

## SECIAL REPORT

29 April 2019

# SPANISH LABOUR MARKET DEVELOPMENTS: FROM THE 2010 REFORMS TO SPRING 2019 ELECTIONS

The economic and real estate crisis that Spain suffered in 2008 caused massive job losses and pushed the unemployment rate up to 26% in 2013, an unmatched level in Europe (except in Greece).

Admittedly, the reforms conducted in 2010 and 2012 introduced more flexibility and restored cost competitiveness and employment, but the Spanish labour market has not yet been completely revived. The employment and unemployment rates have not returned to their pre-crisis levels and many structural weaknesses remain (youth and long-term unemployment, low labour skills, high incidence of precarious work and labour market duality). These weaknesses then have a detrimental impact on potential growth by limiting productivity gains and the country's ability to use its labour resources.

In the wake of the parliamentary elections of 28 April, employment issues are very important. This election could be an opportunity for Spain to get a government that is genuinely committed to tackling the structural weaknesses in the labour market. The four major political parties are aware of this and are proposing measures to address it, which are broadly in line with the OECD's recommendations.

Nevertheless, the 28 April elections resulted in a fragmented Parliament and no party has obtained an absolute majority by itself. From then on, the next government, even though it is the result of a coalition, will very likely be a minority and such a situation will therefore complicate the vote on structural reforms that Spain needs.

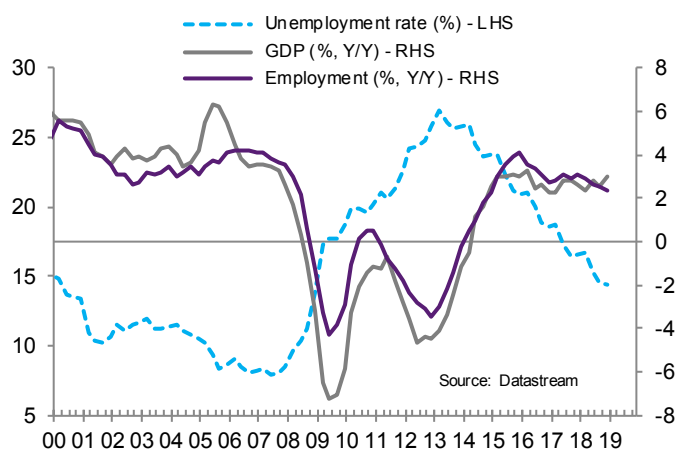


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**1. Following the significant deterioration in employment from 2008 onwards, Spanish governments carried out significant reforms to revive the labour market**

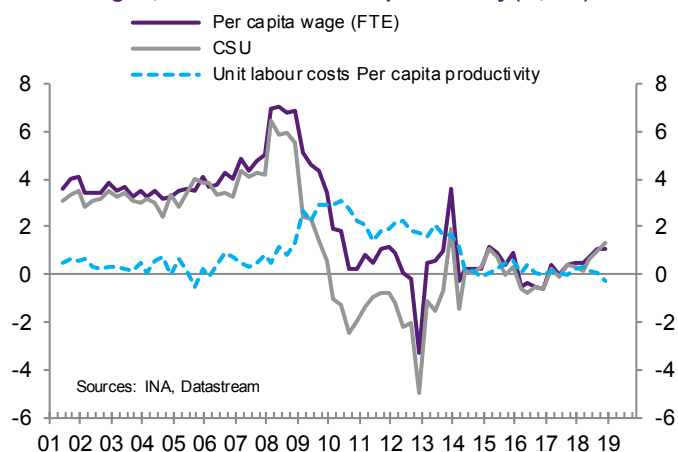
While Spain was affected by the 2008 global economic crisis with the same magnitude as most of its European neighbours, the trend in employment made it stand out. From 2008 onwards, the significant deterioration in employment exceeded that in GDP (chart 1), tripling the unemployment rate from 8.4% in Q3 2007 to 26% in Q2 2013 (a level that has not been reached by any of its European neighbours except Greece).

**Chart 1**  
Employment, GDP and unemployment rate



The characteristics of the Spanish labour market and the real estate bubble explain this massive job loss.

