Severance Pay in Latin America Since the late 1910s

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1. INTRODUCTION

Only a few Latin American countries have unemployment insurance systems, and those that do introduced unemployment insurance fairly recently (Marshall 1995, 17–18). Severance pay programs, providing lump-sum payments from employers to employees at the time of the termination of the employment contract (commonly depending on the length of tenure and the employee’s monthly salary; Holzmann and Vodopivec 2011, 4), are more common.

Severance payments have two functions, to penalize unjust dismissals and to provide economic support in the event of unemployment, and they constitute an important part of the employment protection regimes in Latin America (Cox Edwards 1997, 137-8; Jaramillo and Saavedra 2005, 281). Severance payments in Latin America are among the highest in the world, and they contribute to making the costs of employment termination very high in comparative perspective (Jaramillo and Saavedra 2005, 279, 282). Rights to job security and severance pay are even included in the constitution in some countries, and they are widely seen as an essential element of human rights promotion (ILO 2000, 7).

The aim of this report is to describe the development of major legislation regarding severance pay in twelve Latin America countries between the introduction of the earliest severance-pay systems in the late 1910s and the present. The countries included in the study are Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela.

In order to outline the development of major legislations on severance pay, qualitative resources and legislation databases have been consulted in order to identify major pieces of legislation. The findings of the report show that there were no severance pay programs in place before the inter-war period, but then they became increasingly common. The generosity of severance pay has increased over the years, except in countries that cut severance pay during the recent liberalization period (since the 1990s). The benefits that a worker can receive typically depend on the reasons for the termination of employment. The eligible contingencies have in several countries gone from being restrictive – with benefits being offered only if notice was not given or to compensate for unjustified dismissals – to less restrictive: in several countries, severance-pay-like benefits have developed into being offered regardless of the reasons for the termination of the employment relationship.

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1 This report was written during my internship at the Department of Political Science at Lund University, where I was affiliated with the Reform Capacity project.
Severance payment schemes have in some cases developed into severance pay accounts, or funds, to which the employer contributes regularly and from which the employee receives the accumulated amount as a lump-sum, just as in the case of traditional severance payments schemes. In a few cases, comprehensive unemployment insurance has been established. But severance payments were always introduced prior to unemployment insurance.

The report is structured as follows. The definition of severance payments and the coding procedures used are discussed in more detail in the next section, which also discusses the relevant literature and currently available data. Following that, I provide brief descriptions of the findings regarding the development of severance pay legislation in each of the twelve countries are presented. The following section explains how the information presented in the previous section was coded. An external excel-file is available. I end with some concluding remarks on the findings of this report.

2. LITERATURE REVIEW

Because defining severance payments is a complex issue, this report will have a broad definition, in order not to exclude relevant information. As described above, severance pay is provided to a worker in case of separation from the employer – if requirements are met – and the amount of money is typically based on the number of years of service and the employee’s wage (Holzmann et al. 2011, 17). For example, in Bolivia, the severance pay is simply one month’s salary – based on the average of the three last months’ wages – per year worked. A minimum tenure is in most cases also required; in Bolivia it is 90 days of continuous work (Law 110 of 1 May 2009).

Hence, in the dataset discussed below, the amount of benefits is defined in terms of the number of monthly wages. If a minimum tenure is required, that is also indicated in the number of months (in the case of Bolivia 3 months). In some countries, there is a cap on the amount that a worker can receive; in those cases, the dataset provides information about the maximum as well.

In the case of Bolivia, workers today have the right to benefits regardless of the reasons for termination of employment. In earlier legislations – in Bolivia as well as in other countries – the benefits that a worker can receive typically depend on the reasons for dismissal. A distinction is often made between just and unjust causes for the termination of employment. Just causes are generally disciplinary reasons – such as misconduct, dishonest behaviour or sabotage by the worker – while unjust causes are not connected to any fault on the part of the worker. In some countries, the “needs of the firm” are also considered just causes (Jaramillo and Saavedra 2005, 283).

These distinctions often cause some terminological confusion. Some researchers distinguish between compensations for unjust dismissal on the one hand and severance pay on the other (see, for example, the International Labour Office’s (ILO) overview of legislation on employment termination). Under such definitions, severance pay is an allowance received by the employee regardless of the cause of termination (ILO 2000, 23-25). Other researchers regard penalizing employers for unjust dismissals as one of the functions of severance pay
(Cox Edwards 1997, 137-8), or even as its primary function, because other systems, such as individual unemployment insurance systems (UISA), grant compensation regardless of the cause of termination (Jaramillo, Saavedra 2005, 276). This report covers all of these different types of provisions, since the two types of benefits have a similar structure and are often considered in the same legislative acts, making them difficult to keep apart. However, the provisions regarding eligible contingencies are discussed in the country descriptions section and are listed in the excel-file.

