Liberté • Égalité • Fraternité
RÉPUBLIQUE FRANÇAISE

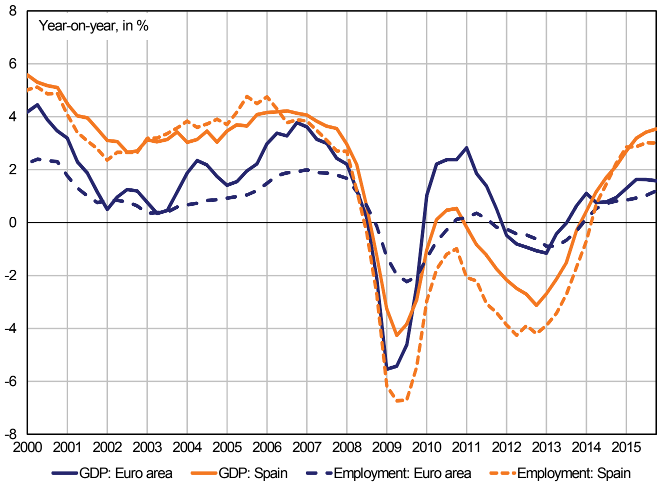
No. 174
August 2016

TRÉSOR-ECONOMICS

Spain's labour market reform: an initial assessment

- The economic crisis caused a steep rise in Spain's unemployment rate, from 8% in 2007 to a peak of over 26% in 2013. No other European Union (EU) country reached such levels of unemployment during the crisis except Greece, where the recession was three times as deep as in Spain.
- Beyond the severe economic downturn, specific characteristics of the Spanish labour market may have helped to drive up unemployment during the crisis, as firms had limited scope for adjusting working conditions to the economic cycle. As a result, the adjustment was performed externally, causing the destruction of 3.3 million jobs, particularly fixed-term contracts.
- Amid these developments, Spain adopted several major reforms of the labour market between 2010 and 2012 to increase firms' internal flexibility and reduce labour market segmentation by reversing the precedence of collective agreements (i.e., by granting priority to firm-level agreements), easing rules for terminating open-ended contracts and defining criteria for authorising layoffs for economic reasons. In 2010, an initial national inter-industry agreement sought to curb wage increases, and another agreement in 2012 gave even greater momentum to wage restraint.
- Since end-2013, job creation seems vigorous thanks, in particular, to the economic rebound and very weak wage growth. Despite a decline in unemployment since end-2013, Spain still posts the EU's highest jobless rate after Greece, registering 20.9% at end-2015.
- The impact of the labour market reforms on the new jobs is hard to assess given the lack of temporal perspective and the magnitude of the adjustments that hit the Spanish economy simultaneously. The implementation of certain measures remains limited since firm-level negotiations are still not a common practice. However, as the reform has given employers greater discretion in internal flexibility, they can carry out adjustments through hours worked, wages or work organisation rather than on employment. It will therefore be necessary to wait for the next cyclical turnaround to see if firms actually implement such adjustments, which preserve jobs.
- Despite its sustained decline, unemployment remains high. The risk is that hysteresis effects can cause a lasting increase in structural unemployment, while skills requirements and difficulties in labour market matching may slow the decrease in unemployment.

Employment and real GDP growth



Source: Eurostat, DG Trésor calculations.

MINISTÈRE DES FINANCES ET DES COMPTES PUBLICS

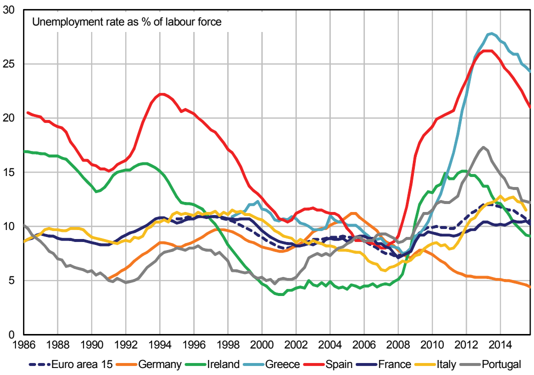
MINISTÈRE DE L'ÉCONOMIE DE L'INDUSTRIE ET DU NUMÉRIQUE

1. Beyond the economic downturn, the unemployment surge during the crisis may have been partly due to specific functional characteristics of Spain's labour market

1.1 Spanish unemployment experienced a particularly steep and rapid rise during the crisis

Between the peak in employment in early 2008 and the end of net job losses in 2013, the Spanish economy destroyed nearly 20% of total employment, or about 4 million jobs. The unemployment rate, which had bottomed out at 7.9% in 2007, surged to a peak of 26.2% in 2013[1]. No other EU country posted such a massive rise in unemployment during the crisis except Greece, whose economy contracted three times as sharply. Job destruction in Greece matched that of Spain, but at the trough in the recession, Greek GDP was 27% below its pre-crisis level compared with 8% for Spain. Factors that may have played a role in the Spanish adjustment include sectoral developments such as the bursting of the real-estate bubble[2], particularly in the first phase of the crisis between 2008 and 2010. Nevertheless, they provide only a partial explanation for the severity of job losses, since all sectors were hit by this overadjustment.