**Chart 2**  
Wages, unit labour costs and productivity (% Y/Y)

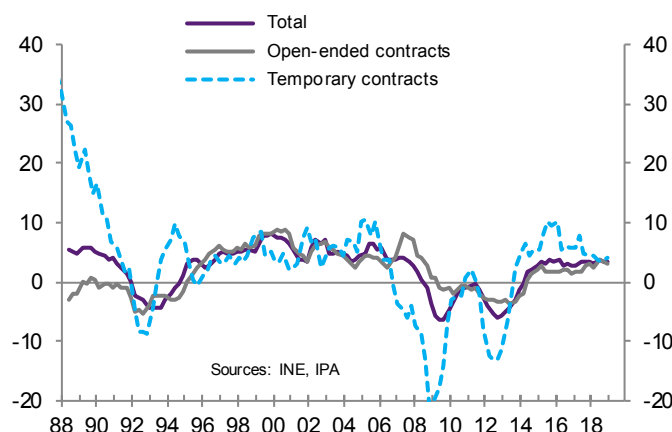


1/ Indexation of wages to inflation was ensured by sector-wide collective agreements and this resulted in higher growth in unit labour costs than in productivity gains (Chart 2). This was therefore detrimental to Spain's cost

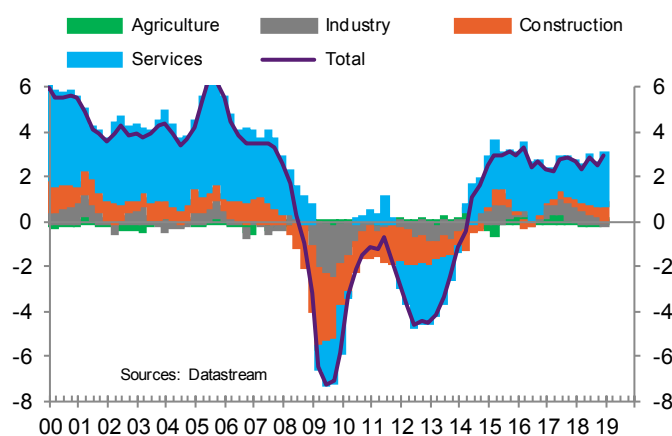
competitiveness and to the internal adjustment<sup>1</sup> of companies in the event of a shock.

2/ The Spanish labour market was characterised by a strong duality of employment contracts, with highly protected permanent contracts and temporary contracts that were relatively less protected. Employers therefore used these temporary contracts on a massive scale, and they accounted for 30% of employment in Q1 2008. Because of wage rigidity, the strong protection of permanent contracts and a large payroll under temporary contracts, employers carried out an "external adjustment"<sup>2</sup> during the crisis by not renewing their temporary contracts (Chart 3). Between Q1 2008 and Q1 2013, nearly two million temporary jobs were lost (40% of temporary contracts) compared with one million job losses for permanent jobs (8% of permanent contracts).

**Chart 3**  
Temporary and open-ended contracts (% Y/Y)



**Chart 4**  
Sector contribution to employment (% Y/Y)



<sup>1</sup> The internal adjustment corresponds to the adjustment of employment through a reduction in production costs (through hours worked or real/nominal wages).

<sup>2</sup> An external adjustment corresponds to an adjustment of employment via the workforce.

3/ The bursting of the real estate bubble was particularly drastic in Spain and had strong repercussions on employment due to the intensity of the labour-intensive construction sector. This sector in particular contributed to a sharp decline in employment in Spain from 2008 (**Chart 4**).

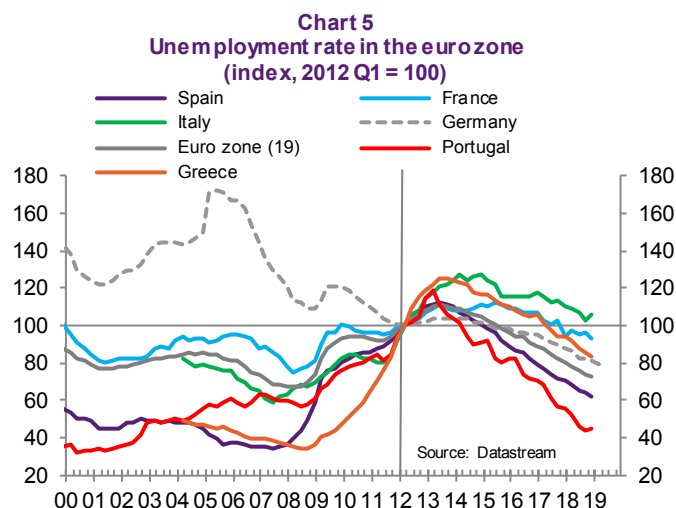
Faced with the labour market meltdown, Spanish political leaders<sup>3</sup> carried out two major reforms in 2010 and 2012 to make the labour market more flexible and to moderate wage increases. The guiding principles for these reforms were:

- **Reducing the duality of the labour market so that temporary contracts become less of an adjustment variable during recession periods:** increase in the end-of-temporary contract severance payment and reduction in the end-of-permanent contract severance payment, reduction in the degree of protection of permanent contracts, subsidising conversion of temporary contracts to permanent contracts.
- **Fostering companies' internal flexibility so that they can adjust independently of sector agreements:** the primacy of company agreements over sector agreements allows each company to adjust its working conditions (reduction in working hours, wage negotiations, internal reorganisation, etc.) according to its own level of activity.
- **Moderating wage increases to restore companies' cost competitiveness:** signing in 2012 of an agreement on employment and collective bargaining defining the path of wages for the next three years and the possibility for companies to individually adjust their working conditions by departing from agreements at a higher level.
- **Increasing employers' power over unilateral changes to employment contracts for economic, technical, organisational or productive reasons:** increased working time flexibility (to encourage part-time contracts), reduced severance pay, simplification, relaxation and legal security of redundancy procedures.

