
Spain's labour market reforms: the road to employment – or to unemployment?

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Laszlo Horwitz and Martin Myant

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Introduction

Spain experienced, after the crisis of 2008, one of the largest falls in employment and also one of the largest increases in unemployment of all EU member states. Since 2010, far-reaching reforms, billed as making the labour market more flexible and efficient, have been implemented. It has been claimed that these so-called ‘structural reforms’ are the key to reducing unemployment levels (Government of Spain 2012). The aim of this paper is to evaluate these reforms against their own stated objectives. In view of the short time-frame, the assessment cannot be definitive and the paper can consider only the reforms introduced up to and including 2012.¹ Nevertheless, the very clear conclusion is that these reforms failed to achieve the stated goals. Indeed, the implication of the analysis here is that, if Spain is to overcome the structural labour market problems that the country is facing, a focus on internal flexibility needs to be coupled with a reduction, rather than an increase, in external flexibility.

This paper will be structured as follows. The first section outlines the reform measures undertaken in 2010 and 2012, the views of the principal critics and the comments from international agencies. The second section sets those arguments against economic theory and against the past operation of the Spanish labour market. Subsequent sections set out evidence for the effects of the reforms in practice.

1. These were (1) the Royal Decree 10/2010, on measures to reform the labour market, passed into law 35/2010 of 17 September 2010 and (2) the Royal Decree 3/2012 of 10 February 2012, on urgent measures to reform the labour market, which became Law 3/2012 of 6 July 2012. Additional reforms were implemented in 2013 and 2014, but their effects cannot as yet be assessed.

1. The reform packages of 2010 and 2012

The reform packages of 2010 and 2012 were billed as reducing labour market dualism and increasing flexibility, the existence of the former and lack of the latter being seen as barriers to employment creation in the aftermath of the crisis. The further aim of reducing wages was included under the heading of ‘aligning pay with productivity’.² The emphasis was very firmly on liberalisation and a reduction in regulation. Active labour market policies played very little role, with spending in that area having begun to fall by 2011 (ILO 2014b: 101-104). The main components of the two most relevant reform packages since the beginning of the economic crisis – Royal Decree 10/2010, which passed into law 35/2010 of 17 September 2010 and Royal Decree 3/2012 which became Law 3/2012 of 6 July 2012 – can be classified under the following three points.

1.1 Collective bargaining

The 2010 reform allowed for modification of multi-employer agreements through bargaining at company level. The 2012 package took this further, giving absolute priority to enterprise-level agreements over higher-level agreements and allowing firms to opt out of a collective agreement, even in the absence of consensus between the two sides of industry, for reasons of an economic, technical, production-related or organisational nature. The legislation thereby entitled employers to introduce unilateral changes to working conditions, such as working hours or wages.

Moreover, the extension of collective agreements beyond their expiry date, if no new agreement was reached, was to be limited to a maximum period of one year. After this so-called *ultra-actividad*, the agreement would cease to be valid; workers would then be covered either by higher-level collective agreements or, if these were not in place, by the legal minimum protection, which would often mean a significant deterioration in their working conditions. This new legal stipulation gives employers greater leverage, as they can insist on entering only such new agreements as would be more favourable to themselves.

According to the Spanish government, the purpose of this reform is to discourage dismissal as the response to economic downturns by allowing,

2. This comes with the highly questionable assumption that excessive wage levels had contributed to Spain’s economic difficulties. As shown by an ILO study, real wage growth in Spain in the years 2000-2007 could not be considered excessive (ILO 2014b: 41-3).

instead, for internal workforce flexibility measures (Government of Spain 2012). Thus reductions in wages or numbers of hours worked could be decided as a means of reducing costs until the resumption of economic growth. Such an approach could appear as a step in the direction of the German system, referred to below, albeit minus the need for government support for shorter-time working and for agreement to be reached in practice with employee representatives who might well resist dismissals.

1.2 Promotion of permanent contracts

The 2012 reform created a new type of full-time permanent employment contract, the *Contrato de Emprendedores*, available to small firms with fewer than 50 employees. The formula allows employers to extend the trial period of new workers up to one year, compared with a previous limit of six months for qualified technicians and two months for other workers. During this trial period, workers can be dismissed for no reason and without compensation. Spain's trial period for firms with less than 50 employees thus became one of the longest among OECD countries.

There were some restrictions. In order to prevent misuse of the *Contrato de Emprendedores*, companies would qualify only if they had not engaged in collective or unfair dismissals within the six months preceding the starting date of the contract. Additionally, the trial period could not be made applicable to temporary employees who had previously been working for the enterprise.

To promote the use of such contracts, the *Contrato de Emprendedores* allows companies to claim several tax benefits. For example, in cases where the newly hired workers were previously in receipt of unemployment benefits, the employer is entitled to a tax deduction of 50% of the amount of benefit the worker would otherwise have received. If the newly hired worker is a young unemployed person, the tax benefit amounts to €3,000 for a first hire. In order to encourage stable long-term employment, companies are required, if they do not retain the worker in employment for at least three years, to repay these financial benefits (ILO 2014b: 134).

The stated reason for this reform is that it allows small firms that have been particularly adversely affected by the economic crisis not only to improve job matches through a longer trial period but also to ensure the economic sustainability of the post. By allowing these firms to lay off poorly performing workers as well as to react to unexpected economic changes within the first year of employment, the reform should lower the risk to the company entailed by a permanent contract. The Spanish government claimed to expect that the reform would promote recruitment of employees on permanent contracts and thereby mitigate the phenomenon of labour market dualism (Government of Spain 2012).