Chart 1: Unemployment rate



Source: Eurostat, DG Trésor calculations.

Job destruction in Spain was so massive that unemployment rose back to its 1980s level, then exceeded it from 2010 onwards. Spain's labour market was characterised throughout the 1980s by an unemployment rate well above that of the other countries that now form the euro area. It was not until the mid-1990s, the onset of a high-growth spell fuelled by the adoption of the euro and, later, the credit surge that unemployment declined significantly, reaching the level observed in the other euro area countries.

1.2 Specific characteristics of the Spanish labour market may have contributed to the sharp rise in unemployment during the crisis

The overadjustment of employment to the crisis may have been partly due to structural characteristics of the Spanish labour market. For example, Di Mauro and Ronchi (2016)[3] have noted the importance of collective bargaining in the labour market's mechanisms for adjusting to the crisis. This system may have rigidified labour relations, placing most of the adjustment burden on employment. In Spain, regional and sectoral bargaining play a key role in setting wages and other working conditions. Collective agreements apply automatically to all firms in a region or sector, even if they have not taken part in negotiations. As a result, the percentage of workers covered by collective agreements is high, at approximately 80-90%. The negative impact of this collective bargaining system[4] may have been aggravated by two factors. The first is the difficulty–particularly acute in Spain–of waiving sectoral or industry agreements, whether permanently through firm-level agreements or temporarily to cope with adverse economic developments. The second is the "ultra-activity" rule, i.e. the tacit renewal of a collective agreement pending signature of a new agreement: this provision makes it harder to adjust agreements to changing economic conditions.

These rigidities are visible in wage movements, which lagged the economic downturn. Between end-2007 and end-2009, average real wages per capita gained over 9%, while unemployment rose by over 10 points and GDP contracted sharply. This inertia undoubtedly contributed to job destruction during the initial phase of the crisis[5]. Its explanation lies in the inflation-indexation provisions of collective agreements and the limited scope for exemptions from these agreements.

Another reason for the high sensitivity of Spanish employment to economic activity is labour market segmentation[6]. The share of fixed-term contracts in total paid employment is particularly high in Spain-at 33% versus approximately 13% for the EU 15 in 1995-2008[7]–

(1) For many years, unemployment was significantly higher in Spain than in the rest of the EU, running at 18-20% in the 1980s and 1990s. The OECD estimates that structural unemployment exceeded 10% before the crisis, compared with a euro area average of 8%.

(2) Nearly half of the job losses (1.7 million) were in the construction sector. However, the negative impact of the sector needs to be nuanced. By way of illustration, if job losses in construction and manufacturing had been similar, total unemployment would still have reached 22% (DG Trésor calculations from INE data).

(3) See Di Mauro, P. and Ronchi, M. (2016), "Centralisation of wage bargaining and firms' adjustment to the Great Recession: a micro- based analysis", *Bruegel Blueprint*.

(4) See Bentolila, S. et al. (2011), "Reforming an Insider-Outsider Labor Market: the Spanish Experience", *IZA Discussion Paper* No. 6186 and Jaumotte, F. (2011), "The Spanish Labor Market in a Cross-Country Perspective", *IMF Working Paper* WP/11/11.

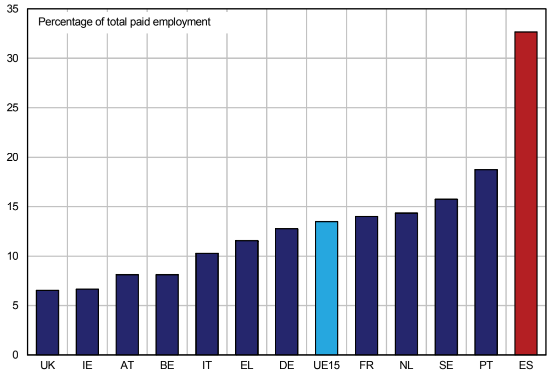
(5) See Bank of Spain (2011), "Wage Adjustments to Shocks in Spain", *Economic Bulletin*, April.

(6) Okun's coefficient is an empirical measure of the sensitivity of unemployment to a 1% change in GDP. It has been estimated at over 0.8 in Spain compared with an average 0.4 for the other advanced countries: see Ball, L. M., Leigh, D. and Loungani, P. (2013), "Okun's Law: Fit at 50?", *IMF Working Paper* 13/10.