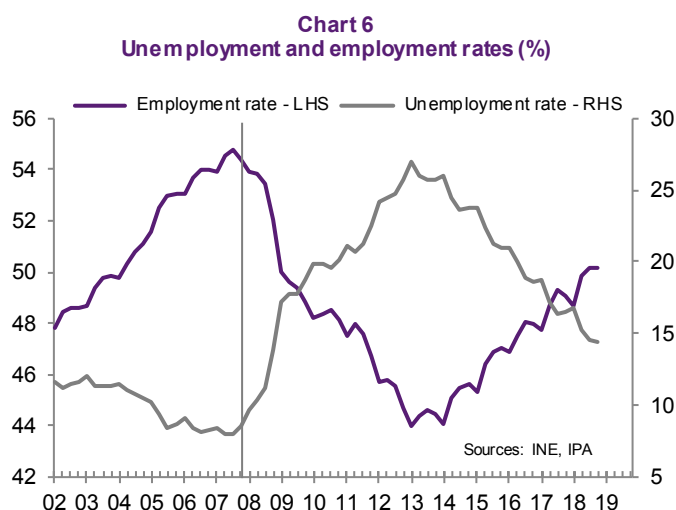
The contribution of labour market reforms to the upturn in employment and activity in Spain is still being debated insofar as it is difficult to isolate the impact from the economic recovery in the euro zone and the ECB's accommodating monetary policy. Nevertheless, the

improvement in the Spanish labour market since 2012 is undeniable.

From 2012 to 2018, the Spanish unemployment rate fell by nearly 10 percentage points (from 24.2% in Q1 2012 to 14.5% in Q4 2018). So Spain has shown one of the largest corrections in terms of reducing unemployment since 2012 in Europe (**Chart 5**), even though the unemployment rate remains above its pre-crisis level (8.4% in Q4 2007) owing to the very high starting point (**Chart 6**).



In parallel, employment increased by around 10% since Q1 2012 and Q4 2018. The vigour of the services sector (+11%) explains this growth in particular as this sector accounts for 75% of total employment in Spain. This made it possible to increase the employment rate to 50% in Q4 2018 (from 45.7% in Q1 2012), although it remains lower than its pre-crisis level (54.4% in Q4 2007) (**Chart 6**).

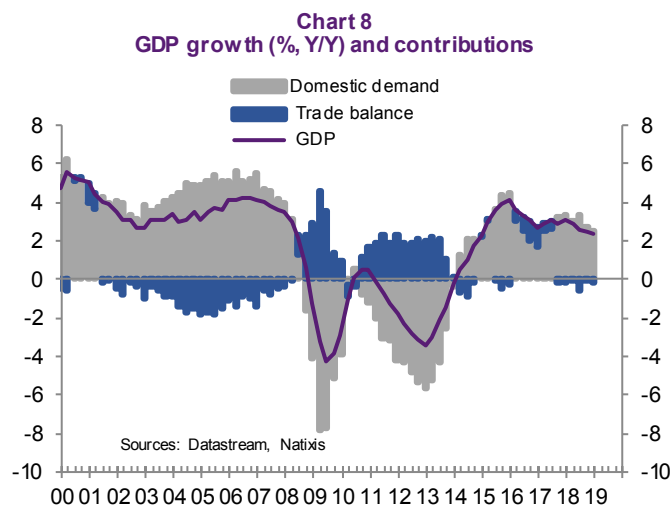
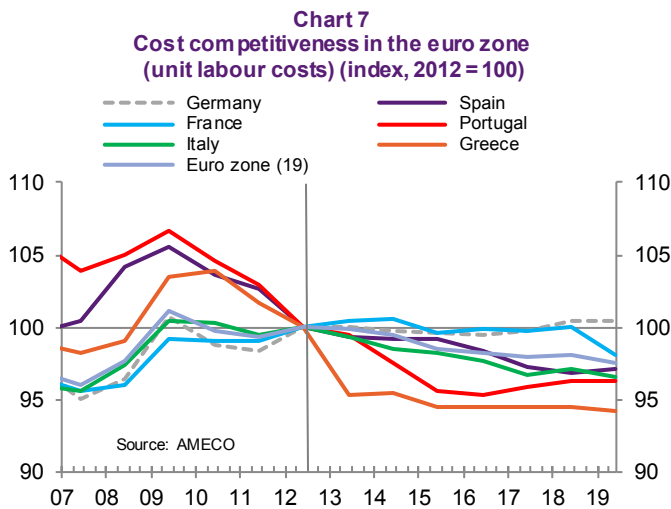


One last development to highlight is cost competitiveness, as reflected in the development of unit labour costs. Since 2012, unit labour costs in Spain have fallen more sharply than for the euro area average (especially compared with

<sup>3</sup> Spain had two governments between 2004 and 2018: the government of Zapatero (Socialist Party) from 2004 to 2011, then that of Rajoy (People's Party) from 2011 to 2018.