1.3 Employment protection

Changes to employment protection legislation were introduced in 2010 and 2012. In the 2010 package, the government claimed that the conditions for fair dismissal were merely clarified by the inclusion of explicitly economic, organisational, technical and production-related reasons as grounds for fair dismissal (OECD 2014b: 130). Severance pay under these circumstances was reduced to 20 days per year of employment instead of the previous 45 days. Simultaneously, the notice period was reduced from 30 to 15 days, irrespective of the length of employment. The reform thereby reduced the difficulty and the cost of *fair* dismissals.

As part of the 2012 reforms, monetary compensation for the *unfair* dismissal of workers on new permanent contracts was reduced to 33 days per year of service down from the previous 45. Unless the dismissal is based on illegal grounds, such as discrimination, the employee does not have the right to reinstatement, but only to a reduced monetary compensation. Additionally, the requirement of administrative authorisation for collective redundancies was abolished. These could henceforth be justified by an employer faced with a continuing decrease in revenue or ordinary income (ie excluding effects of quite exceptional circumstances unrelated to the firm's normal business activity, such as natural disasters) over three consecutive quarters. There is no requirement to prove that the dismissal is relevant for the future profitability of the firm.

All these reforms encountered fierce opposition from part of the Spanish population, reflected in multiple strikes as well as a general strike. The ILO was sympathetic to a trade union complaint that the *Contrato de Emprendedores*, in allowing small firms to extend their trial periods of new recruits to one year, were in breach of ILO convention 158. Alongside a confirmation that each country is solely responsible for deciding the appropriate length of a trial period, provided that this is done in good faith, the ILO Committee stated that until now, 'no direct link between the facilitation of dismissals and job creation has been demonstrated' (ILO 2014a: 61). It therefore invited the Spanish government to consider adapting this measure in consultation with the social partners.

The ILO backed procedural complaints voiced by unions about collective bargaining reforms on grounds of insufficient consultation and notice in relation to draft laws (ILO 2014c: 129). Although it had previously been possible for unions and employers' representatives to find common ground and to organise the decentralisation of collective bargaining in a way that was acceptable to both sides, these efforts at social dialogue were, according to the Spanish Labour Minister, 'clearly insufficient' to cope with the current labour market challenges (Molina and Miguelez 2013: 21). This explains the unilateral introduction of Royal Decree 3/2012 which allowed firms to opt out from and stop applying collective agreements.

Deaf to criticism, the Spanish Ministry of Employment and Social Security was not slow to conclude that the reforms were producing rapid and positive results. The claim was that 'despite seven successive quarters of recession, the faster pace of the credit squeeze and the loss of nearly 400,000 jobs in the public sector, the reform has managed to contain the increase in unemployment, stop the destruction of jobs and improve the flexibility of the labour market. It has allowed companies to adapt more easily to the economic context and has made our economy more competitive' (Government of Spain 2013: 4).

This assessment was echoed by various international organisations. According to the European Commission (2014b), the 2012 reforms included decisive measures in the direction of a broad set of goals, such as promoting internal flexibility as an alternative to job destruction, modernising and decentralising collective bargaining, and reducing labour market dualism.

The OECD evaluated the reform very positively, finding that, among other things, it improved 'de jure flexibility of the collective bargaining system in a way rarely seen before the crisis in either Spain or other countries of the Euro area' (OECD 2014a: 6). It claimed that there was evidence of definite positive results (discussed below) and saw the reforms as 'a significant step in the right direction' (OECD 2014a: 45), arguing that still more changes to increase labour market flexibility were desirable to overcome the structural weakness of Spain's labour market (OECD 2014a). BusinessEurope (2014) contributed to the eulogy, citing Spain's labour market reforms as a positive example of increasing labour market flexibility, while also requesting still further changes, notably to reduce the tax burden borne by employers by a lowering of social contributions.

The IMF too released various papers³ advocating labour market flexibilisation, claiming that it can be a way of reducing unemployment. In an IMF publication by Anderson *et al.* (2014), the reforms in Spain have accordingly been judged as promoting employment. However, as Aleksynka (2014) has shown, the methodology used in the IMF papers to reach these conclusions is severely flawed. Among other shortcomings, the authors base their evaluation on the World Bank Employing Workers Indicator which the World Bank itself no longer uses because it measures only the costs of employment regulation while disregarding the benefits.

Indeed, the arguments and evidence in support of the chosen policy direction are extraordinarily weak and the claims of success were coming so thick and fast as to lack serious credibility. The next section therefore looks more closely at the underlying theory before outlining how it will be tested in the case of Spain.

3. Bernal-Verdugo, Furceri and Guillaume (2012a,2012b); Crivelli, Furceri and Toujas-Bernaté (2012); and Furceri (2012)

2. The theory behind the policies

Following comparisons between the USA and Europe as a whole, the claim that high employment protection could lead to high unemployment has gained prominence in the thinking of international agencies and was embodied in OECD (1994) recommendations on the benefits of greater flexibility as well as being advocated by the findings of academic studies (e.g. Nickell 1997; Nickell *et al.* 2005). However, the basis for linking the two phenomena is in fact remarkably weak in two respects: at the level of a priori reasoning from economic theory it is flimsy; nor does it find support in empirical evidence.

Logical reasoning suggests two possible effects from strict employment protection, the more obvious being that it will discourage dismissals at times of falling demand. In view of the high costs of making workers redundant, employers will prefer to find other solutions, such as carrying the costs of employment themselves until such time as demand recovers; alternatively, they may seek to impose pay or working time reductions. The less obvious effect, pointing in the opposite direction, is a disincentive to increase employment at times of high or rising demand for fear that it will be difficult to shed unwanted labour should hard times return in the future. Likely discouragements to recruitment might include short trial periods, tough terms for collective or individual dismissals, and restrictions on altering workers' terms of employment once they have been settled.

