjustified dismissal.

b) did not protect the good worker, because causes that could be proved in court were not always the most serious ones;

c) acted as a stimulus to replace labor with capital; and

d) stimulated short-term contracts[4].

Law D.L 2.200 amended the dismissal norms, establishing what is known as "free dismissal", but imposing a severance payment. Letter f) of Article 155 of the Labor Code establishes as cause for dismissal: "written severance by one of the parties, which has to be given to the other party with at least 30 days' notice, and a copy sent to the respective employment inspectorate. However, this notice is not required when the employer pays the worker redundancy in cash equivalent to the last monthly accrued wage".

Later, in Article 159, it adds that workers in this situation should receive redundancy pay at the last monthly wage rate, equivalent to 30 days' per year of service, with a limit of 150 days' wages, except where collective or individual bargaining has agreed higher redundancy pay. The transitory article eliminates the 150-day limit of for workers hired before the August 14th 1981.

According to Rodrigo Alamos, this transitory norm has created two classes of workers, which, on the one hand, generates pressure for the upper limit to be eliminated for all hirings after 1981, and on other hand causes firms with older staff to have greater difficulties in adapting to possible recessions[5].

Debate on Article 155 does not focus on the validity of severance pay for the dismissed worker, which nobody discusses or disputes, but

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[3] Rodrigo Alamos, "La Modernización Laboral", *Estudios Públicos*, 26 (Autumn 1987).

[4] See *Economía y Sociedad*, January-February 1989.

[5] Rodrigo Alamos, op. cit.

rather the amount of the payment and the need to justify a cause, with "objectively justifiable reasons".

The empirical result of this new legal norm is a matter of controversy. Fernando Coloma states: "Some people dispute that making labor relations more flexible, and specifically the abolition of the so-called tenure law, has empirically translated into greater job creation. This observation has no basis in reality. For the period 1981-1986, there were no great practical differences between the old and new regulations, except as regards the greater expeditiousness of the new system and the introduction of new causes giving rise to justified lay-off. The difference in dismissal costs only begins to be established after August 1986, and since that period the level of employment has increased steadily. Thus, one can argue that the abrupt fall in the level of employment that the Chilean economy experienced in 1982 and 1983 had little to do with the changes under discussion, and responded more than anything else to the severe economic crisis that was being lived through during that period"[6].

Apart from the empirical evidence, there are many opinions that have accumulated on the issue of job stability. The quotes that follow illustrate this point:

a) "Stable and fairly paid work, more than any subsidy, provides the intrinsic opportunity of reversing the circular process you have referred to as the repetition of poverty and marginality". (Juan Pablo II, speech at ECLAC, 1987).

b) "There are very few people outside government circles, who still consider current legislation to be appropriate. The consensus is that it must undergo significant changes… [in] legal norms assuring greater stability in employment that at present".

(CIEPLAN: Social-democratic Economic Consensus is Possible).

c) "The employer's right to free dismissal is consistent with, and crucial to a social market economy framework. Competitiveness between producers of goods and services and their respective possibilities for development and survival, presuppose a flexible labor market".

(Rodrigo Alamos, "La Modernización Laboral" *Estudios Públicos*, 26 (Autumn 1987).

d) "The rules of job tenure will have to be re-established and redefined, taking into account the interest of workers and firms, particularly on matters of productivity and technological change. The employer's faculty

[6] Fernando Coloma, op. cit.

to terminate contracts without due cause needs to be ended, and the upper limit on severance pay which can be decreed in such cases, abolished."

(CUT proposal for the transition to democracy, April 1989)

e) "The Right to Work: The right to work and to a reasonable wage should be guaranteed by the State for all Chilean people of working age who are able to work. Access to work should therefore not be left exclusively to the laws of the market. No worker should work more than eight hours a day. An end should be put to the abuse of working overtime which is paid badly, or never, and which in practice constitutes job replacement and an increase in unemployment".

(CDT, "Letter to the Presidents of the Coalition Parties", May 2nd, 1989)

f) "Starting from the principal that "work has pride of place over capital", as an unavoidable consequence of the fact that men are more important than things", we argue that the law should protect the worker so as to ensure him working conditions and a wage appropriate to his dignity as a person, and to provide for the risks of old age, illness, accidents and unemployment. What should be expected of us? A review of the causes justifying termination of contracts and the establishment of redundancy pay systems based on years of service, except in cases of dismissal for proven faults".