France and Germany) (Chart 7), which Salas (2018)<sup>4</sup> explains by the impact of the labour market reforms of 2010 and 2012. The improvement in Spain's cost competitiveness has enabled it to regain export market shares and to anchor its economic growth to a greater contribution from foreign trade, even though domestic demand (and especially construction) was contracting (Chart 8).

of total unemployment, while in 2008 it represented only 2.6% of the labour force and 23% of total unemployment (Chart 9). This situation is all the more problematic as long-term unemployment erodes workers' skills and thereby hinders their return to the labour market.

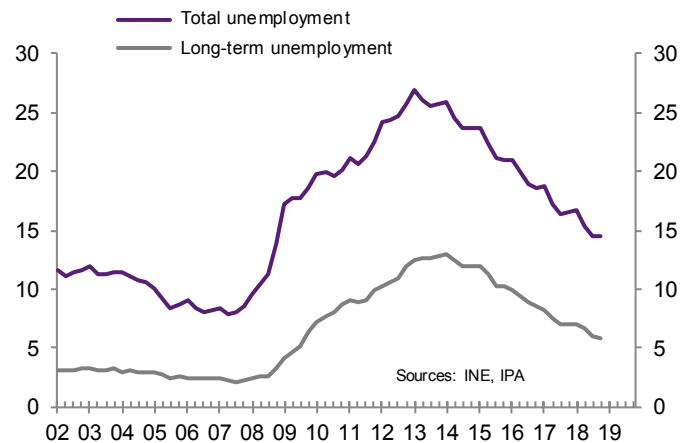


## 2. The upturn in employment has not taken place without imbalances and it has not eliminated the structural labour market problems

Although employment has picked up dramatically in Spain, the labour market remains subject to many structural problems.

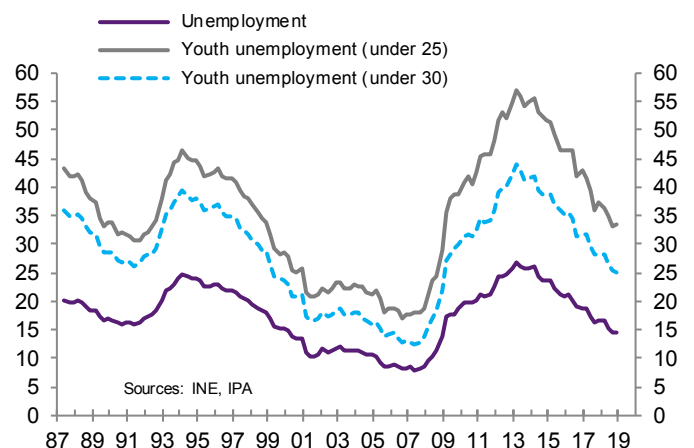
### 1/ The long-term unemployment rate remains high. It has reached 5.8% of the labour force and represents 40%

**Chart 9**  
Long-term unemployment rate (%)



**2/ The youth unemployment rate is high.** The unemployment rate of young people under 25 is currently 20 percentage points higher than the total unemployment rate (34% vs. 15%) (Chart 10). The rate for young people under 30 is slightly lower but remains higher than the total unemployment rate (25% vs. 15%).

**Chart 10**  
Youth unemployment (%)



**3/ The level of labour force skills is relatively low.** 70% of the population has a low or medium skill level<sup>5</sup> (Chart 11) and their unemployment rate is higher than for those with a high skill level (Chart 12). This structural weakness

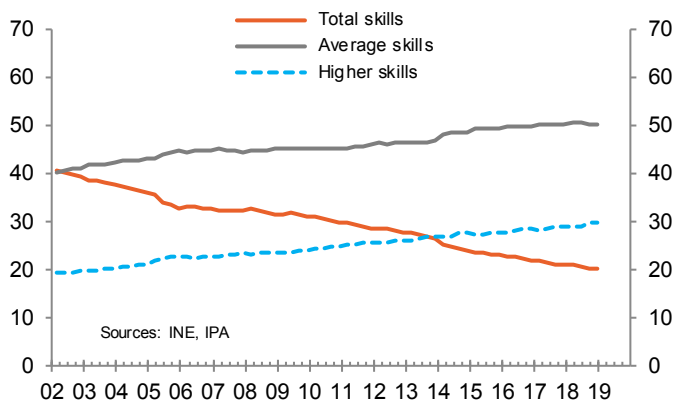
<sup>4</sup> Salas J. (2018), "Drivers of Spain's Export Performance and the Role of Labor Market Reforms", IMF Working Paper.