If both of these effects are in operation, at least to some extent, strict employment protection could be expected to lead to greater employment stability over the course of the cycle with less recruitment in upturns and fewer dismissals in downturns. Any net effect on employment and/or productivity levels is thus not clear from theoretical reasoning alone. Even if the two effects balance out over time, greater employment protection might be expected to lower labour turnover which might be judged positively, insofar as it could lead to higher productivity and maintenance of higher employment levels by encouraging commitment and skills acquisition; it might be judged negatively, on the other hand, from a productivity standpoint, insofar as it would slow adaptation to changed circumstances. Empirical evidence is needed to determine whether either, or both, of these tendencies are significant and what impact they may have.

Empirical testing has been based on comparisons between different countries. It is possible to compare the effects of employment protection on indicators such as unemployment or employment in general, or more specifically labour

turnover, long-term unemployment, and responses to cyclical fluctuation. Even a first glance at the data shows that any relationship is unlikely to be strong. Unemployment levels are high both in some countries that record high employment protection and in others where it appears to be low. Labour turnover rates do not obviously follow levels of employment protection and nor does the incidence of long-term unemployment. Indeed, even agencies that proclaim the benefits of deregulation have to accept that any relationship between employment protection and long-term unemployment is weak, as evidenced by the OECD's admission in its discussion of Spain that any such correlation is, 'at best, small' (OECD 2014b: 18).

Even this concession to the limits of the relationship would appear to be an exaggeration. The most thorough empirical studies show that any claims of a positive impact on employment are highly sensitive to the inclusion, or exclusion, of particular countries (Avdagic and Salardi 2013; Avdagic 2015). In short, there is no empirical evidence, either way, of any relationship at all.

For this there are three obvious explanations. The first is that employment protection has the predicted effects (see above), with each cancelling out the other. The second is that while employment protection is indeed important, it is inadequately measured by the standard measures, namely, the OECD's EPL indices. These set boundaries for determining the index in terms of specific requirements, for example, for length of trial period, and the divisions chosen might not be those of most relevance to decision-makers. The third explanation is that any effects of employment protection come to appear relatively unimportant if considered alongside other factors. Thus employment depends much more on general economic development, on access to credit, on training and skill levels, and maybe even on active labour market policies. All of these factors could be expected to have a much greater impact on employment decisions than any fears about specific terms governing employment reductions at some future date should current business decisions turn out to have been misguided.

As will be seen below, Spain appears a particularly unconvincing case for supporting the argument that its strict employment protection might be the cause of its high unemployment. To maintain any such argument, a further twist needs to be added, bringing in an argument about labour market dualism. According to this argument, strict protection in a secure part of the economy has encouraged employers to increase their labour forces by offering new recruits fixed-term contracts which are, by definition, less secure. Thus with the downturn, a large part of the labour force is relatively unprotected and can be quickly dismissed. Adjustment is thus achieved by reducing overall employee numbers alone rather than by altering the terms of employment enjoyed by the more secure, permanent employees. This observation could be used as an argument for improving protection for those on fixed-term contracts but it is adduced instead as grounds for arguing that permanent employees enjoy too much protection. If that were reduced, so the argument goes, more permanent employees would be taken on.

Testing this claim empirically for one country over a short period is highly problematic. An OECD study (OECD 2014a) used a so-called ‘regression discontinuity model’. It looked for discontinuity in what were seen as key variables, such as numbers employed on permanent rather than temporary contracts, which could not be explained by the general development of the economy as expressed in aggregate employment and unemployment changes. Its conclusion was that there had been in Spain a small shift towards more hiring by big firms and towards more permanent contracts being offered; this finding was seen as a sign that the reform packages had delivered some positive results.

The method used by the OECD was unable to take into account all the other factors at play. For example, no account was taken of the changing sectoral structure of the economy, even though different sectors clearly have different employment practices. Nor was the method able to show effects on aggregate employment levels, but only shifts between types of employment contract. Thus although there might seem to be some indications that reduced employment protection would result in more permanent relative to temporary contracts, what further benefits such a shift might bring with it remained obscure.

We therefore choose a different method. We first provide a comparative overview of how the Spanish labour market operates, contrasting the reality with certain established claims about its specificity. We then consider each element of the reform packages separately and try to find indicators of any differences that might have been produced by their implementation. While there is some evidence of changes, these are best seen as increasing the already high level of external flexibility; there is no serious evidence of a move towards the kind of negotiated internal flexibility that would reduce the ease with which employers resort to external flexibility.