Because of the broad definition of severance payments that I rely on here, systems of severance payments accounts or similar systems financed by external funds will be included, since they often seem to have developed from traditional severance pay schemes and since they provide the same type of protection. The funding method is another way to distinguish among severance payment systems, and again, this has led to some terminological confusion. For example, while the ILO definition of severance pay allows for several different types of financing – such as internal cash flows or an external fund to which the employer makes regular contributions – Jaramillo and Saavedra (2011) only count as severance-pay systems those systems that are funded by internal cash flows; they refer to systems funded by external funds as UISAs (Jaramillo and Saavedra 2011, 288). I include both kinds of systems in my definition, but I do not count funds to which employees contribute as parts of the severance-pay system. For example, Chile and Ecuador have, in addition to traditional severance payments schemes (which provide compensation for unjustified dismissal), individual accounts systems to which both employers and employees contribute. In traditional severance payment schemes, it is the employer’s duty to provide benefits for dismissed workers; consequently, those individual-accounts systems are best categorized as unemployment insurance systems and will therefore not be included in the country descriptions or the excel-file. However, if a country has legislation on severance-payment funds to which only employers contribute to, it is included. The funding method is coded as internal cash flows (I) or through an external fund (E).

There is no clear-cut distinction that tells us what types of cash payments count as severance payments. Additional terms used in English for severance pay and similar benefits exist, such as “redundancy compensation,” “termination benefits,” “seniority pay,” “indemnities,” and “leaving allowances.” Furthermore, different purposes could be ascribed to all the different types of benefits. Hence, severance pay is complex, and serves different functions at the same time (Holzmann et al. 2011, 17), including providing compensation for job loss, stabilizing employment, reducing transaction costs, preventing unemployment by discouraging dismissals, and encouraging long-term relationships with workers (Holzmann and Vodopivec 2011, 2).

As this project aims to describe the development of major legislation on severance pay in Latin America between their first introduction in the late 1910s and the present, it is important to discuss the state of the current research on the origins of severance pay. According to Holzmann et al., severance payments were provided in many countries by employers before they were required by law. The programs also often existed simultaneously as firm-based schemes. Severance pay schemes were often established prior to the introduction of more complex and formal social protection systems, such as unemployment insurance and pensions (Holzmann et al. 2011, 17). But as I mentioned in the introduction,
there has not been much research on severance payment programs in a longer historical perspective. Hawkin (1940) provides information about laws on severance pay in the late 1910s and 1930s, but current research is almost exclusively concerned with more recent times, especially the period from the late 1980s to the present, with severance pay being put in the context of other major labour reforms made during this period of democratization and liberalisation in many Latin American countries (Islas 2002; Murillo 2001; Cook 2007; Cox Edwards 1997).

Research on existing severance payments systems in Latin America is easier to find. Holzmann et al. (2011) and Holzmann and Vodopivec (2011) provide extensive information on current severance pay systems in selected countries. The time of introduction of severance pay in some Latin American countries is discussed, but the analysis does not cover the development of severance pay reforms since then (Holzmann et al. 2011, 18–19). Jaramillo and Saavedra (2005) and Ferrer and Ridell (2011) compare UISAs to severance pay and offer country descriptions of reforms in different systems, but only cover reforms made in recent years. Moreover, there are many country-specific studies of severance pay reforms, such as, for example, Amadeo et al. (2000) and Chahad and Fernandes (2000) on Brazil, Acevado et al. (2006), Montenegro and Pagès (2004), Gamonal (2011), and Cox Edwards (2000) on Chile, Kugler (2005, 2000, 2004, 2002) on severance payments in Colombia, Hopenhayn (2004) on Argentina and Zelek de la Vega (1992) and Antón et al. (2012) on Mexico. Few of these country studies cover previous legislation on severance pay. Some countries are more well-researched than others.

In addition, useful legislation databases are provided by the ILO, such as the employment protection database (EPLex) and NATLEX, which provide information on legislation on labour and social security. ILO (2000) also have an extensive review on the legislation on termination of employment, where severance pay and dismissal compensation are considered. The international social security association (ISSA) also offers descriptive data on severance pay. However, all of these databases only offer information on current legislation, and the extent of the information varies between countries; some countries are not covered at all. There is also rich data on OECD-countries in general, but in our sample only Chile, Mexico, and Brazil are OECD countries.

My own compilation is based on the qualitative resources and databases that I listed above. I have complemented the information that they provide about the timing of major pieces of legislation with information from the legislative registers of individual countries. In many cases, those registers go back more than a hundred years. Since the main aim of this report is to describe the development of severance pay legislation, the most central categories when coding is the year of reform and the number (or name or date) of the law. A short description of the types of changes the law made to the severance payments system is included for each major reform.

3. COUNTRY DESCRIPTIONS

The aim of this chapter is to provide brief country descriptions that discuss the timing and content of major pieces of legislation on severance pay from their first introduction in the late
1910s to the present in twelve selected Latin American countries: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela.

3.1 Argentina

Severance payments were introduced in 1933 in order to protect workers from arbitrary dismissals in the trade sector (Hawkins 1940, 246; Carnes 2014, 165; Galiani and Gerchunoff 2003, 161). Compensation is provided if the firm ceases to exist – for example through bankruptcy – and in all cases of dismissal if notice is not given. Severance payments are at least one half of a month’s wage for each year of service at the firm, with a maximum of five wages (Law 11,729 of 1933; Hawkins 1940, 246). In 1945, severance payments were extended to cover all wage earners through Decree Law 12,921 (Galiani, Gerchunoff 2003, 161).