(Patricio Aylwin, "Entrepreneurs and Workers: Unity Needed for National Development", at the *Entrepreneur-Workers-State* Forum, Konrad Adenauer Foundation).

As can be seen, at least at first sight, there are different arguments in this regard. One should keep in mind, however, that behind labor is the person, but then there is also a person behind capital. In the modern world capital does not hire labor. Things do not hire people, but instead it is the entrepreneur who coordinates the different actors and brings workers together, with financiers (capital and debt), specialized technicians, technology, access to markets, etc., in a juridical fiction known as the firm. The real issue is not between giving preference to labor over capital or vice-versa. Instead it is a question of favoring global economic development to raise everyone's living standards.

It should do not be forgotten that more jobs are there to be created than those currently existing. New jobs are created both to replace old occupations that have become obsolete (for example, stagecoach driver is replaced by the airline pilot), and also as the product of economic growth. In this way, prohibiting dismissal means prohibiting replacement. The entrepreneur adapts to the regulations that are in force; so in the end it is

consumers and the unemployed who pay the costs of tenure. No one can argue that the principal of job tenure is absolute. When this topic is analyzed it is important to define who one is talking about. Does the Colo-Colo goal-keeper have tenure? The domestic help? A senator? Undoubtedly tenure cannot hold for everyone. So when tenure is established it ends up becoming a sort of apartheid that creates an insurmountable barrier between two Chiles: on the one hand, those who have jobs, and on the other those who want jobs but cannot find them. Tenure give stability to those who are employed today, but also to those who are unemployed. Entrepreneurs perceive in the tenure law their biggest obstacle to increased hiring[7].

Tenure protects those who have jobs rather than protecting the weakest, and it prevents firms from adapting in periods of lower demand. Thus tenure becomes a threat to the survival of jobs in the long run, conspiring especially against the most labor-intensive activities.

Should the state and a few power groups conspire to keep people who do not have jobs today out of work? The answer is clearly no. For that reason legislative proposals governing dismissal and resignation should, at all costs, avoid becoming an obstacle to the generation of jobs and a brake on labor mobility. What needs to happen is simply to generate a formula for severance payments that balances the relationship between employee and employer, and at the same time creates a cushion against unemployment which one assumes affects the person who is dismissed; nothing more and nothing less.

A Well Founded Proposal

When one thinks of the origin of the need to compensate a worker when he loses his job (in terms of the harm this causes him), and analyzing the theories on this issue, one discovers one of the important reasons justifying compensation. Apart from ethical questions, the fact that a worker deserves compensation arises from the fact that when he or she loses their job, they also lose the investment they have made in the firm where they work. An investment which often is useless for carrying out any other function and which is specific to the firm. This is what technical people call “specific human capital”, i.e. the knowledge the person has about what they were doing, which enables them to do their job well, and which is lost

[7] Fernando Coloma, “Institucionalidad laboral en el marco de una economía social de mercado, algunas reflexiones”, *Boletín Económico*, 28 (January-May 1989), specifically quotes from Flaño and Jiménez, “Empleo, Política Económica y Concertación”.

when the person changes job. If a higher wage is related to productivity, losing specific human capital because of job loss obliges redundancy compensation to be paid. This is because the worker's wage in a new job will most likely be less as a result of having lost the part of his knowledge that is only usable in the old job.

However, it has to be recognized that when the worker resigns of his own free will, the firm often loses the investment that it has made in him, part of which will be useful in achieving greater productivity in another job.

To apply a perfectly symmetrical argument, it could be argued that if lay-off generates an obligation on the firm, then resignation should generate an obligation on the part of the worker. However, the freedom to choose one's place of work does not admit thoughts of compensation symmetry. Thus, redundancy pay is called for to compensate the worker for the loss of his specific training, with no economic recognition in the other direction for non-specific training.

The theory of specific human capital establishes that because of the training he obtains in his job, the worker will see his capacity to generate income grow over time. At the same time, for those who receive specific training, the wage they obtain in their firm should be higher than what is offered to them in the next best alternative. However, their remuneration (R) will be less than the value of their marginal product (MPV). This differs from the case where human capital is not taken into consideration, in which the wage is equal to the value of the worker's marginal product.

If the equality between R and MPV is fulfilled, a company that acted only on the basis of maximization criteria, would lay off workers or try to cut their wages even in the face of temporary falls in demand.