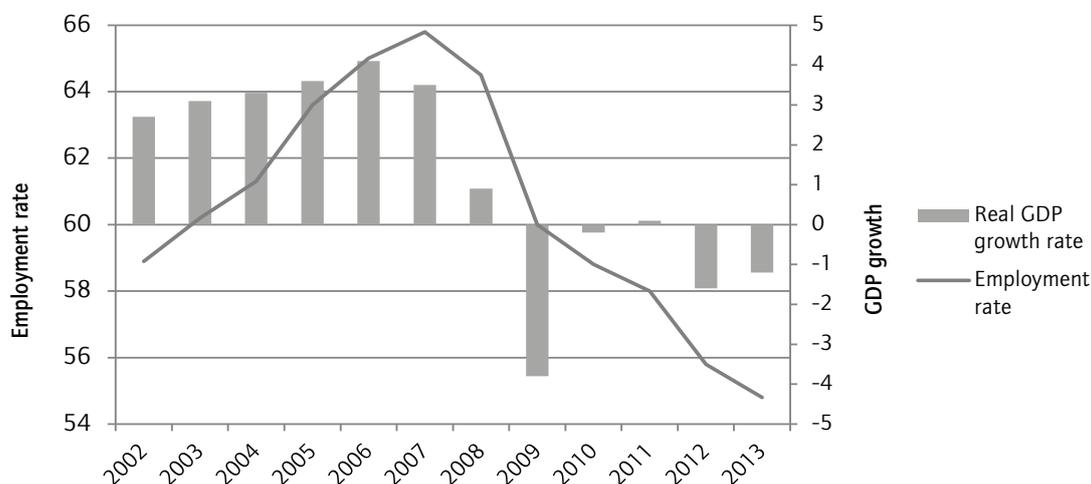
3. Spain's experience during the crisis

After 2007 Spain experienced the third highest increase in unemployment levels of the EU28, behind only Greece and Cyprus. In 2013, compared to the average EU28 unemployment rate of 10.8%, the Spanish level reached 26.1%. This followed past experience of large increases in unemployment during economic crises of the 1980s and 1990s, when unemployment had similarly approached 25% (Montalvo 2012). Such high unemployment levels indeed suggest the presence of some features specific to Spanish employment behaviour, but this need not necessarily signify a specifically labour-market-related problem, for the 'problem' could well pertain to other aspects of the economy. More than 40% of the job destruction in Spain from 2008 was in the construction sector and it could be argued that Spain was faced with a problem of economic structure that was exposed by the end of the easy credit that had financed the building boom, rather than with a labour market problem. Evidence in support of this view, and its policy implications, is pursued elsewhere (cf. Myant and Piasna 2014).

Levels of unemployment can be affected by changes in the size of the labour force, reflecting factors such as emigration or immigration or sections of the population becoming economically inactive. It is important, therefore, to look also at total employment and at the employment rate. Such comparison confirms that the decrease in GDP was significantly outpaced by the drop in employment. The following graphs set real GDP growth in four different cases against the employment rate.

Surprisingly, the Spanish employment rate was already falling in 2008, when GDP growth was still positive. In 2009, when the recession hit Spain fully, the employment rate dropped by 4.5 percentage points (meaning a 6.3% drop in total employment), outpacing the 3.8% fall in GDP. Compared to other European countries, the decrease in GDP was hardly striking. However, the responsiveness of the labour market, as seen by the reduction in employment, was exceptional. Even during the two following years, when the economy remained stable, employment continued to drop. Thus the Spanish labour market appears to have been highly flexible in terms of adjusting the number of employees even before the labour market reforms. Overall, during the six years after 2007, Spain was faced with a continuous decline in its employment rate, totalling a reduction of 11 percentage points.

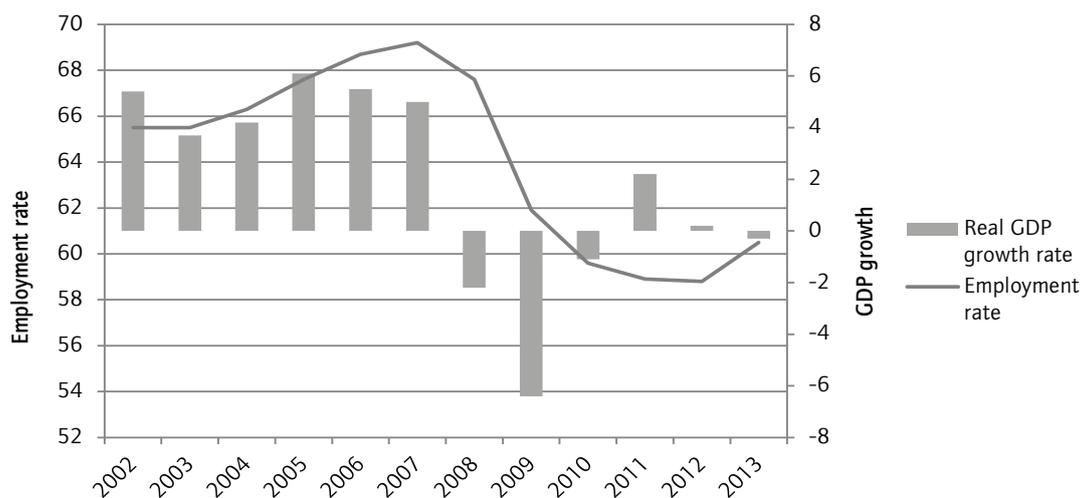
Figure 1 GDP growth and employment rate in Spain



Source: Eurostat (Ifsi_emp_a; tec00115), own calculations.