(7) This duality is an old phenomenon, dating from the late 1980s. Between that period and the crisis, the share of fixed-term contracts fluctuated around 30%. Dualisation was triggered by the 1984 reform, which extended the potential application of new forms of temporary work to many situations. See Bentolila, S., Dolado, J. and Jimeno, J. (2012), "The New Labour Market Reform in Spain: Objectives, Instruments, and Shortcomings", *CESifo DICE Report* 2/2012.

and most of the adjustment of employment to the crisis involves these contracts. Unlike layoffs, the non-renewal of fixed-term contracts allows a relatively unconstraining adjustment of the workforce to a negative shock–given the limited scope for firms to adjust working conditions to business conditions.

Chart 2: Share of fixed-term contracts in total paid employment, 1995-2008 average



Source: Eurostat, DG Trésor calculations.

The increase in fixed-term contracts before the crisis, and their exceptionally high incidence in 1995-2008, seem linked to regulations governing open-ended versus fixed-term contracts. Legal compensation for termination of open-ended contracts was very high in Spain[8] compared with the severance benefit paid on termination of fixed-term contracts. The disparity was amplified by the fact that almost 90% of terminations of open-ended contracts before 2008 involved payment of compensation for unfair dismissals. This practice was mainly due to an accelerated dismissal procedure for open-ended contracts–called *despido exprés*[9]–that made it possible to avoid litigation in exchange for the higher compensation. Moreover, the restrictions on the duration and renewal of fixed-term contracts could be easily circumvented, and the authorities did little to control the compliance of fixed-term contracts with legal provisions[10]. In other words, fixed-term contracts were presumably used more loosely than stipulated by law. These two factors–the gap in termination costs between fixed-term and open-ended contracts, and the ease of use of fixed-term contracts–seem to have been the main drivers of the widespread adoption of fixed-term contracts in Spain.

2. The 2012 reform covers many areas and aims to give the Spanish labour market further capacities to adjust to changing economic conditions

2.1 To allow a better adjustment of working conditions to the firm's environment, the reform of collective bargaining significantly changes the precedence of agreements

The 2012 reform gives precedence to collective bargaining at firm level. When the focus is on key aspects of the workplace relationship, company-level agreements now take precedence over agreements reached at a higher level, such as a region or industry. The reform also abrogated the general notion of ultra-activity (see above): from now on, provisions of terminated agreements can be extended for only one year before expiring. This measure was designed to incite all social partners to reach timely agreements adapted to changing economic conditions. Its scope of application has, however, been restricted by a recent ruling of the Spanish Supreme Court (Tribunal Supremo)[11].

The social partners dropped inflation indexation as a bargaining principle in the inter-industry agreements of 2010-2012 and 2012-2014. Before 2010, inter-industry agreements reached at national level–which defined the structure of collective bargaining and formulated recommendations on working conditions–used inflation as a benchmark for setting wage adjustment procedures, sometimes combined with clauses allowing adjustments based on inflation observed ex post. Inflation-indexation explains such phenomena as the strong inertia of wages relative to the economic cycle, and the loss of competitiveness in the 2000s due to the disconnection between wage movements and productivity. The 2010 agreement made it possible to implement wage restraint[12], while the 2012 agreement[13] marked a sharper break with past practices. The latter agreement, which applied to 2012-2014, severely curtailed wage growth via a clause requiring adjustments to reflect inflation observed ex post. The practical outcome was a significant loss in purchasing power[14]. The agreement also recommended taking additional criteria into account for determining wage increases, such as the firm's performance–measured by profits, sales and other criteria–and the economic environment.

(8) Twenty or 45 days per year of seniority respectively depending on the type of dismissal-for economic reasons or unfair-compared with 21 days in the other EU Member States. See Jaumotte, F. (2011), op. cit.

(9) The despido exprés clause, introduced in 2002, aimed to reduce the number of litigations. By recognizing from the outset the lack of objective reasons for dismissal and by paying the maximum compensation for unfair dismissal, employers did not have to pay wages due pending settlement of a dispute. As for employees, having obtained the maximum compensation for which they were eligible, they no longer had an incentive to litigate. For a detailed discussion, see Malo, M. (2011), "Labour Market Policies in Spain Under the Current Recession", *ILO Discussion Paper* DP/2010/2011.

(10) See Wolf, A. and Mora-Sanguinetti, J. S. (2011), "Reforming the Labour Market in Spain", *OECD Working Paper* No 845, and Bentolila, S. et al. (2012), "Two-Tier Labour Markets in the Great Recession: France Versus Spain", *The Economic Journal*, 122:F155-F187.

(11) Supreme Court ruling no. 264/2013 of 22 December 2014, stating that after a year following the expiration of the agreement, its provisions continue to apply to current workers.

(12) In the 2010 agreement, the reference adjustment rate was set at 1% for 2010, then capped at 1-2% for 2011.

(13) In the 2012 agreement, the reference adjustment rate was capped at 0.5% (with scope for an update clause) for 2012, and targeted at 0.6% for 2013 and 0.6-1.5% for 2015.

2.2 The reform strengthens mechanisms for internal flexibility in work organisation by widening their scope and making it easier for the employer to apply them

The 2012 reform grants firms greater internal flexibility[15] by broadening the array of measures that they can implement in response to an economic shock. By reducing legal uncertainties, it also gives employers greater latitude to enact such measures at short notice.