Following that reform, there does not seem to have been any major legislation on severance payments until 1974, when law 20,744, the Labour Code, was passed (Ley de Contrato de Trabajo). Now workers had the right to severance pay regardless of the reason for termination. The employee was entitled to one month’s pay per year of service, with a yearly minimum of one month’s wage. The maximum was three wages, based on the single worker’s average wage. If dismissal was caused by force majeure or the needs of the firm, the compensation was half of that amount (Art. 245, 246, 253, 251). A minimum of three months of employment at the same firm was also required. The law did not cover domestic or agricultural workers. Workers with fixed-term contracts only had the right to severance pay if their contracts were terminated in advance. The 1974 law was modified in 1976 through Law 21,297. The minimum of one month’s wage was increased to no less than two months’ wages yearly (Pessino 1997, 189–90).

Further changes were made in 1991 and 1995 (Hopenhayn 2004, 498). In 1991, Law 24,013, Ley National de Empleo, established an unemployment insurance system and raised the maximum severance pay (Cook 2007, 82; Murillo 2001, 146). The maximum of three times the workers wage was increased to three times the average wage of all workers, if that was more favourable for the worker. The minimum amount of two wages was calculated on the same basis (Art. 76). The severance pay for fixed-term contracts remained the same as in the law of 1976. Training-promotion contracts were established, but workers on such contracts did not have the right to severance pay (Art. 56) (Hopenhayn 2004, 499). In 1995 the new law, 24,465, established so-called trial periods (three months, extended by Law 25,250 in 2000) for special employment promotion contracts. During this period, employers could dismiss workers without cause, and did not have to pay severance pay (Art. 92).

Law 25,013 of 1998 reformed severance payments again (Cook 2007, 83). The severance payment, compensation for seniority or dismissal, now became one-twelfth of the best monthly wage of the last year or during the time of service, depending on which was less, for each month. The amount could not exceed the sum of three times or be less than one sixth of the average collectively-bargained monthly wage. In case of unjust dismissal, the compensation remained the same as that in 1976 (Art.7). Law 27,877 of 2004 changed the 1976 legislation by lowering the minimum from two to one month’s wage per year; the maximum of three average wages was still the same (Section 5).
3.2 Bolivia

Severance pay legislation was first introduced in Bolivia in 1924 and 1925 (Holzmann and Vodopivec, 71). The law of 21 November 1924 states that employers are obliged to pay compensation to a worker whose contract has been interrupted. The compensation varied depending on the length of tenure (with a qualification period of three months worked). The compensation was calculated in terms of a number of wages for the length of tenure according to the following scale: 3 months to 1 year: 1 wage; 1–2 years: 2 wages; 2–5 years: 3 wages; 5–10 years: 6 wages; 10–20 years: 12 wages; 20–25 years: 16 wages; 25–30 years: 20 wages. The scale of benefits was 0.6–3 month’s benefit per year of service. If the employee was dismissed because of the needs of the firm, the compensation was half of the previous amounts. The law covers salaried employees in commerce and other industries (Law of 21 November 1924; Hawkins 1940, 232; Schwenning 1932, 250). The scope of the law was expanded several times in the following years to include mine and office workers employed in publicly and privately owned railway companies, professional drivers, employees of bars and hotels, garage mechanics and assistants (Law of 8 January 1925, Law of 19 November 1925, Law 766 of 23 March 1929, Law of 11 October 1938).

The Labour Code of 1939 changed the severance pay to one month’s wage per year of service. If the dismissal was caused by bankruptcy, the employed received half of this amount. A minimum of three months continuous work was required. The severance pay was calculated on the basis of the average of the three last months’ wages. Agricultural workers and civil servants were still covered by other laws (Art. 13 and 14 of Law of May 24 1939, elevated status in 8 December 1942). The scope of the general labour code was later extended to cover hairdressers, manual workers and state employees, train drivers, telephone operators, telegraphers, radio operators, bartenders, professional musicians and domestic workers (Law of 23 December 1944, Law of 16 October 1948, Law of 29 of December 1948, Law of 30 December 1948). The labour code also established that a worker with a tenure of more than eight years had the right to severance if he or she quit voluntarily. In 1974 the tenure of eight years was decreased to five (Law 11.478 of 16 March 1974).

The legislation on severance pay that was established in 1939 does not seem to have gone through major changes in Bolivia. As the Supreme Decree 0110 from 2009 indicates, the severance pay established by the Labour Code in 1939 is more or less the same, but there is no longer a minimum tenure required (earlier 5 years) in order to receive severance in case of quitting voluntarily (Law 110 of 1 May 2009).

3.3 Brazil

The earliest Brazilian law on severance pay that I have found is Law 62 from 1935. It covered workers in industry and commerce and established a notice period of 90 days and compensation in case of dismissal without cause; force majeure was considered just cause. The compensation was one month’s pay, based on the highest wage of the worker, per year of service, with a minimum of one year of employment (Hawkin 1940, 232). If the salary was paid per day or hour, the compensation was calculated in different terms (Law 62 of 5 June 1935).