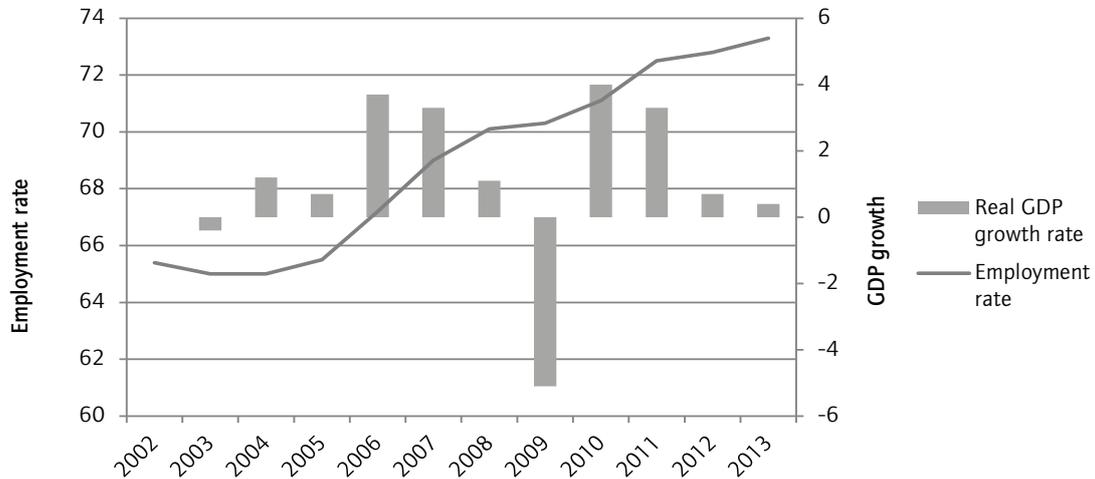
As Figure 2 indicates, while Ireland faced an economic crisis similar to that of Spain in terms of the fall in GDP, its employment rate started to decrease only once GDP had actually begun to fall. Even though in 2009 the 5.7 percentage-point drop in Ireland’s employment rate was steeper than that of Spain, this was less than the 6.4% reduction in its GDP. Ireland’s employment level was thus less responsive than Spain’s to movements in GDP. Moreover, the Irish employment rate showed some recovery after three years of economic contraction.

Figure 2 GDP growth and employment rate in Ireland



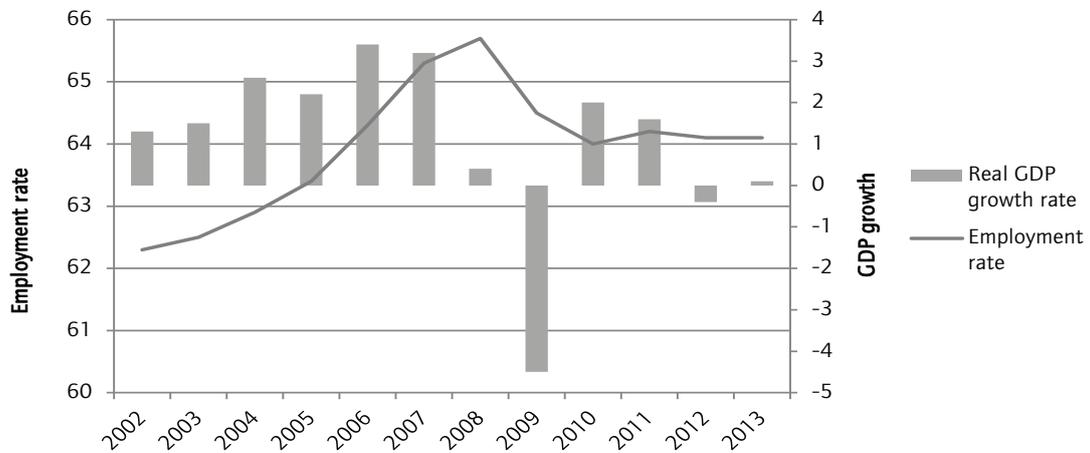
Source: Eurostat (Ifsi_emp_a; tec00115), own calculations.

Figure 3 GDP growth and employment rate in Germany



Source: Eurostat (Ifsi_emp_a; tec00115), own calculations.

Figure 4 GDP growth and employment rate in the EU28



Source: Eurostat (Ifsi_emp_a; tec00115), own calculations.

The case of Germany provides another important point of comparison. This country's GDP declined in 2009 by 5.1%, considerably more than the 3.8% decrease in Spain; and yet Germany managed to overcome the 2009 decline in GDP with a slightly increasing level of employment.⁴ This means that since resumption of Germany's economic growth in 2004, the employment rate has increased every year, despite several years of low levels of GDP growth and even negative growth in 2009. Lastly, a glance at the average of the EU28

4. This is the only time when employment rate and absolute employment differ. In terms of absolute employment, Germany experienced a decrease of approximately 0.2% in 2009 compared to the previous year.

shows once again Spain's specificity. The employment rate continued to increase during the slowdown of GDP growth in 2008. Not until 2009, when the GDP growth rate was -4.5%, did the EU28 employment rate begin to fall. However, as in the other cases presented above, the responsiveness of the employment rate was far below the drop in GDP. In total across the EU28, the employment rate fell by only 1.2 percentage points.

As this section has shown, compared to Ireland, Germany and the EU28, the Spanish labour market is characterised by a high degree of external flexibility. In other words, lower output leads quickly to lower employment. Explanations for this difference could be sought in the force of the demand-reducing shock, in the sectoral structure of the economy, and/or in generally weak levels of protection for employees. Insofar as all of these explanations would seem intuitively plausible, they are the first possibilities worth considering. There is no obvious basis to be derived from these comparisons for blaming the unusual behaviour of Spanish employment on excessive employment protection.

Such allocation of the blame requires a rather convoluted argument, within the context of a highly dualised labour market: a protected primary sector, so it is argued, encourages recruitment of labour into a highly (numerically) flexible secondary sector which then takes the brunt of adjustment processes. Because employees are so well protected in the primary sector, there is no incentive for employers to develop adjustment mechanisms based on internal flexibility. The next section sets out how this argument has been applied to Spain.

4. The story of Spain's labour market

Job losses after 2008 certainly did hit temporary workers much harder than those on permanent contracts. That is exactly as would be expected and it was a common trend across Europe. Even then, a plausible conclusion would be that the low level of protection granted to temporary contracts is the real underlying specificity of the Spanish labour market. The Spanish government has, however, as indicated, placed the emphasis on reducing dualism by worsening the conditions of those workers employed on permanent contracts.