<sup>5</sup> We distinguish three different levels of skills: low, medium and higher. The low level of skills concerns those who have (at best) completed primary education (levels 0-1 of UNESCO's international standard classification of education, CITE 2011). The medium skill level concerns those who have completed secondary or post-secondary non-higher education at most (levels 2-4 of the CITE). The higher skill level applies to those who have completed higher education (bachelor, master or PhD) (CITE levels 4-6).

helps to explain the scale of youth unemployment (linked to the high school dropout rate, the low vocational skills of young people, their lack of experience and professional opportunities) and long-term unemployment (the people concerned seem less well trained and have less professional experience than others).

a significant proportion of workers who have to ensure their own rights to social security. Lastly, the Spanish labour market presents gender inequalities, whether through wage gaps between men and women (largely unfavourable to women) or through the **labour force participation rate**: that of women is much lower than that of men (53% for women versus 65% for men).

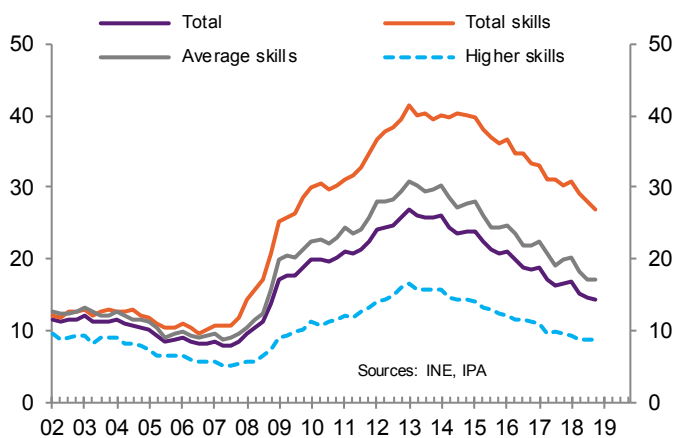
**Chart 11**  
Breakdown of the population aged over 16 by skill level (%)



**Chart 13**  
Under-employment (% of total employment)



**Chart 12**  
Unemployment rate by skill level (%)



**4/ The employment recovery since 2013 has not corrected the high incidence of precarious work or dualism in the labour market.**

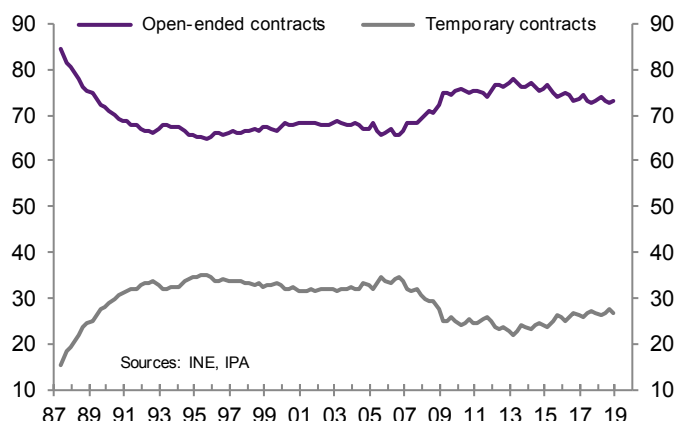
Precarious work takes several forms. **Under-employment** fell from 15% of total employment in Q2 2013 (its highest level since 2008) to 9% in Q4 2018 (**Chart 13**). Although this shows an improvement in the quality of employment over this period, the current level of under-employment nevertheless remains higher than before the crisis (7.5% in Q4 2007). At the same time, **self-employment** constitutes almost 20% of employment, which represents

The **duality of the labour market** between employees on temporary contracts and those on permanent contracts has gathered momentum since 2013 (**Chart 14**). Although employers' reaction to the economic crisis has contributed to reducing the share of temporary contracts in employment, since 2013 job creation has been achieved more through temporary contracts than through permanent contracts. This pushed the proportion of temporary contracts up to 27% of employees at the end of 2018 (i.e. one of the highest rates in Europe), whereas it had fallen to 22% in 2013. Furthermore, 15% of workers today have a **part-time contract** (a percentage that has been almost stable since 2008). Moreover, the majority of people concerned by this type of contract would like to work more. This situation illustrates another facet of the duality and precariousness that prevail in the labour market.

All in all, these structural weaknesses are holding back Spanish potential growth by limiting productivity gains and the country's ability to use its labour resources. This may become problematic at a time when the cyclical slowdown in the euro zone is providing less support for Spanish growth in the short term. In the longer term, it is population ageing that will have to be offset by increasing labour productivity.