The Brazilian Consolidation of Labour Law (CLL) from 1943 (Decree No. 5452 of 1 May) remains the source of laws on termination of employment (ILO 2000, 67). Regardless of
the reasons for termination of the employment contract, workers have a right to severance pay that is equal to one month’s pay per year of service. One year of employment is still required (Art. 477–480). Since the creation of the CLL, a time-of-service fund was established in 1966, the Fondo de Garantia do Tempo de Servicio (FGTS) (Decree Law No. 5.107 of 13 September 1966 approved by Act No. 2 of 27 October 1965). It complemented the traditional severance pay formula of one month’s pay year of service, and if an employee chose the fund program the employer was obliged to put 8 percent of the employee’s wage into the severance fund. In case of termination of employment the worker may draw the money out of the fund, and in case of dismissal without cause, the worker would receive an additional 10 percent of the total amount of the fund as compensation (Cook 2007, 49; Amadeo et al. 2000, 4-5; Jaramillo, Saavedra 2005:286, EPLex1). This compensation was increased in 1990 to 40 percent of the total amount in the FGTS fund (Law 8.036 of May 11 1990). In 2001, the fine was further increased to 50 percent, with the extra 10 percent paid directly to the government; at the same time the employer’s contribution to the fund was increased from 8 to 8.5 percent (Decree Law 3.914 of 11 September 2001). Furthermore, temporary workers that are not covered by the severance fund and those workers that do not choose the program with the employer have the right to a minimum of 60 percent of the severance pay set by the traditional system governed by the Labour Code of 1943 (Law 8.036 of May 11 1990; ILO 2000, 71–72). Domestic workers and agricultural workers are not covered by the fund (Holzmann and Vodopivec 2011, 76). Brazil has also had an unemployment insurance system since 1986 (ISSAb 2014).

3.4 Chile

In Chile, severance pay was first introduced through legislation from 1924 (Holzmann, Vodopivec 2011, 71). At this point, the employer or the employee could end the contract with six days’ notice in advance to the other part or by paying the equivalent of the salary for six days of work. Domestic and agricultural workers, firms with fewer than ten employees, and enterprises where only family members are employed were excluded from the law (Hawkins 1940, 244; Law 4,053 of 29 September 1924, art. 7). In law 857 of 1925 it is found that in case of the termination of a contract, other than through quitting voluntarily, retirement, or misconduct by the employed, he or she has the right to one month’s salary per full year of service. The law does not cover civil servants, employees of the Mortgage Bank, the Savings Bank of Santiago or the National Savings Bank, members of the army and navy, the police, the gendarmerie, domestic workers, temporary workers, railway workers and employees of other independent fiscal management companies (Law 857 of 16 December 1925). In 1966, severance pay was extended to cover all workers, not just white-collar workers, by the Immobility Law (Decree Law 2,200). It should be mentioned that Chile also has an unemployment funding system since 1937 (Law 6020), which became a part of the general social insurance for salaried workers (Hawkins 1940, 244–5; Cohen 1945, 17). After 1942 employees also made contributions to this system (Cohen 1945, 18).

Returning to severance payments, in 1981, a cap was set to a maximum amount of five months’ wages (Law 18018 of 7 July 1981, art. 11). Later on, in 1990, the cap on severance payments was extended to 11 months’ wages. If the employee was dismissed because of an unjust cause, the severance payment was increased to 1.2–1.5 months per year.
of service (Cook 2007, 132, 139; Law 19010 of 19 November 1990). This amount was further increased in 2001 to severance plus 30% in case of dismissal under the “needs-of-firm” clause, and in case of other unjust dismissals, workers had the right to severance plus 80–100% (Cook 2007, 131, 139, Ley 19,759. 5 October 2001).

The law of 1990 also permitted workers and employers to make the severance pay payable regardless of the reason for termination by creating an insured pension fund for the employee at the AFP (Administrados de Fondos Pensiones). The agreement is possible from the seventh year of service and the employer is required to deposit 4.11 percent of the monthly wage (EPLex2, 2014). In a similar manner, a new system of individual accounts was established for domestic workers. The same amount was put in a fund at the AFP, but from the first year and to a maximum of 11 years. This amount is payable regardless of the cause of termination (Cortázar 1997, 252-3, Ferrer and Riddell 2011, 15, EPLex2, 2014).

In 2001, Congress approved a new unemployment insurance scheme (Cook 2007, 134, 138) which was implemented in 2002 (ISSA1, 2014). From now on, employers could deduct from the severance pay the amount that had previously been contributed to the worker’s individual account (Acevado 2006, 17).

3.5 Colombia

In Colombia, the first legislation on severance pay was introduced in 1934 (Holzmann and Vodopivec 2011, 71). It covered salaried workers in private employment. In case of dismissal not caused by misconduct, the worker would receive one month’s pay, the average of the last three years, per year of service (Law 10 of 20 November, art. 14; Hawkin 1940, 232). This amount remained the same in the Labour Code of 1950 (Decree Law 2663 of 9 September 1950, Art. 249). In 1965, it was established that if the employer fails to provide a just cause, the worker has the right to a higher level of compensation, according to the following scheme:

- 0-1 years: 1950 - 45 days’ salary.
- 1-5 years: 1950 - 45 plus 15 days’ salary for each year of service.
- 5-10 years: 45 plus 20 days salary for each year of service.
- 10 or more years: 45 plus 30 days salary for each year of service.

For workers on fixed-term contracts, the severance pay was equal to the value of the wages of the remaining contracted days, but no less than fifteen days (Law 2351 of 4 September 1965, Art. 8). In 1990 the severance pay in case of unjust dismissal for workers with more than 10 years of tenure was increased to 45 plus 40 days’ salary for each year of service (Law 50 of 28 December 1990, Art. 6). In 2002, the severance pay was set at different amounts depending on whether the worker’s average salary was more or less than 10 minimum wages. If it was less, the worker had the right to 30 days’ salary plus 20 days’ salary for each year of service. If it was more, the amount was 20 days’ salary plus 15 days’ salary for each year of service. If the worker had less than one year of continuous work at the time of dismissal the amount was simply the wage of 30 or 20 days’ work (Law 789 of 27 December 2002).