First, for aspects covered by collective agreements, **the law now allows the temporary suspension of agreements for economic, technical, organisational or production-related reasons.** It also defines with precision the "persistent" nature of the difficulties that need to be invoked to suspend an agreement–a definition similar to the one allowing layoffs for economic reasons. Suspension requires the social partners' consent, with a 15-day consultation period. In the event of disagreement, the law sets out a codified procedure with a nominal time limit to overcome any stalemates. The reform also simplifies the use of part-time unemployment by abolishing the prior administrative authorisation previously required[16].

Second, the reform gives employers greater latitude outside of collective agreements. They can now unilaterally reorganize 10% of working time over the entire year without obtaining a prior collective agreement. Moreover, the classification rules under which workers could be assigned to different tasks in the firm have been considerably eased.

2.3 The gap in termination costs between open-ended contracts and fixed-term contracts has been narrowed by (1) simplifying and clarifying the law, and (2) reducing compensation for unfair dismissals

To curtail litigation that entails the reclassification of layoffs for economic reasons as unfair dismissals, the Spanish reform broadened and specified the criteria for justifying layoffs for economic reasons. For unfair dismissals, the reform lowered the level of legal compensation from 45 to 33 days per year of seniority, capped at 24 months versus 42 previously[17]. It also abrogated (1) the accelerated layoff clause (*despido exprés*), which incited employers not to resort to layoffs for economic reasons, even when they were entitled to do so, in order to avoid any risk of litigation, and (2) payment of wages for the duration of any litigation arising from a layoff for economic reasons. As a result, layoffs for economic reasons have become cheaper for the employer through the combined effects of (1) a reduction in compensation due in the event of litigation, and (2) a secure definition of layoffs for economic reasons, which should limit the number of litigations.

Concerning the criteria allowing employers to justify layoffs for economic reasons, several clarifications have been added since 2010. The Zapatero government reforms in 2010 and 2011 had already extended "economic reasons" to current or future losses, and to "persistent" declines in revenues that could affect the firm's viability and its capacity to maintain workforce volume. The 2012 reform added a further criterion: the "persistent" decline in sales. Lastly, and more fundamentally, it introduced a specific circumstance in which layoffs are automatically justified: when normal revenues or sales, for three consecutive quarters, fall below their levels of the same year-earlier quarters. Judges may thus confine their reviews to examining whether an "economic cause" exists that complies with this specific criterion.

Procedures have been streamlined mainly by eliminating prior administrative authorisation for mass redundancies. This change has, however, increased uncertainty over the outcome of litigation-a situation that, according to the OECD[18], may explain the decline in mass redundancies observed in the months after reform.

2.4 The reform has also strengthened tax and social-contribution incentives to hire workers under contracts more stable than fixed-term contracts

The 2012 reform created a new open-ended contract–*contracto indefinido para emprendedores*, i.e., "permanent contract for entrepreneurs"-**reserved for firms with fewer than 50 employees**, and including a trial period of up to one year[19]. Hiring a young person under 30 or an unemployed person over 45 qualifies the employer for a tax deduction and lower social contributions for three years in exchange for guarantees on job security. Since 2010, the use of fixed-term

(14) The rules aimed at pegging index revisions to actual rather than forecast inflation tend, in principle, to mitigate index changes. This is because they eliminate the upward uncertainty of the index (relative to inflation) due to situations where forecast inflation exceeds actual inflation-a rather routine occurrence in the euro area since the crisis.
In practice, actual inflation in 2012 was 2.4%, causing an upward adjustment in wages ex post (admittedly, the increase was a very modest 1.17% as against 1.04% before taking inflation into account). Conversely, in 2013, with inflation under the 2% regulatory threshold, wages were not adjusted ex post. The loss in purchasing power was thus 1.2 points in 2012 and 0.9 points in 2013.

(15) Internal flexibility denotes the measures that an employer is allowed to take in order to freely adjust labour costs (wages, partial unemployment, and so on) or work organisation (working day, hours, mobility, and so on) in response to events such as an economic shock, without resorting to layoffs. By contrast, external flexibility refers to the ease with which the employer can adjust the workforce through layoffs.

(16) The reform has made the conditions for implementing internal and external flexibility more symmetrical. This could facilitate the conclusion of internal adjustment agreements in preference to an external adjustment via downsizing when warranted by economic conditions

(17) Spanish law has provided for capping benefits in the event of litigation since the adoption of the Workers' Status Act (the equivalent of France's Code du Travail) in 1980.

(18) See OECD (2013), *The 2012 Labour Market Reform in Spain: A Preliminary Assessment.*

(19) The reform included a provision that this new open-ended contract would be available for a limited period only, until unemployment had returned to below 15%.

contracts has been regulated more strictly: the possibility of extending one or more fixed-term contracts for more than two years is limited, including for fixed-term contracts under which an employee has been assigned to different positions in the firm.