In 2007, before the economic crisis hit, 88% of all newly concluded labour contracts were temporary, although this figure needs to be interpreted with some care as frequent renewal of such contracts means that it is in fact only a minority of the labour force who are affected by them. Moreover, other countries recorded similarly high figures, such as Italy or France, in both of which 78% of all newly concluded contracts were temporary (OECD 2014a: 23). The problem in Spain was said to be the very low transition rate between temporary and permanent contracts such that fixed-term employees are trapped in a rotation of temporary jobs to an even greater extent than in other countries.

Additionally, so it is argued, as a result of the institutional rigidities so prevalent in Spain, companies cannot make use of internal flexibility measures. Collective agreements typically contain a strict schedule for wage increases, which outpaces the rise in productivity. For this reason, so it is argued, instead of coping with economic downturns by adjusting wage levels or reducing working hours per employee, Spanish companies simply lay off workers employed on temporary contracts.

In this way, so the argument continues, Spain responds to economic crisis through adjustment of employment rather than through application of internal flexibility, leading to the steep rises in unemployment rates. This, incidentally, also complicates entry to the job market for young people who might be better equipped to deal with some of the challenges thrown up by the labour market. The lack of labour continuity and the threat of employment instability that hangs permanently over temporary employees affect the degree of willingness on both the employer and employee side to invest in training and development. This ultimately has an adverse effect on the competitiveness of the Spanish labour force (Montalvo 2012).

Germany, by way of contrast, despite suffering its worst economic crisis of the post-war period, experienced a so-called ‘employment miracle’, ending the recession with even higher employment rates than before its onset. Herzog-Stein *et al.* (2013) argue that the underlying reason for this success was the internal flexibility available to firms. More precisely, collective agreements enabled many employers to adjust to the economic circumstances by reducing their employees’ working time according to an arrangement whereby workers would be paid for each hour worked and would, in addition, receive 60% of the net wage for every hour not worked. Employers, accordingly, had not found it necessary to reduce their workforces in response to the business cycle.

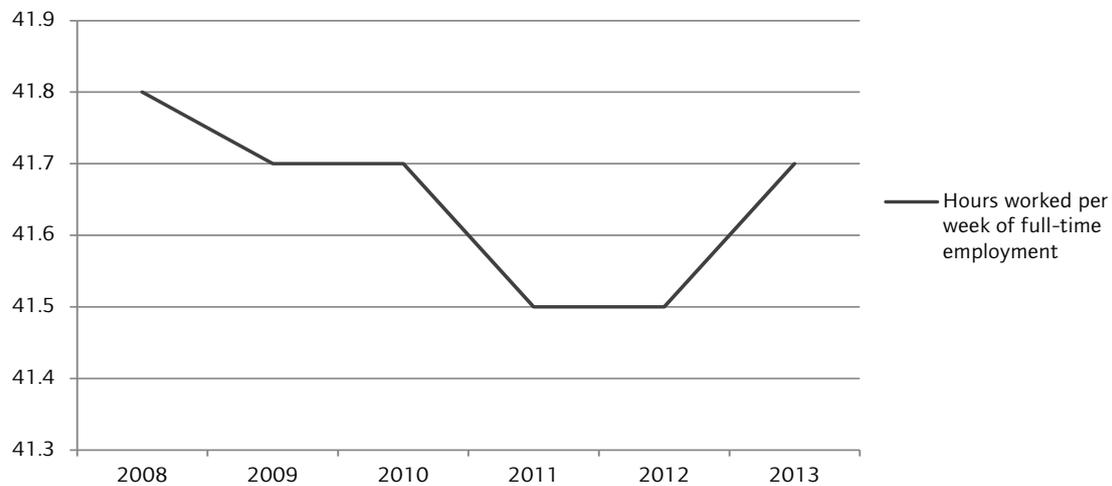
The Spanish reforms manifestly did not lead to the same set of conditions as in Germany. The Spanish government, as we have indicated, did not choose the road of social dialogue, but rather gave employers a much stronger hand to impose conditions they saw as desirable. The effects of the different components of the resulting reform packages are considered in the following sections.

5. Effects of changes to collective bargaining

To evaluate the impact of the collective bargaining reforms, we will look first at the number of hours worked per full-time employee as an indicator of one form of increased internal flexibility and secondly at wage developments.

It is significant to note that the average number of hours worked per week was decreasing before the reform. As illustrated in Figure 5, however, after implementation of the reform in 2012, the average number of hours worked weekly per full-time employee increased. Whereas before the reform the weekly average in Spain had been below the EU28 average, after 2012 Spain exceeded the EU28 level.