Returning to law 50, as amended in 1990 (Art. 98-99), the law also established a system of severance payments savings accounts (SPSAs) for new employees. With this system, employers were obliged to deposit one month pay every year worked based on the salary of each point in time to an individual account of the employee (Kugler 2002, 5–6;
Ferrer, Riddell 2011, 19). If the employer failed to contribute to the fund annually, a fine of 12 percent of the total severance pay was added (Ferrer and Riddell 2011, 19). In addition, workers with salaries higher than ten times the minimum wage were allowed to forsake all severance payments for a higher monthly salary (Lora and Luz Henao 1997, 264; Jaramillo and Saavedra 2005, 303).

3.6 Costa Rica
The first legislation on severance that I have found is the Costa Rican labour law of 1943, covering employees in the private sector. If the cause of termination was by no fault of the employee, he or she had the right to severance pay. If the employee had three to six months of continuous work, the value of the severance should be the same as ten days work. With more than six months but less than a year, the compensation corresponds to twenty days’ salary and with a tenure of one year or more the severance pay is one month’s salary per year of tenure. However, the severance pay could never exceed eight months’ salaries. The payments were calculated on the basis of the average of the wages earned the last six months. Workers on fixed-term contracts had the right to one day’s salary for every six days of continuous work, but no less than three days. If the contract was made for six months or more, the employee had the right to at least one month’s salary as compensation (Law 2 of 27 August 1943, Art. 29–31).

The articles on severance pay in the Labour Code do not seem to have been reformed until 2000 with law 7983. For fixed-term contracts it decreased to one day’s salary for every seven days of work and if the contract is stipulated for more than six months the worker has the right to no less than 22 days’ salary. The severance payments for open-ended contracts was reformed into the following scheme (Art. 88):

- 3-6 months, seven days wages
- 6-12 months, 14 days salary.
- More than a year:
  - Year 1: 19.5 days per year worked.
  - Year 2: 20 days per year worked.
  - Year 3: 20.5 days per year worked.
  - Year 4: 21 days per year worked.
  - Year 5: 21.24 days per year worked.
  - Year 6: 21.5 days per year worked.
  - Year 7, 8, 9: 22 days per year worked.
  - Year 10: 21.5 days per year worked.
  - Year 11: 21 days per year worked.
  - Year 12: 20.5 days per year worked.
  - Year 13 and the following: 20 days per year worked.

The law also established a mandatory individual capitalization account, to which employers made a 1.5 percent contribution of the workers monthly salary. The employee receives all the money in the event of termination of employment, regardless of the cause (Law 7983 of 16 February, Art. 3-6; ISSA₂).
3.7 Ecuador
The first legislation on severance pay in Ecuador was the decree law 018, Caja de Pensiones, from 8 March 1928 on social security (ISSA, 2014). It states that if an employee was dismissed without cause and without notice, the worker had the right to an amount equal to one month’s pay per year of service. All workers, except agricultural and domestic workers, employed in public or private sector were covered (Hawkin, 1940, 245; Schwenning, 1932, 253). On 6 October of the same year, the law was expanded to cover workers employed at banks (IESS, 2014). In 1936, several amendments were passed that were later incorporated in the Labour Code of 1938. The Labour Code established a reserve fund for dismissal compensations, Caja del seguro de Empleados Privados y Obreros. The employer was now obliged to make a contribution to the fund, monthly or yearly, of one month’s pay per year of service. In case of termination of the contract, unless the employee did not give notice or was dismissed because of misconduct, the worker had the right to the money in the fund. Even workers who leave their employment voluntarily are entitled. One year of complete service was required. The system covered all work classes except domestic workers. If the employee is dismissed without just cause after two years of employment, he or she is also entitled to one month’s wage per year of service (Labour Code of 1938, 1940, 677). An unemployment insurance system based on individual funds was established in Ecuador in 1988 (Isas, 2002, 29). In addition to those benefits, workers are eligible to a seniority bonus and to compensation for unjust dismissal. The system is today governed by Law 55 of 27 November 2001, being part of a greater social security reform, Seguro General Obligatorio (SGO) (ISSA, 2014). Severance payments were further reformed by law 133 of 21 November 1991 (NATLEX, Holzmann and Vodopivec 2011, 78, 94). I have found no information about the specifics of this reform, but the codification of the Labour Code in 1997 states that at the termination of the employment contract, the worker has the right to an amount equal to 25 percent of last month’s salary per year of service, in addition to unemployment benefits. In case of dismissal without just cause, an additional amount of three months’ salary should be paid to workers with less than three years tenure, and one month’s salary per additional year of service. A cap was set at 25 salaries (Labour Code of 1997, Art. 172, 185, 188, 189). If a worker on a fixed-term contract was terminated in advance, the compensation was now 50 percent of the total amount of the salary of the remaining time (Art.181). As mentioned above, Ecuadorian workers have the right to the money from the reserve fund, and in case of dismissal further compensations. In 2009 (Law 644 of 29 July 2009), workers that had previously had amounts saved in the reserve fund would now have these amounts repaid or transferred to the social security system (IESS).