Tableau 1 : Main components of Spanish labour market reform

Collective bargaining	
Reversal of legal precedence	Firm-level agreements now take precedence over agreements at higher level (sector or industry), with positive effects–in theory–on *productivity* and *employment*.
End of "ultra-activity" principle	The "ultra-activity" principle ensured that an existing agreement would be renewed if a new one was not reached. The new rule should entail a more frequent renewal of agreements.
Wage restraint	Wage indexation on ex-post inflation and rules restraining increases help to *curb wage growth* and maintain employment.
Internal flexibility	
Change in working conditions on the employer's initiative	A new procedure allows employers to propose changes in working conditions in response to an economic shock.
Temporary suspension of collective agreements	Along with changes in working conditions, the reform allows temporary suspension of collective agreements in the event of an economic shock.
Partial unemployment and temporary suspension of contract	Elimination of prior administrative authorisation and alignment of criteria on those for layoff for economic reasons.
Workers' internal mobility	Change in worker classification system, replacing occupational category with occupational group; further scope for horizontal (intra-group) mobility and extending vertical mobility (between groups).
Working time	Employer can modulate working time by 10% over the year, even without collective agreement.
External flexibility	
Layoff for economic reasons	Definition of an objective criterion for layoff for economic reasons.
Layoff compensation	Cap on compensation for unfair dismissal lowered from 45 to 33 days per year of seniority; total capped at 24 months.
Abrogation of *despido exprés*	Accelerated layoff system abolished in exchange for abrogation of requirement to pay wages until outcome of litigation.
Mass redundancies	Abolition of prior administrative authorisation, and scrapping of requirement to provide support plan for redundant workers for firms with under 50 employees, but outplacement remains mandatory.
Employment contracts	
Contract for firms with fewer than 50 employees	New open-ended contract with longer trial period and strong tax incentive. Expected to impact *employment level and labour-market duality.*
Regulations on use of fixed-term contracts	Two-year limit on fixed-term contracts, except special contracts (three years) to minimise *labour-market duality.*
Easing of part-time work contracts	To ensure better adjustment to economic cycles, overtime now allowed for workers under part-time contracts..
Unemployment insurance	
Scaled reduction in unemployment benefits	Wage replacement rate after six months' unemployment cut from 60% to 50%, as an *incentive for job-seekers to return to employment*.
Requirement to seek work	Unemployed persons now required to prove job-search activity or else have benefits suspended.

Source: DG Trésor.

3. The reform's impact on employment and the functioning of the labour market cannot be reliably estimated at this point

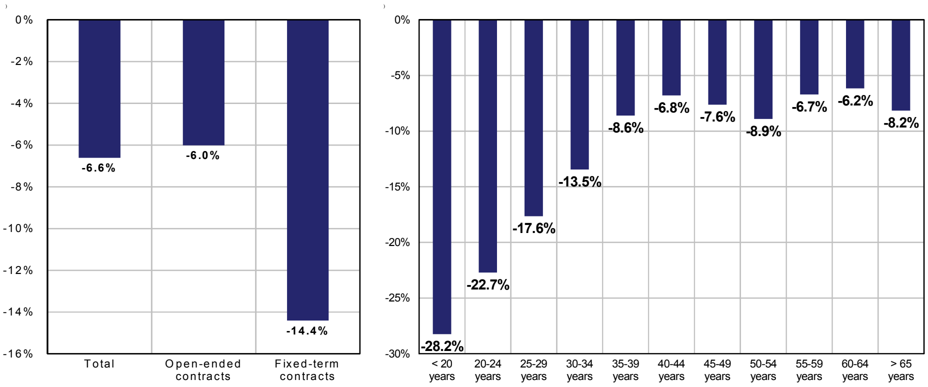
3.1 Spanish job creation has been buoyant since end-2013, no doubt partly thanks to wage restraint applied during the crisis

Between end-2013 and end-2015, the Spanish economy created almost 950,000 jobs and the unemployment rate fell 5.3 points. Employment gained 5.3% over the period, a rate comparable to the 5.4% growth in GDP. In other words, jobs recovered in step with GDP against the usual pattern, as employment typically lags economic activity. Unemployment, which had peaked at 26.2% of the labour force in mid-2013, eased to 20.9% by end-2015.

With Italy, Portugal and Greece, Spain is one of the euro area countries that recorded the sharpest fall in the average real wage per capita in the non-farm sector from 2009 onwards: the loss totalled approximately 6% between mid-2009 and end-2015. This (aggregate) decline in real wages was caused mainly by the fact that wages grew by less than inflation, rather than by a decrease in nominal wages. The aggregate changes, however, mask contrasting patterns in individual sectors, since real wages edged up in manufacturing but fell in services and construction.