<sup>6</sup> According to the International Labour Organisation, under-employment reflects "inappropriate employment with respect to work duration and productivity, determined by comparing the person's current situation with regard to employment with another possible professional situation, i.e. a situation of employment that workers are willing and able to occupy".

**Chart 14**  
**Temporary and open-ended contracts**  
**(% total employment)**



**3. The four main political parties have become aware of these structural problems and the measures they want to undertake are a step in the direction of the OECD's recommendations**

In the run-up to the general elections on 28 April, labour market issues were centre stage. This election could be an opportunity for Spain to get a government that is genuinely committed to tackling the structural weaknesses in the labour market. Below we will compare the political programmes of the four major political parties (Unidos Podemos, Partido Socialista Obrero Español (PSOE), Ciudadanos (C's) and Partido Popular) with the OECD's recommendations on employment, unemployment and education.<sup>7</sup>

Here we present the main measures that the parties propose and we compare them with the OECD's recommendations. These measures and recommendations concern youth unemployment (**Appendix 1**), long-term unemployment (**Appendix 2**), the skill level of the labour force (**Appendix 3**) and precarious work and labour market duality (**Appendix 4**).

By reading of the Spanish parties' political programmes in terms of employment and unemployment, we can highlight three main conclusions:

**1/ All four major political parties are aware of the structural labour market problems.**

**2/ The measures the parties want to take are at least partially in line with the recommendations set out by the OECD.**

**3/ For certain measures, there is a convergence of the proposals of the political parties, which opens the door to coalitions of parties on the same political side (left or right) or relatively centrist parties (PSOE and Ciudadanos).** We can therefore imagine ad-hoc coalitions for passing specific laws. For example, with regard to school grants, the left-wing parties (Podemos and PSOE) agree to increase their amount and quantity regardless of their effectiveness, while the right-wing parties (C's and PP) seek to control their effectiveness. In the same way, the left-wing parties want to continue to increase the minimum wage while the right-wing parties do not mention any reform of this issue.

\* \* \*

Despite this awareness of the structural weaknesses of Spanish employment, there are still two limitations that could delay the vote on structural reforms.

On the one hand, the outcome of the elections shows that the Parliament will be very fragmented and that no party by itself has an absolute majority (necessary to vote on the reforms it wants to conduct). And even though coalitions are likely to emerge, it remains likely that the next government will be a minority government and will therefore be blocked in its draft bills submitted to Parliament.

On the other hand, it can be seen that the parties propose measures generating public spending more than income, and that no party provides figures in its electoral programme on the spending associated with the measures it proposes. However, the issue of financing the reforms could become a constraint for the next government, as debt still remains very close to its record level (97.4% of GDP in 2018 versus 100.4% in 2014) and therefore requires real structural efforts to cut spending to continue its reduction (even though the cyclical effects linked to growth are likely to run out of steam in the short term). Moreover, the future draft budget could still be exposed to political risk if the future government is a minority government because it could not then adopt it, as was the case at the beginning of the year for Pedro Sanchez.

<sup>7</sup> These recommendations are drawn from the Spanish Economic Studies produced by the OECD in March 2017 and November 2018.

The four annexes below each focus on a labour market theme and are constructed in the same way. Each OECD recommendation has a corresponding number and the measures proposed by the four main Spanish parties associated with it are preceded by the same number. We also highlight measures by parties that do not respond to the OECD recommendations and these are preceded by a dash.

**Appendix 1: Measures to combat youth unemployment and OECD recommendations**

OECD	<ol style="list-style-type: none"> <li>1. Introduction of a basic supplement for young people who sign apprenticeship or training contracts</li> <li>2. Improvement in vocational education and training (VET), ensuring that young people's skills at the end of their studies are compatible with companies' needs by making employers take part in the training of young people</li> <li>3. Reduction in employers' social contributions for young people with low skill levels on permanent contracts (to make it easier for them to find employment)</li> </ol>
Unidos Podemos	<ul style="list-style-type: none"> <li>- 50% reduction in the contribution period required to obtain unemployment benefits for those aged under 30</li> <li>- Increase in the duration of unemployment benefits for those aged under 30 (from one-third to one-half of the time worked)</li> </ul>
PSOE	<ol style="list-style-type: none"> <li>2. New shock plan for youth employment for 2019-2021 (50 measures and €2 billion) to improve employment and training opportunities for young people (in particular by improving basic digital skills) and hire an additional 3,000 guidance counsellors during the next three years</li> </ol>
C's	<ol style="list-style-type: none"> <li>1. Creation of a guaranteed additional wage (gradual implementation, starting with young workers)</li> <li>2. National strategy for vocational training: doubling of vocational training places in work-linked training</li> </ol>
Partido Popular	<ol style="list-style-type: none"> <li>1. Continuation of the 2017 shock plan for youth employment : approval of a statute for internships outside employment contract, employment policy programme for the young without professional skills, launch of a training and knowledge transfer programme in terms of employment via bridging contracts</li> <li>2. Strengthening of public-private cooperation for services to help people return to employment (social services, employment services and companies)</li> <li>3. Reduction in social contributions for companies that hire young people</li> </ol>