Figure 5 Hours worked per week of full-time employment in Spain

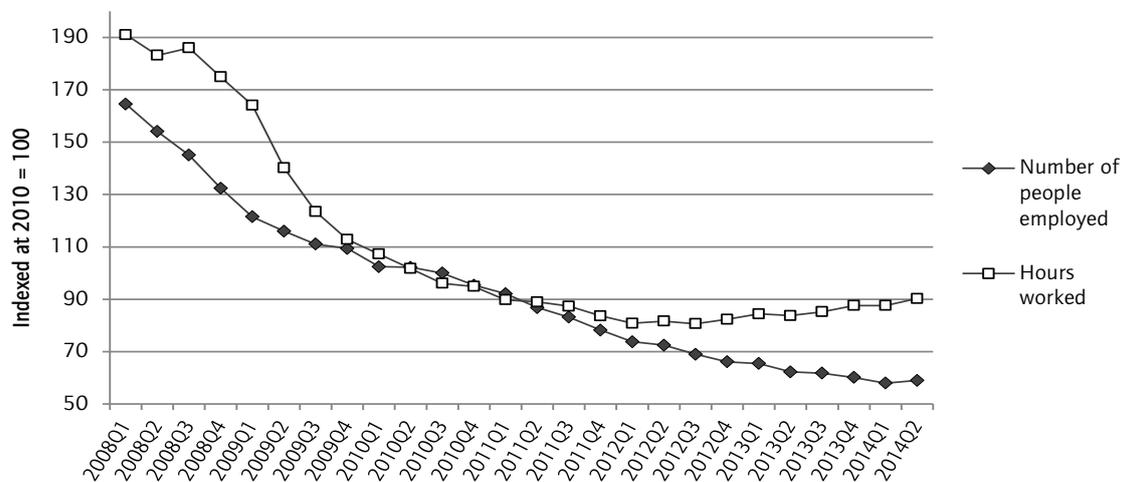


Source: Eurostat (lfsi_emp_a; tec00115), own calculations.

Developments in the construction sector, which represented more than 40% of the post-2007 reduction in employment, raise further doubts about the positive impact of the reforms. Figure 6 shows that seasonally adjusted hours worked, indexed at 2010, were decreasing up until 2012, after which the hours worked started slowly to increase once more. On the other hand, the seasonally adjusted number of employees in the construction sector, also indexed at 2010, continued to decline, despite the reform in 2012 and the increase in hours worked since then.

Thus in construction, as indeed in the Spanish economy as a whole, the reform has entailed no positive impact in terms of preventing employment losses through the reduction of hours worked per employee. Instead the average number of hours worked per full-time employee actually increased. Thus, either firms made no use of the internal flexibility measures available to them, or they used these measures to increase the number of hours worked per employee. Either way, the reform has not resulted in internal flexibility representing a viable alternative to dismissal.

Figure 6 Absolute hours worked in construction in Spain compared to number of people employed



Source: Eurostat (ei_isbu_q), own calculations.

Turning now to wage developments, OECD data (http://stats.oecd.org/Index.aspx?DataSetCode=AV_AN_WAGE) show an increase in average annual wages of 10.3% from 2007 to 2010 and then a fall of 6.3% to 2013. Much of this fall was due to changes in public sector pay that were the result of state budgetary decisions (cf. Myant and Piasna 2014). There is also a likely effect from restrictions on collective bargaining, the scale of which is difficult to estimate, not least because the largest pay reductions took place before the restrictions took effect.

Since the implementation of the reform in 2012, the registered non-application of clauses in collective agreements (derogations) has substantially increased. During the period immediately following the reform, from March to December 2012, 748 such derogations were registered affecting 29,352 employees. This number jumped to 2,512 derogations in 2013 affecting a total of 160,000 workers. Already in the first six months of 2014, more than 1,500 derogations were registered, indicating a further increase (Government of Spain 2014). According to the ILO (2014b), 92% of registered cases of derogation relate to wage levels and remuneration systems specified in the agreements. Hence, the ability of firms to opt out of collective agreements can be seen as a likely contributory factor to the reduction in average real wages in Spain.

An additional explanation for the lower real monthly earnings may well be introduction of the rule according to which collective agreements lose their validity one year after their expiry date. As a response to the reform, the rate of newly concluded collective agreements initially began to increase after 2011. While in 2011 only 1,362 agreements were reached, affecting 2.6 million workers, this number increased to 2,464 in 2013, with twice as many workers affected. From the most recent data, it seems that this upward trend was reversed in 2014, with only 1,091 agreements having been concluded up until October of that year, affecting 1.5 million people. This represents a 25% drop in the numbers of agreements reached, and a 61% reduction – compared to the same period in 2013 – in employees covered by newly concluded agreements.

There was also a small shift towards company-level agreements. While in 2011 76% of all agreements were concluded at company level, affecting 9.6% of workers covered by agreements, the proportion increased in October 2014 to 80% of agreements being concluded at company level, affecting 10.8% of covered workers (own calculation based on Government of Spain 2014).

The data also show that more old collective agreements expired than new ones were created. In 2013, only 2,371 collective agreements were active. This represents a sharp decrease compared to 5,987 collective agreements in place in 2008 and 4,585 in 2011, the year before the reforms. Critically, the number of workers covered by these agreements fell from 10.7 million in 2011, to 7 million in 2013, representing a fall of 34.6% over a period of only two years (Rocha 2014). Overall, coverage by collective agreement as a share of total employment was stable from 2008 at around 59%. In 2013, however, the percentage had dropped to 41%.

According to the OECD (2014b: 1), the falling wages in Spain have been 'helping to boost competitiveness'; the ILO (2014b: 12) on the other hand points out that 'further wage cuts would undermine domestic demand, outweighing any possible benefits that could arise in terms of higher exports'. Both types of outcome are plausible effects of wage reductions. The former could predominate only if lower wages fed through into lower export prices and if exports were strongly price-elastic. Evidence does not support these hypotheses. Wages have risen in many export-oriented sectors (perhaps suggesting that wages are a result rather than a determinant of export success). Moreover, the industries contributing most to Spain's export growth are among those characterised as high-value-added. Thus, 46.4% of export growth by Spain in 2013 came from technology-intensive industries, namely vehicles other than railway, nuclear reactors and other machinery as well as aircraft (calculated from the UN Comtrade database).