The burden of wage restraint appears, however, to have been borne unequally between categories of workers. According to the annual survey on wage structure by the Spanish statistical institute (INE), the fall in real wages between 2009 and 2013 was twice as steep for employees on fixed-term contracts as for those on open-ended contracts. By age group, the survey data also show that young workers bear a far larger share of the decline in wages than their elders. These observations suggest the persistence of strong downward nominal rigidity, as most of the wage adjustment was applied to new hirings (young people and temporary contracts)[20]. This finding is consistent with that of Garcia-Perez and Jensen (2015)[21], who show that wage adjustment during the crisis was distinctly stronger for workers who changed jobs than for those who kept them.

Chart 3: Average real wage by type of contract and by age, 2009-2013



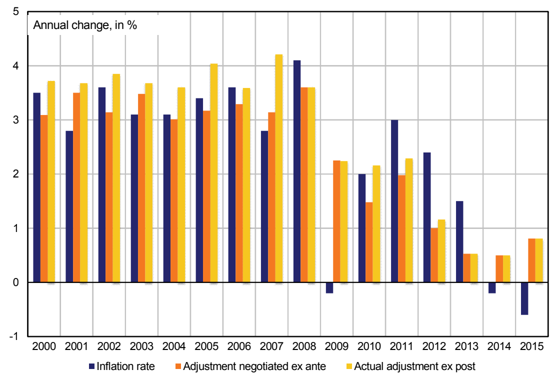
Sources: Spanish National Statistical Institute (INE) and DG Trésor calculations.

3.2 Beyond the impact of inter-industry agreements, the sharp rise in unemployment likely played a key role in wage restraint

Wage restraint probably resulted from the change in the unemployment rate more than from the reforms aimed at increasing flexibility. The surge in unemployment to a record 26% in 2013 no doubt put strong downward pressure on wage demands, but the impact is hard to measure. Moreover, the effects of the institutional reforms on wage formation are hard to distinguish from the automatic effects of the 2010 and 2012 inter-industry agreements, which reflected the social partners' commitment to wage restraint. This consensus was effectively enacted and incorporated into the collective agreements signed (see Chart 4)–evidencing the key role they appear to have played in the wage movements observed. The inter-industry agreements thus had a likely influence on wage movements for all paid employees, under open-ended as well as fixed-term contracts. Nevertheless, the agreements do not account for the magnitude of the adjustment effects observed specifically for workers under fixed-term contracts (see Chart 3), which are linked to the wage bargaining over hiring contracts. The OECD (2013) estimates that, after factoring in the effects of the economic cycle, the reform and the January 2012 agreement between trade unions and employers may jointly account for one-half of the wage restraint effects observed in the months following the reform's adoption.

So far, employers seem to have made relatively limited use of the new flexibility measures allowed by the reforms in regard to wage movements. The option of suspending the application of collective agreements concerned only a moderate number of workers, although its use increased in 2013[22]. This observation is consistent with a 2013 survey by the Spanish Ministry of Employment[23], which found that only 6.8% of firms applied internal flexibility mechanisms to modify wages and the pay system. As Dolado (2012) notes[24], while the reform facilitated waivers of higher-level agreements at firm level, their administrative costs and procedural complexities remain high-especially for small businesses, which account for two-thirds of Spanish employment. These data tend to suggest that the 2012 reform played a lesser role compared with wage restraint agreements and the effects of the crisis.

Chart 4: Wage adjustments negotiated in collective agreements



Sources: Eurostat, DG Trésor calculations.

3.3 Despite the legal precedence given to firm-level agreements, collective bargaining is still generally conducted at a higher level

For now, firm-level agreements cover a smaller proportion of workers than higher-level agreements. Although the number of firm-level agreements increased in 2013, the number of workers covered remains small and actually below the pre-crisis percentage, at 9% of the total in 2013 versus 10% in 2008. This apparent slowness in the evolution of collective bargaining procedures may, however, be due to the need for employers to adjust gradually to this new form of organisation of the social dialogue. Moreover, the increased lati-

(20) This observation is confirmed by the results of a study by K. Orsini (2014), who shows that the adjustment was significantly greater for fixed-term contracts, even after incorporating composition effects. See Orsini, K. (2014), "Wage adjustment in Spain: slow, inefficient and unfair?", *ECFIN Country Focus* Vol. 11, Issue 10, November.

(21) See Garcia Perez, I. and Jansen, M. (2015), Reforma laboral de 2012: ¿Que sabemos sobre sus efectos y que queda por hacer?, *Fedea Policy Papers* 2015/4.

(22) Spain's Ministry of Employment and Social Security puts the figures at 29,000 or 0.3% of workers covered by a collective agreement in 2012, 160,000 (1.6%) in 2013 and 66,000 (0.9%) in 2014.

(23) Spanish Ministry of Employment, 2013 and 2014 *Encuesta Anual Laboral* (Annual Labour Force Survey).