**Appendix 2: Measures to combat long-term unemployment and OECD recommendations**

OECD	<ol style="list-style-type: none"> <li>1. Improvement in support services for job seekers (Spanish employment agency) to ensure a more individualised follow-up of job seekers (and thereby reduce the time spent on job hunting): innovative profiling tools (digital), better specialisation for counsellors, etc.</li> <li>2. Increase in the rate of counsellors per job seeker</li> <li>3. Reduction in employers' social contributions for long-term job seekers with low skill levels on permanent contracts (to make it easier for them to find employment)</li> </ol>
Unidos Podemos	-
PSOE	<ol style="list-style-type: none"> <li>3. Continuation of the Rein corpora-t programme (for example, 5% of public contracts are reserved for long-term unemployed)</li> </ol>
C's	<ol style="list-style-type: none"> <li>1. Development of a national statistical profiling and matching system between labour supply and demand (by drawing on Big Data), development of an individualised work guidance system to adapt vocational training to each job seeker's needs</li> <li>1. Implementation of an incentive reward system for the training centres that deliver the best results in terms of returning job seekers back to employment</li> <li>- Systematic assessment of employment policies to improve their efficiency</li> </ol>
Partido Popular	<ol style="list-style-type: none"> <li>1. Modernisation of public employment services: extension of the most advanced systems to improve the guidance processes, preparation of individualised career paths and intermediation with job seekers</li> <li>3. Reduction in social contributions for companies that hire long-term unemployed</li> <li>- Tax exemption on earnings during the first two years for long-term unemployed who create a company</li> </ol>

**Appendix 3: Measures to improve the skill level of the labour force and OECD recommendation**

OECD	<ol style="list-style-type: none"> <li>1. Improvement in school success so young people leave the educational system later (by intensifying support tailored to the individual needs of pupils at academic risk in early grades)</li> <li>2. Improvement in skills to ensure that they are better matched to future labour market needs (whether through university education or life-long learning)*</li> <li>3. Increased spending on training and job search for job seekers</li> </ol>
Unidos Podemos	<ol style="list-style-type: none"> <li>1. Increase in the number and the amount of scholarships (which depend only on the beneficiaries' economic situation)</li> <li>1. Free mandatory education (books, school materials and canteens at all levels) for families in vulnerable socio-economic situation, free university</li> <li>1. Shock plan against school dropout and premature school leaving</li> </ol>
PSOE	<ol style="list-style-type: none"> <li>1. Creation of a Great Education Pact to ensure that investments in education and scholarships reach 5% of GDP by 2025</li> <li>1. Modernisation and improvement in the scholarship system for all students and all education levels</li> <li>1. Gradual introduction of a system that guarantees free initial registration for undergraduate studies in public universities</li> <li>2. Adoption of a new law for the modernisation of education that will include more sustainable development, digital capacity, etc. in school programmes</li> <li>2. Improved coordination between the school education system and vocational training for employment</li> </ol>
C's	<ol style="list-style-type: none"> <li>1. Strengthening of education to develop extracurricular support (as an alternative to repetition and dropout), establishment of innovative programmes in cooperation with civil society to fight dropout and premature school leaving</li> <li>1. Equalisation of university registration costs across all Spanish communities</li> <li>1. Increased financing of university scholarships across Spain (with a scholarship observatory, an independent body in charge of controlling, assessing and monitoring the scholarship policy)</li> <li>2. System of incentive awards (via additional funds) for university faculties and departments with the best results in terms of research, innovation, knowledge transfer and employability</li> <li>2. Transparency of schools' educational outcomes (weighted according to the socio-economic environment) to target schools that need funds and additional teaching staff</li> <li>2. Establishment of an internal training system coupled with an entrance exam (like the "Medico Interno Residente" for doctors), to attract the best to the teaching profession and develop their full potential, establishment of a teaching profession status to give them a real professional career and put an end to the abuse of temporary work in education</li> <li>- Fostering harmonisation of school programmes between autonomous communities and establishment of national apprenticeship standards</li> </ol>
Partido Popular	<ol style="list-style-type: none"> <li>1. Promotion of an overall policy in terms of scholarships that takes into account not only the students' economic and social situation, but also their efforts</li> <li>2. Creation of a digital application to inform employed workers and job seekers on the educational offering provided by the national employment system, with details on programmes and centres that have the best results</li> <li>3. Facilitating access to training centres (notably thanks to a training premium that will enable the beneficiary to freely choose the training services provider)</li> <li>- Extension to all autonomous communities of undergraduate level education and basic vocational training to ensure that this stage does not fall outside the current financing system</li> </ol>