3.8 Mexico
Severance pay legislation in Mexico is based on the constitution of 1917 (Art. 123) and the Federal Labour Law of 1931. Changes have been made, but the core principles remain the same (Cook, 2007:151). The article governs workers, day labourers, domestic workers, artisans and, in general, all work contracts. Regarding severance pay, workers dismissed without just cause have the right to three months’ salary as compensation (Constitution of 5 February 1917, Art. 123). The laws on severance pay remain the same when codified in the
Federal Labour Law of 1931, but in addition, this law states that in case of dismissal because of bankruptcy, the worker has the right to one month’s compensation (Federal Labour Law of 28 August 1931; Hawkin 1940, 233; Schwenning 1932, 254). Publicly employed are excluded by the Labour Law (ILO 2000, 225). These laws was changed in 1970 by the Federal Labour Act of 1 April, which are the most recent laws on severance pay (Cook 2007, 151). The law established a length-of-service bonus of 12 days’ pay per year of service. When a worker has passed 15 years of tenure, he or she has the right to severance pay even in case of voluntarily quitting or being fired with just cause. In case of dismissal without just cause, the worker has the right to an additional amount of 20 days’ pay per year of service if the contract is open-ended. If the contract is less than a year on a fixed term, the amount should be equal to half of the wages of the tenure, and if a fixed-term contract exceeds a year, the compensation should be six months for the first year and then 20 days’ pay per year of service. If there is a reduction of personnel due to the introduction of machinery, workers have the right to compensation equal to four months’ pay, and twenty days’ pay per year of service, plus the seniority bonus. In the case of termination of employment because of force majeure, inability to pay, or bankruptcy the worker has the right to three months’ pay (Federal Labour Act of 1 April 1970, Art. 47-50, 162, 434-9; EPLex, 2014; OECD, 2013; ILO 2000, 129; Zelek, de la Vega 1992, 467; Dávila Capalleja 1997, 308). For simplicity, the dataset includes only the length of service compensation (0.4 months) and the compensation for unjustified dismissal of 20 days’ (0.7 month) pay.

Furthermore, the law excludes the following types of workers: “Workers in positions of trust, seafarers, flight crews, railway workers, road transport workers, the labour force in zones under federal jurisdiction, rural workers, commercial travelers, sports professionals, actors, musicians, home workers, domestic employees, workers in hotels, restaurants, bars and similar establishments, family undertakings, resident medical doctors during specialist training and employees of universities and autonomous institutions of higher learning are subject to special legislation” (ILO 2000, 225).

3.9 Paraguay
The earliest legislation on severance pay that I have found in the case of Paraguay is the Labour Code of 1961. The code covers all workers and state employees. In case of bankruptcy or closure of the firm, or if the worker ends the contract on justifiable grounds, a worker with one to five years of tenure is entitled to severance pay amounting to one month’s salary, with a five to ten years tenure the amount is equal to two months’ pay and if even longer three months’ pay (Law 729 of 31 August 1961, Art. 80-82, 85-86). In case of dismissal without just cause, the compensation is 15 days’ wages per year of service, based on the average wages earned during the past six months (Art. 84, 91). Workers with a tenure longer than ten years have the legal right to replacement in case of dismissal without just cause; if that is not possible the employer is obliged to pay twice the amount. If the employer dismisses permanent workers because of lack of work, the compensation is half of the compensation for unjustified dismissals (Art. 98). The Labour Code was reformed in 1993. However, the legislation does not seem to have gone through any changes when it comes to severance payments (Law 213 of 29 October 1993; Jaramillo and Saavedra 2005, 301).
3.10 Peru

Several severance-payment reforms has been made over the years in Peru. The first traces are found in the Code of Commerce from 1902, where it is stated that a worker or employer could, upon termination of the employment relationship, give one month’s notice or pay the salary corresponding to that time. These regulations were extended in 1924. The law of 1924 covers salaried employees in commerce (Schwenning 2000, 255; Holzmann and Vodopivec 2011, 71). If an employee was dismissed without notice (90 days), he or she was entitled to compensation depending on tenure according to the following scale (Law 4916 of 7 February 1924, Art. 1):

- 2 years: one month’s salary
- 2–5 years: 2 salaries
- 5–10 years: 4 salaries
- 10–20 years: 8 salaries
- 20–25 years: 10 salaries
- 25–30 years: 12 salaries

In 1925, the eligible contingencies of law 4916 were modified. Now an employee had the right to receive compensation not only in cases when notice was not given, but in all cases except if voluntary quitting or being fired for misconduct (Law 5119 of 15 June 1925, Art. 2). The law was further reformed in 1930. The severance pay was changed to half of a month’s salary for each year of service. Three months (probation period) of employment was required (Schwenning 2000, 255; Hawkin 1940, 233; Law 6871 of 5 May 1930). In 1945, the amount was increased further, to one month’s pay per year of service. The law also stated that the employee had the right to compensation in case of retirement (Law 10239 of 31 August 1945). The coverage was extended in 1962 to cover all employees and workers in the private sector, not only those in commerce (Law 13842 of 12 January 1962; Carnes 2014, 141). Later the same year it was decided that employees dismissed during the probation period had the right to one twelfth of their monthly salary for each month worked (Law 14218 of 19 October 1962).