(24) See Dolado, J. (2012), "The Pros and Cons of the Latest Labor Market Reform in Spain", *Spanish Labour Law and Employment Relations Journal.*

tude for exemptions from higher-level agreements in the event of difficulties may lead firms to continue to prefer such agreements, which have become less constraining. The adoption of firm-level agreements also involves many barriers, particularly for small and medium-sized enterprises (SMEs).

3.4 Studies conducted since 2012 have trouble clearly identifying the effects of Spanish reforms on employment

Several studies published since 2012 have sought to measure the impact of Spain's reforms (see Box 1), but their conclusions still seem fragile and should be interpreted with caution. First, the lack of temporal perspective undermines the ability of statistical methods to identify a possible change in patterns. Second, most of these studies cannot clearly distinguish the effects of the reforms from the other contemporaneous changes. In particular, several studies actually measure the impact of wage restraint on employment. Others measure the total effect of all the reforms, without being able to attribute it to a specific measure such as the reform of layoff procedures or the reform of internal flexibility. While the Spanish labour market's good performance in the recovery seems to indicate an increase in the job content of growth, this change may reflect a catch-up that is hard to distinguish from a possible change in momentum at this stage.

Some of the reform's desired effects–such as the substitution of internal flexibility for external flexibility in response to an economic shock–will, in all likelihood, be impossible to assess before the next cyclical turnaround. It is also likely that most of the employment adjustment had already occurred by the time the reform was adopted in 2012, diminishing the attractiveness of these new measures for now. Arguably, the only way to assess the reforms accurately is to see how well they can preserve jobs in the next crisis.

Box 1: **What do the available studies on the impact of reforms on employment say?**

The Spanish government conducted an initial assessment (2013)[a], using the standard method to regress employment variations on GDP variations with only four quarters of data since the adoption of the reform package in 2012. The study concludes that the reform saved an estimated 225,000 jobs. More recent estimates by the European Commission (2016)[b], using a similar method, find that the reforms spared 400,000 jobs between 2012 and end-2013. In another study, the Bank of Spain (2013)[c] examined residuals from Okun's law and found that employment fell by less than expected after the reform. The BBVA bank (2013)[d], using a structural VAR, estimates that wage restraint saved 60,000 jobs in the short term and 300,000 in the medium term. A 2016 update to this study[e] found that the reform saved 910,000 jobs between 2012 and 2015, and 1.5 million in the medium term. Concerning the impact of the reforms on the job creation threshold, the Spanish government (2016)[f] estimates that the 2012 reform significantly lowered the minimum GDP growth rate needed for job creation to become positive-from 1.5% before the reform to 0.4% after 2012. This result may be corroborated by Spain's recent performance, since employment has risen in step with GDP, as noted by Garcia-Perez and Jansen (2015)[g] and the European Commission (2016)[h]. De Cea and Dolado (2013)[i], as well, expected the reforms to lower the growth threshold, but their result is sensitive to assumptions about the maintenance of wage restraint.

The fullest study to date is that of the OECD (2013)[j]. Using a discontinuity regression model, the OECD reckons that the reforms had a significant impact on the propensity to hire-particularly under open-ended contracts-and improved the rate of return to employment. For the OECD, the 2012 reform increased the number of new open-ended contracts by 25,000 a month (or 300,000 over 12 months), with the impact concentrated on firms with fewer than 25 employees. These results, however, seem tenuous. Garcia-Perez and Jansen (2015) note that the effect is distinctly weaker, or even non-significant, if the 2013 data are added to the sample. The OECD study also concludes that the reforms do not seem to have had an accelerator effect on dismissals.

a. Ministerio de Empleo y Seguridad Social (Spanish Ministry of Employment and Social Security) (2013), *Report Evaluating the Impact of the Labour Reform*.
b. European Commission (2016), Country Report Spain 2016, *working paper*.
c. Bank of Spain (2013), "The 2012 Labour Reform: A Preliminary Analysis of Some of Its Effects On the Labour Market", monthly Economic Bulletin, September.
d. BBVA (2013), *Economic Outlook: Spain, 2nd*-quarter report.
e. Doménech, R., Ramon Garcia, J. and Ulloa, C. (2016), *Los Efectos de las Reformas Laborales sobre el Crecimiento y el Empleo*, mimeo.
f. See http://www.thespanisheconomy.com/stfls/tse/ficheros/2016/160229_Kingdom_of_Spain.pdf.
g. Garcia-Perez, J. and Jansen, M. (2015), "Assessing the impact of Spain's latest labour market reform".
h. European Commission (2016), op. cit.
i. De Cea, P. and Dolado, J. (2013), "Output Growth Thresholds for Job Creation and Unemployment Reduction in Spain".
j. OECD (2013), *The 2012 Labour Market Reform in Spain: A Preliminary Assessment*.