**Appendix 4: Measures to combat precarious work and labour market duality and OECD recommendations**

OECD	<ol style="list-style-type: none"> <li>1. Reduction in and convergence of termination costs for temporary and permanent contracts (for example by introducing a single permanent contract for new employees, for whom severance pay is low at the outset and then gradually increases with seniority)</li> <li>2. Fight against abuse of temporary contracts by companies</li> <li>3. Increase in the minimum wage</li> <li>4. Extension of preschool education from 0 to 3 years, increase in the length of paternity leave and subsidies for parents of children aged under 3 (to increase the participation rate for women and fight part-time contracts that young parents have to accept)</li> </ol>
Unidos Podemos	<ol style="list-style-type: none"> <li>2. Strengthening of legislation against the abuse of temporary contracts: creation of a single type of temporary contract that must be exceptional and justified by the company, ban on temporary contracts shorter than one month, automatic transformation of temporary contracts longer than 6 months into permanent contracts (to avoid the linking of temporary contracts), penalties for companies that use temporary contracts excessively by increasing their employer social security contributions, establishment of a specific control programme in particularly precarious sectors, etc.</li> <li>3. Minimum wage of €1,200 per month during the next parliamentary term</li> <li>4. Equal, non-transferable paternity and maternity leave</li> </ol> <ul style="list-style-type: none"> <li>- Implementation of the prevalence of industry level agreements to avoid a deterioration in working conditions through company-level agreements, re-establishment of the "ultra-activity" of agreements (i.e. automatic renewal if no new agreement is signed)</li> <li>- Introduction of the 34-hour work week</li> <li>- Putting an end to the fraud of false self-employed (campaign of labour inspection in companies, redefinition of the subordinate relationship worker-employer) and to overtime fraud</li> <li>- Making permanent contracts really stable (40% are terminated after one year according to Podemos): repeal of two Zapatero and Rajoy labour reforms and establishment of regulations (adjusted to the economic situation) for dismissals for economic reasons</li> <li>- Creation of a guaranteed minimum income (initial amount per adult: €600 per month, which will increase according to the number of household members up to €1,200). This guaranteed income will periodically be adjusted with the highest value of the CPI and average wage growth. The plan is that this reform will cover 10 million people</li> </ul>
PSOE	<ol style="list-style-type: none"> <li>1. Simplification of labour supply in three contractual forms: indeterminate, temporary and formative</li> <li>2. Fight against abuse of temporary contracts: transformation of irregular contracts into permanent contracts, more stringent criteria for hiring on temporary contracts</li> <li>3. Gradual increase in the minimum wage to reach 60% of average income</li> <li>4. Extension of paternity leave from 8 to 16 weeks over the next three years, so that paternity and maternity leave are equal and not transferable, development of free nursery schools for children aged 0 to 3 (starting with the most vulnerable families)</li> </ol> <ul style="list-style-type: none"> <li>- Fight against irregular part-time work (by forcing the recognition of overtime), against abuse of training contracts and false self-employed</li> <li>- Change to the special regime for self-employed workers so they contribute according to their real income</li> <li>- Further development of the blueprint for decent work until 2020, by putting the emphasis on a reduction in temporary work and forced and in fraudulent part-time work in the recruitment process for young people</li> </ul>
C's	<ol style="list-style-type: none"> <li>1. Elimination of temporary contracts: all contracts will be permanent</li> <li>2. Plan to fight against fraud in social and labour regulations (with the use of innovative technological tools and Big Data)</li> <li>4. Extension and equalisation of maternity and paternity leave to 16 weeks for each parent, creation of a "childcare voucher" so families can cover the cost of a place in an approved centre of their choice, financing of the gradual creation of new places in centres subsidised by public funds in a balanced manner with a new Concilia 3 plan</li> </ol> <ul style="list-style-type: none"> <li>- New legislation to favour self-employed: no contributions to pay if their real income is lower than the annual minimum salary, no obligation to pay VAT up front on invoices that self-employed and SMEs have not received, same unemployment system as employees, etc.</li> </ul>
Partido Popular	<ol style="list-style-type: none"> <li>1. Introduction of mechanisms to encourage hiring on permanent contracts</li> <li>2. Mechanism to sanction unwarranted hiring on temporary contracts: increased sanctions against companies that use temporary contracts without reason, strengthened role of collective bargaining to limit the use of temporary contracts and correct abuses of temporary contracts, limiting the linking of temporary contracts</li> <li>4. Maintaining "0-3 vouchers" of €1,000 per year to support families with children aged under 3 for childcare costs and school fees as well as childcare professionals</li> </ol> <ul style="list-style-type: none"> <li>- Application of a reduced tax tariff for self-employed whose income does not exceed the annual minimum wage</li> </ul>

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