However this is not what one sees in the real world. Companies try to keep their workers on in deteriorating market conditions, especially where specialized workers are concerned. Moreover, workers also do not resign immediately in response to new job offers that promise to pay slightly higher wages, because they would lose their specific human capital.

In this way, specific training is a factor that needs to be taken into consideration for a better understanding of job-stability problems. It is, therefore, economically advantageous for firms to keep their workers on in a situation of falling demand that is thought to be temporary. As well as training-related arguments, the search costs a firm that opts for lay-offs must incur when demand recovers its former level, should also be factored in.

The theory of on-the-job training means, therefore, an implicit agreement between workers and employers.

According to this point of view, wage cuts or lay-offs motivated by the desire to cut costs in temporarily recessionary conditions in the labor market, are only profitable in the short run. The big disadvantage of these measures is the fact that workers lose confidence in the employer as a counterpart for complying with the terms of the "contract relating to specific human capital". The central idea here is that workers accept a flow of wages below their MPV, plus training in skills and knowledge that are not transferable to another firm, in exchange for a reduction in the risk of dismissal when demand falls.

Mutual convenience, therefore, makes the firm assume a more than proportional fraction of the risk of a slowdown in activity, charging a premium in the form of wages slightly below MPV. The natural tendency, therefore, is for the firm to offer stability conditions of its own free will

It can be shown, under certain conditions, that if workers are risk-averse and companies are risk-neutral, the firm will ensure employment and wages independently of conditions in the economy. If workers are willing to assume some risk in employment levels, they will be able to raise their expected income[8].

It might be thought that compensation for to job loss should grow over time, because capital does not appear from one day to the next, but instead is built up steadily as the worker comes to know his job. From a certain point on, compensation would begin to decline as the worker gets closer to retirement, after which he will no longer be active. If we rely solely and exclusively on the specific capital argument we would come to the conclusion that severance pay should be related to years of service. But, on the other hand, there should be a limit on their amount, after which they should decrease. The question that arises next is whether or not specific human capital is the only element that gives rise to the need for severance pay.

Two other arguments could be added: the second relates to the moment at which the worker is laid off. This moment might not be the most convenient for the worker. There is a problem of timeliness in this choice, in which in a certain sense, should be compensated. The third relates to years of service as such, in other words a sort of complement to the pension.

If the payment for loss of specific capital starts from zero, grows and then declines, the second payment: i.e. compensation for the choice of moment of lay-off is a constant which does not increase with time. The

[8] For a more complete discussion of this issue see Thomas Sargent, *Macroeconomic Theory* (Academic Press, 1979), Chapter 8.

third concept grows constantly with years of service (see Figures Nºs 1 and 2).

FIGURE Nº 1 (A)
COMPENSATION FOR SPECIFIC HUMAN CAPITAL

FIGURE Nº 1 (B)
FIXED COMPENSATION

FIGURE Nº 1 (C)
COMPENSATION FOR YEARS OF SERVICE

Where:

I $	:	Compensation in $
T	:	Length of service at the moment of dismissal
J	:	Age of retirement
O	:	Date of hiring

FIGURE Nº 2 (A)
SUM OF (A) + (B)

FIGURE Nº 2 (B)
SUM OF (B) + (C)

Initially, the value of specific human capital may grow faster than a rate of one month per year. This is because initial knowledge may be used over many years. If one accepts the premise that a formula to compensate specific human-capital loss should generate an expected severance payment similar to that which could be obtained on the basis of one month per year, then if dismissal occurs in the early years, compensation for specific human capital would generate a larger payment (area 1 of Figure Nº 3). In the case where dismissal occurs in the later years, compensation of one month per year would be greater (area 2 of Figure Nº 3).

FIGURE Nº 3
DIFFERENCES BETWEEN (A) AND (C)

A1 : Area 1
A2 : Area 2

In the end, the formula that generates largest compensation is an empirical matter. As the average permanency of the person being laid off has been long, the affected person should tend to prefer one month per year without limit. If dismissal occurs in the early years, the dismissed person would have preferred compensation for specific human capital. The implementation of a regime that compensates specific human capital is probably

too complex to be able to think of a concrete application. Of course, compensation in this case would be dependent not only on years of service but also on the age of the worker and probably also on the activity that he carries out.

In my view, it is the two first concepts —compensation for specific human capital and compensation for the choice of the moment of lay-off— and not the third which are eligible for job-loss related compensation. In theory, one might argue that compensation for losing one's job should grow over time, not starting from zero, because there is an effect related to the second cause mentioned, and on reaching a certain point it ought to began to decrease. This is what emerges from pure analysis. However, there are other useful considerations to be made. Firstly, obviously the first cause of compensation excludes the third, because paying compensation as a rising function of time also compensates for loss of specific human capital.