4. The labour market reform, however, leaves aside major structural problems that hinder the return to full employment

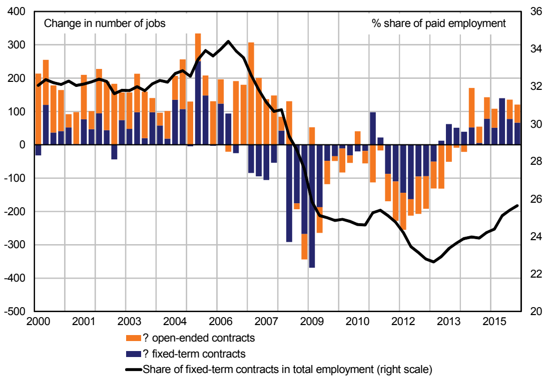
4.1 So far, the reform has not yet remedied the problem of duality in the Spanish labour market

Since the recovery, the share of fixed-term contracts has been trending up again. The incidence of fixed-term work fell sharply at the start of the crisis, among other reasons because of the slump in construction, where the share of fixed-term contracts in paid employment was particularly high at 60%. Since 2013, the share of fixed-term contracts has been trending up again, reaching 25.6% by end-2015, or 3 points above its trough. Almost two-thirds of jobs created since 2013 are under fixed-term contracts, the reform having generated no observable significant or lasting downturn in the share of open-ended hirings. While these movements should still be interpreted with caution, they seem to suggest that the reforms have not yet made open-ended hirings sufficiently attractive for employers relative to fixed-term hirings, as Dolado pointed out in 2012[25]. Nor have the incentives to open-ended hirings implemented in 2014-2015 led to a marked rise in open-ended versus fixed-term contracts. Lastly, the *contracto indefinido para emprendedores* ("permanent contract for entrepre-

(25) Dolado, J. (2012), op. cit.

neurs"), targeted at firms with fewer than 50 employees, has so far been adopted by a very limited number of businesses. In other words, the changes in labour market segmentation since the enactment of the 2012 reform have been rather modest, but this does not rule out the possibility of even more negative changes had the reform not been implemented. We still lack empirical studies to cast full light on the effects of the reform.

Chart 5: Change in employment by type of contract



Sources: Eurostat, DG Trésor calculations.

The crisis has also led to a rise in part-time work–a possible cause for concern in the longer run. Part-time work offers many advantages, such as raising the labour force participation rate and providing a transition back into employment, but it is also linked to a higher risk of poverty. In the event, the incidence of part-time work rose 5 points during the crisis, from 12% in 2008 to over 17%, with over 60% of "involuntary" part-time work. If this trend lasts, it could reflect a new form of duality in the Spanish labour market.

4.2 Despite its substantial fall since 2013, Spanish unemployment remains extremely high; its further decline may be delayed by the employability problems of a certain category of jobless persons

The persistence of high unemployment aggravates the risk of hysteresis and of a lasting increase in structural unemployment. The most recent estimates of the structural unemployment put its rate at over 18%, versus 10% or so before the crisis[26]. Long-term unemployment, which concerned a mere 2% of the labour force in 2008, stood at nearly 13% in 2014–compared with a 5% EU average-and affected more than half of Spain's jobless. Despite the many proactive policy initiatives since 2011, their wider implementation has been curbed for several reasons including the severe fiscal constraint.

Skills requirements and labour-market matching problems could further inhibit the decline in the number of unemployed. Spain is characterised by a low average skill level, and its early school leavers still differ from their EU counterparts in this respect. In 2015, Spain had one of the lowest youth skill rates in the EU, with more than 30% of 25-29s in the low-skill category versus an EU average of under 20%. Spain also suffers from a particularly strong mismatch between labour demand and worker skills, as noted by the Bank of Spain (2012)[27] and Dolado et al. (2013)[28]. Once the positive catch-up effects of the recovery have faded, these factors-which impair the employability of a large share of jobseekers-could significantly slow the decline in unemployment.

Jonas ANNE-BRAUN, Marine BOGUE, Christophe GOUARDO, Rémy MATHIEU

(26) Measured by NAWRU and NAIRU, the latest estimates by the European Commission (February 2016 winter forecasts) and the OECD (Economic Outlook no. 98, November 2015) put structural employment at around 18.5%.
(27) Bank of Spain (2012), *Sectoral change and implications for occupational mismatch in Spain*.
(28) Dolado, J. et al. (2013), "Youth labor market performance in Spain and its determinants: a micro-level perspective", *OECD Working Paper*

Publisher:

Ministère des Finances et des Comptes Publics
Ministère de l'Économie de l'Industrie et du Numérique

Direction Générale du Trésor
139, rue de Bercy
75575 Paris CEDEX 12

Publication manager:

Michel Houdebine

Editor in chief:

Jean-Philippe Vincent
+33 (0)1 44 87 18 51
tresor-eco@dgtresor.gouv.fr

English translation:

Centre de traduction des ministères économique et financier

Layout:

Maryse Dos Santos

ISSN 1962-400X
eISSN 2417-9698

Recent Issues in English

http://www.tresor.economie.gouv.fr/tresor-economics