The military regime in 1968–80 introduced a number of actions in favor of workers (Cook 20007:111). One of the major reforms was the introduction of a system of years-of-service bonuses in 1975 (Carnes 2014, 142). The compensation took the same form as previously, 30 days’ wages per year of service, but it now applied to all kind of causes for the termination of employment. Even workers dismissed because of serious misconduct were eligible for payments. If the worker’s tenure was shorter than one year, the compensation was one twelfth of the salary for each month worked. The system was funded through monthly contributions from the employer to an account in the employee’s name. The law did not cover agricultural workers. It was also added that only employees with more than three years of service had the right to compensation for unjust dismissal (three months) (Law 21,116 of 11 March 1975). In 1978, the compensation for unjustified dismissals was increased to twelve months’ wages. 90 days’ notice was required, and those with a tenure shorter than three years had the right to a compensation equal to 90 days wages if notice was not given (Decree Law 22,126 of; Cook 2001, 115). However, in 1986 these amounts were adjusted again, to severance payments of three months’ wages for workers with less than a year’s employment, six months’ wages for those with one to three years of employment; for those with more than
three months’ employment the amount remained the same (Carnes 2014, 143; Law 24,514 of 4 June 1986).

In 1991, substantial labour reforms were made. The funding of the length-of-service benefits was reformed (Ferrer and Riddell 2011, 26; Islas 2002, 22–23; Law 650 of 23 July 1991). The Law of Employment Promotion (Ley de Fomento del Empleo) was also introduced in 1991. It weakened severance payments for dismissals without just cause and made the definition of unjustified dismissals more restrictive (MacIsaac 2000, 8). The compensation was changed to one month’s pay per year of service, with a minimum of three months’ pay and a maximum of twelve months’ wages. The right to severance pay for those with less than one year of employment was removed (Cook 2007, 122–123; Islas 2002, 22; Law 728 of 8 November 1991, art 71–76). In 1995, the minimum compensation for unjustified dismissals was also reduced, from three to one month’s pay (Carnes 2014, 146; Law 26,513 of 27 July 1995, art. 76). Furthermore, in 1996 the compensation for unjustified dismissal was increased from one month’s pay to 1.5 months’ wages per year of service (Cook 2007, 122; Law 871 of 31 October 1996). After this reform, no further changes to the severance pay schemes have been made in Peru. The exception is special conditions established in 2008 for micro (1–10 workers) and small (10–100) enterprises, who compensate workers with a lower amount in case of unjustified dismissals. Workers in micro enterprises have the right to 10 days’ wages per year of service to a maximum of 90 days’ wages and in small enterprises 20 days’ wages per year of service to a maximum of 120 days’ wages (EPLex4).

Although the regulations on severance payments in case of unjustified dismissals and the compensation for length of service in Peru have remained the same, they are currently governed by other laws: The Law on Labour Competitiveness and Productivity (Supreme Decree 003 of 21 March 1997) and the Law on Training and Labour Promotion (Supreme Decree 002 of 21 March 1997).

3.11 Uruguay

Before 1944, dismissal compensation were governed by the pensions system. However, it only covered workers with more than 10 years of tenure and resembled unemployment insurance more than dismissal compensation or severance payment schemes (Hawkin 1940, 248; Schwenning 1932, 256–257). The legislation introduced in 1944 can therefore be considered the first legislation on severance payments in Uruguay, which is supported by Holzmann and Vodopivec (2011, 71). It was established that all workers and employees (monthly wage earners) in the trade sector had the right to a compensation equal to one month’s pay for each year of service. Later the same year, the benefits were extended to cover workers and employees in industry and private providers of public services. The severance payments had a cap of three months’ wages if the worker was entitled to retirement (removed in 1974), otherwise six months’ wages (which is the value I coded in the dataset). The benefits do not apply to dismissal because of severe misconduct (MTSS; Law 10,489 of 6 June 1944; Law 10,542 of 15 December 1944; Law 14,188 of 5 April 1974; Amarante et al. 2011, 6–7). In 1958, the legislation also provided severance payments for day labourers. Workers has the right to 25 days’ (coded as 0.83 month) wages per year of work with 240 working days. If a worker had worked more than 100 (coded as 3.3 months) but fewer than 240 complete working days, the amount was equal to two days’ pay for each 25 worked (coded as 0.27 month’s pay). The
workers are entitled to a maximum of 150 days (coded as 5 months) (MTSS; Law 12,597 of 13 December 1958).

In 1978, as one of the few countries in Latin America, Uruguay established that rural workers were also covered by the general rules (Law 14,785 of 19 May 1978). In 2006, the coverage was also extended to workers providing domestic services. 90 working days were required (MTSS; Law 18,065 of 27 November 2006). Taxes on severance payments that exceeded the legal minimum wage were also introduced (Law 18,083 of 27 December 2006). Seasonal, temporary, and fixed-term contract workers still do not have the right to severance payments (MTSS). It is also worth mentioning that Uruguay have one of Latin Americas most advanced social protection systems, including pensions and, since 1981, unemployment insurance (the first law was introduced in 1934) (ISSA).

3.12 Venezuela
The first legislation on severance payments was introduced in Venezuela with the Labour Code of 16 July 1936 (Holzmann et al. 2011, 71). The code covered wage earners, salaried employees and domestic workers. The severance payments were given to employees in case of unjust dismissals, amounting to half a months’ wage for each year of service with a maximum of six months’ wages (Hawkin 1940, 231). In 1974 (8 August), severance pay was increased to one monthly salary, counted on the last, per year of service in case of dismissal without just cause. The law also established a seniority bonus, a lump sum payable independently of the cause of termination. The employer was required to deposit the amount of one month’s salary per year in an account during the employee’s time of service, and at the termination of employment or retirement the worker would receive the accumulated amount (IMF 1998, 26–27; Murillo 2001, 65).