The second relates to the fact that, in practice, it is complicated for compensation to be solely and exclusively paid when the firm lays a worker off, without including voluntary wirthdrawal. It is complex because it leads to a working climate, and attitude among individuals which often involves higher costs than benefits. At the same time, it also translates into problems of equity. There are people who may have done their work very well and don't want to be fired. However, if they resign of their own free will, they obtain less than a person who loses his work for reasons of bad performance. This is a problem that has to be resolved. Failure to do so leads to workers whose performance is satisfactory being treated worse than those who do not perform satisfactorily. From this point of view, the distinction between a person who goes voluntarily and one who is is fired, in practice, loses significance because it leads to problems of equity, and also generates inappropriate incentives.

In the third place, whether or not there should be limits to compensation, the answer that emerges from the analysis is that yes there should be. However, here also a practical problem arises. Although one could say that technically there should be a limit in months, people's behavior and reality are more complex and oblige other considerations to be taken into account. If a limit exists, one cannot adequately resolve certain serious incentive problems which would remain, if the limit were set at five months. Once this limit (i.e. months of salary) has been reached, it leads to people tending to prefer a new job, so as not to lose years-of-service compensation. Thus, worker X replaces worker Y and vice-versa. Thus both start from zero once again, and society loses out because resources have to

be allocated to make this change possible. Each worker will have to devote time to learning his new job. In the light of this analysis, a concrete mechanism for regulating the problem of firing might be as follows:

a) Keep lay-off without the need to have to prove any specific cause, within a pre-established group.

b) Make severance pay of one month's wage per year of service compulsory, without limit, with compensation payable both in the case of lay-off and in cases of voluntary resignation.

c) Establish the obligation to constitute reserves in the firm to make such severance payments.

d) As severance pay would be a certain event, it woulld be possible to constitute provisions for these purposes which would be a deductible expense for tax purposes.

e) Establish by law prohibited causes of lay-off. The aim of this would be to avoid discrimination against certain groups. Examples of prohibited causes could be maternity, religious belief, political tendency, disability or professional illness, etc.

This concept could be extended to compulsory non-discrimination in hiring between equals.

The law also could consider a variant to severance involving temporary lay-off —temporary severance— with partial compensation and the obligation to re-hire after a pre-established period of time.

Proposing the five aspects mentioned above consists of generating a uniform set of rules, equal for all Chileans, which does justice in terms of compensation without prohibiting la-off. At the same time assuring that the full benefit of severance payment is obtained by the worker affected and not by other groups (unions, lawyers, etc.).

It is also crucial that there should be no room for legal conflict in general cases, and the involvement of third parties (tribunals or Ministry of Labor authorities) in dismissal cases should be the exception rather than the rule. For this to be possible, dismissal and its corresponding compensation need to be clearly allowed in the first case, and defined in the second case.

A great advantage of equitable and *a priori* well defined formulas, such as the one proposed, is to allow market wages, plus a pre-established compensation, be known by the worker when he evaluates the benefits package the firm is offering when attracting him into their employment. In this way, severance pay becomes part of remuneration; a right in all events. However, as wages over and above the minimum wage established by law are the result of market forces, so also will be compensation. Hence it

cannot be argued that the system of compensations proposed here will act as a brake on hiring labor.

Currently, for workers hired before 1981, there is the rule of one month per year with no upper limit in the case of dismissal. For people hired after 1981 there is a five-month redundancy pay limit. A change in the rules in line with what is proposed here would mean transforming what today are posible compensations into certain ones, as well as adding four months' wages to those hired in 1981 and who are still in their jobs, three months for those hired in 1982, two for 1983 and one for those hired in 1984.

If one considers that today, in practice, many voluntary quits also attract redundancy pay (either because the collective bargaining contract establishes this, or for reasons of equity), and that compensations are paid each year only to those who leave the firm at any moment, so most of them are deferred until the moment of retirement, the financial impact of a formula like this might be small.

For example if in a firm 5 per cent of the workers retire with an average of twenty years service, 1.25 per cent are fired, and 1.25 percent quit voluntarily, both with an average of 5 years' service, the annual cost of severance pay under the system proposed would be 1.25 months' payroll (20 x 5% + 5 x 2.5%). Given this example, if today half of the workers who retire or resign take their severance pay, the annual cost of the current system would be 0.5938 months' payroll (20 x 1/2 X 5% + 5 x 1/2 x 1.25% + 5 x 1/2 x 1.25%).

Incentive o Instability?

It might be argued that an all-events compensation could generate additional incentives to staff turnover. This would occur because the worker who stays in his job postpones obtaining one month's remuneration until his labor contract comes to an end, with the consequent financial disadvantage. The desire to accede "now" to the one month per year could lead him to give notice voluntarily; on the other hand if compensation is only paid against dismissal, this incentive would not be present.

What is true is that the argument that all-events compensation would create incentives to turnover should be set against other factors operating in the opposite direction, and which are without doubt more important.

If we assume that the expected (average) duration in a job is five years, for example, and that the worker quits in order to anticipate his first month's compensation, the benefit (B) which obtained will be.

Falta fórmula

where

S : Worker's wage

I : Interest rate

If his wage was $ 50,000 and the rate of interest (i) is 8 percent, the benefit obtained is $13,249. This is equivalent to just 5.5 days' wages (approximately one week).

In the case of having to find a new job, and if the task of searching for one takes more than a week, the worker would have lost more than he obtained by quitting.

In a Santiago newspaper (*El Diario Financiero*, Tuesday February 6th, 1990) they published what is probably the CUT's proposal for modifying current labor legislation, which obviously covers broad aspects of the legal framework of the labor market. Below I will refer only to those aspects that relate to the rules of dismissal contained in the Title V, Book I of the Labor Code on Individual Labor Rights. The proposals for amendents on this issue range from Article 155 to 165 in the Title mentioned.

A summary of what is proposed there is as follows:

a) Prohibit dismissal except for proven justified cause.

b) Limit justified causes only to serious non-compliance of work obligations.

c) Admit as a justified caused that originating from technological modernization accredited before a Judge in the Labor Tribunal, always providing relocation or retraining are not possible.

d) Abolish the five-year upper limit on severance pay for for dismissal.

e) Establish additional restrictions on laying off more than ten workers or closing down operations.

f) Require written notification of the justified cause from the employer.

g) Establish the obligation to re-hire in cases where the cause invoked can not be accredited by the employer. To this is added the obligation to pay the corresponding compensations or wages for the periods not worked.

h) Oblige voluntary resignation from a job to be signed not only by the worker, but also by the president of the union.

i) Establish that voluntary withdrawal does not give the right to compensation.

It is difficult to see how this set of elements could comprise a framework to contribute to reducing dismissal disputes. One probable consequence of the arguments summarized here would be to bring a large number of dismissal cases to the respective tribunals, thereby involving the political authority in generating solutions which could have been achieved at the employer-employee level. A consequence of this, in the medium term, would be to slow down the strong boost our economy has given to labor demand.

Conclusions

While recognizing the need to maintain flexibility, it is worth indicating that this is not lost when a regime of compensation is established involving the number of years' service without limit, independently of whether it is the worker or the firm that decides to terminate the contract.

Leaving aside the topic of compensation, and recognizing that people have the right to severance pay and to comensation for job loss, the question now is whether there ought to be certain reasons defined by law that clearly specify when a person can be fired and when not.

In this respect, the ideal thing would be to seek a system that reduces the number of disputes, while at the same time being as fair as possible. For this purpose, it is better to agree a list of reasons for which it is not legitimate to bring a labor contract to an end (for example: religious belief, membership of political groups, etc.) and incorporate them into the law, rather then the alternative of listing the reasons for which one can bring a labor contract to an end, although included in such reasons would be one that takes into consideration the firm's reality and the productivity or performance of the worker.

Stability in employment is closely linked to macroeconomic factors which escape direct individual relations between workers and employers. On the other hand, it has to be recognized that the labor contract is a long-term one. Although sometimes it may not be long-term from the formal point of view, it is so from a tacit perspective, because labor is not just one more factor of production. Although it should be accepted that a worker deserves compensation when for various reasons he loses his job, it is

necessary to ensure that this compensation is paid on the basis of mechanisms that make it possible to balance the financial cost against the need for the firm to survive over time, without disputes escalating, and in fact being kept at the lowest level possible.

General solutions, with clear rules that are uniform and equal for everyone, must be the preferred ones. Only in this way can one achieve the desirable goal of fewer rather than more cases that have to be resolved in the Courts.

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