Severance pay legislation was reformed further in a law from 1990, which is still the primary source of labour legislation in the country. All state-owned and private establishments and enterprises is covered by the Basic Labour Act (Ley Orgánica del Trabajo) (ILO 2000, 361; Law of 27 November 1990), but “apprentices, young persons, domestic workers, caretakers, home workers, professional sports people, rural workers, persons employed in land, air and inland water transport, seafarers, motorized workers, actors, musicians, folklorists and other intellectual and cultural workers and disabled persons are covered by special conditions” (ILO 2000, 361). The seniority bonus scheme was reformed to 10 days’ wages for a tenure between three and six months, if longer 30 days’ wages per year of service up to a maximum of 150 days’ wages. If the worker was dismissed without just cause, the compensation was doubled (Law of 27 November 1990, Art. 108, 125).

The seniority-bonus scheme was reformed to look more like a UISA system in 1997 when reforming the labour code. The employer makes monthly contributions of 5 days’ wages per month worked, starting from the fourth month of employment (a total of two month’s wages per year after the first year); after the first year of employment the contributions increase, with 2 days’ wages per month every year to a maximum of 30 days per year, in total three months’ wages per year of service. At the point of termination of the employment relation, the worker receives the accumulated amount (Ferrer and Riddell 2011, 27; ILO 2000, 366; Law of 19 June 1997, Art. 108). In addition, the worker still has the right
to additional compensation in case of unjust dismissal (and some cases of bankruptcy), twice as much as in the law of 1990 (IMF 1998, 27; ILO 2000, 366).

4. DATA

Coding of the national characteristics and their development described above:

**Reforms**
Year of reform.
Law number or date of promulgation of the law.
Type (short description of what kinds of changes were made in the legislation).

**Coverage**
Short description of which groups were covered by the legislation.

**Eligible contingencies – type of termination**
Short description of the type of termination of employment that entitle the worker to severance payments. Some examples are “dismissal without just cause,” “with just cause”, “voluntarily terminated by the worker” or “regardless of reason for termination.”

**Minimum tenure in months**
The minimum number of months the worker must have worked for the current employer in order to be entitled to severance pay.

**Benefits**
Monthly wages per year of tenure (the number of monthly wages the worker received at the end of service).
Maximum wages (if there was a maximum number of monthly wages that a worker could receive).

**Funding**
State contribution indicates whether firms received any assistance from the State (coded Yes=1, No=0).
Funding method indicates how firms finance severance pay (coded I = Internal, E = External; an example of the latter is a fund that employers contribute to).

*Notes*
In this column, further explanations are provided if needed.
5. CONCLUSIONS

The first thing to note, when examining the data, is that the frequency of reforms regarding severance pay varies between countries. In some countries, very few changes have been made since the introduction of severance payments schemes; in other countries, for example Peru, these programs has been object of reform many times. The graph below illustrates the timing of reforms and the accumulated number of reforms made in each country. As we can see, countries such as Peru and Bolivia have reformed their systems more often than other countries, such as Paraguay and Costa Rica.

![Graph illustrating the timing of reforms and accumulated number of reforms in each country.](image)

We can also see that most severance payments schemes were established around 1920–1940. The exceptions are Peru, which had some sort of severance payments in place already in 1902, and Paraguay, which was the last of the countries in the sample to establish severance payments in 1961. Furthermore, punishment for arbitrary dismissals was the main reason for establishing compensations, but with time, severance payments have developed into more generous and comprehensive schemes. Severance-payment schemes provided to employees regardless of the reason for termination of the employment contract can today be found in most of the countries (in parentheses, the year of establishment): Argentina (1974), Bolivia (2009), Brazil (1943), Chile (1990), Costa Rica (2000), Ecuador (1936), Mexico (1970), Peru (1974) and Venezuela (1936). Traditional severance-payment schemes have also been transformed into funds or accounts to which employers make regular contributions. These systems make it easier for the employee to pay the generous amounts severance payments may consist of; hence it also increases the likelihood that the worker will actually receive the compensation in case of dismissal. Countries where employers are obliged to make monthly
contributions to funds or individual accounts are Brazil (1966), Chile (1990), Colombia (1990), Costa Rica (2000), Ecuador (1936) and Venezuela (1997).

In most cases, the laws considered in this report only cover private sector employees and workers. Civil servants are in most cases covered by separate laws. Other commonly excluded groups are domestic and agricultural workers. In order to get a broader understanding of severance payments and other unemployment benefits, it would be necessary to get further information about the laws and rights covering these groups.

The main challenge when trying to describe the characteristics of severance payments is to understand other employment protection legislation provisions. For example, most labour laws have extensive descriptions of what is considered “unjustified dismissals,” and what is not. What is not included or covered only superficially in this report are the often complicated rules on reinstatement or procedures with courts or labour unions connected to both individual and collective dismissals and workers’ rights to severance payments. In order to develop a broader understanding of severance payments, it would therefore be useful to dig further into the development of related employment protection legislation, since severance payments often depend on it, or at least has done so in the past. It would also be of interest to determine how many of the workers that have been eligible for the benefits have actually received them, in order to ascertain what role severance payments schemes have had as a proxy for unemployment benefits.
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