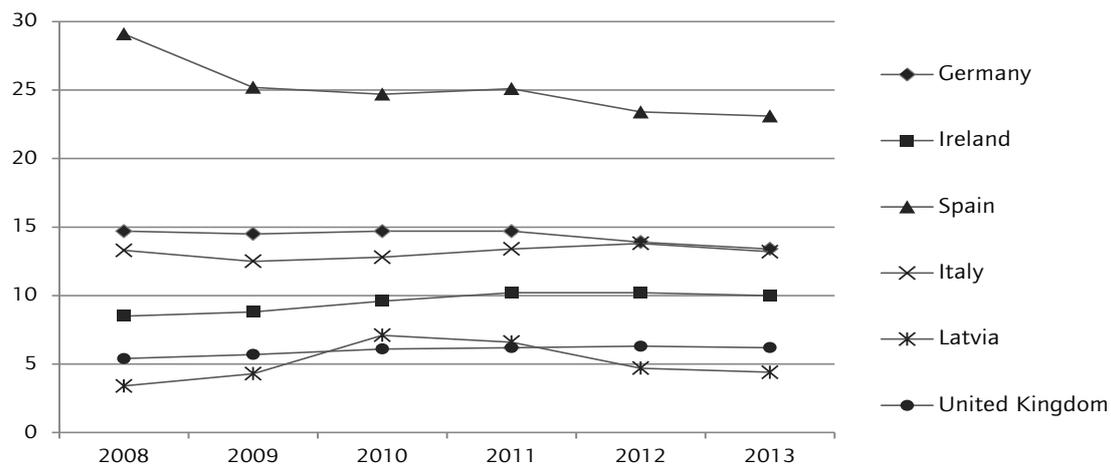
The conclusion to be drawn from the foregoing facts and figures must be that the reform has not led to any significant movements in the direction of sharing working hours to prevent dismissals. The development of this practice, however, was the success factor of the so-called 'German employment miracle' (Herzog-Stein *et al.* 2013). What this Spanish move – billed as improving internal flexibility – achieved instead was a severe reduction in wage levels.

Spain's economic growth of 2014, meanwhile, was spurred by rising exports in technology-intensive rather than labour-intensive industries. This means that the considerable rise, since the introduction of the reform, in company opt-outs regarding the wage components of collective agreements, was not the driving force behind any resurgence that may have taken place in the Spanish economy.

6. Effects of promotion of permanent contracts

The reforms made Spain the country with the longest trial period in civil-law OECD⁵ for new employee recruits to companies with fewer than 50 employees. This lengthening of the trial period should lead, according to the Spanish government (Government of Spain 2012), to an increasing share of permanent contracts in the labour force. The information supplied in Figure 7 might, at a first glance, appear to indicate that this reform has achieved its goal.

Figure 7 Share of employees with temporary contracts in six countries



Source: Eurostat (lfsi_emp_a), own calculations.

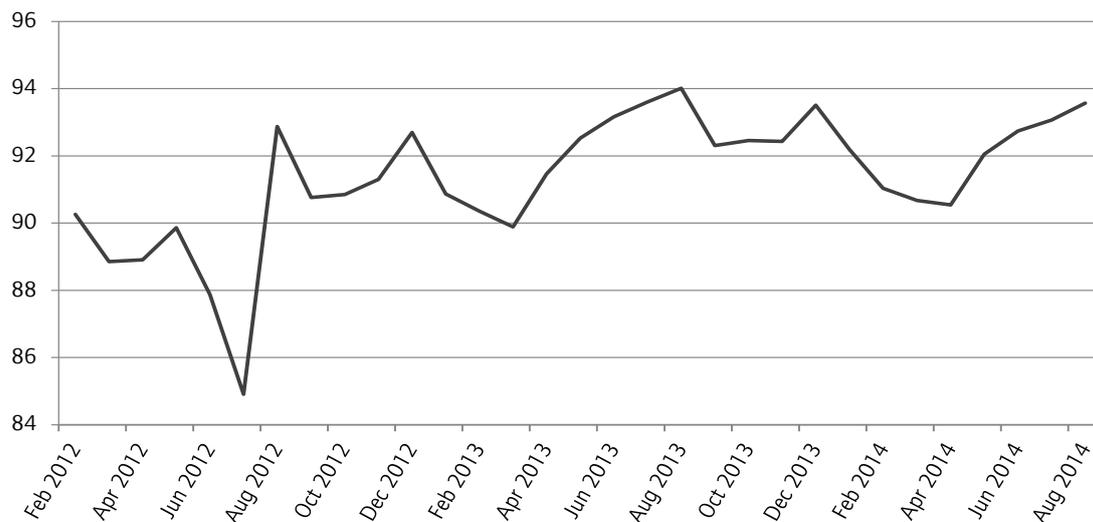
These data showing the evolution of temporary contracts do not, however, indicate that more people than before are being given permanent contracts. Rather, it shows that, as far as Spain is concerned, most of the dismissals were among workers employed on temporary contracts, something which we already know. Between 2008 and 2011 around 90% of total job losses were among temporary workers (ILO 2014b: 25-6).

Figure 8 demonstrates that there has been no positive effect of the reform on the issuing of permanent contracts. Within the first six months of the reform, there was indeed a decrease from 90.3% to 84.9% in the percentage of newly

5. Common-law countries typically have lighter levels of statutory regulation. In most US states there is no legal provision on unfair dismissal while in the UK there is a trial period of two years.

issued contracts that were temporary in nature; but this effect was quickly reversed, with temporary contracts as a share of newly issued contracts subsequently rising to 93.6% in August 2014, a significantly higher level than before the reform. Thus, in spite of fluctuations, there is certainly no clear downward trend.

Figure 8 Share of temporary contracts in newly issued contracts in Spain



Source: SEPE (http://www.sepe.es/contenidos/que_es_el_sepe/estadisticas/datos_avance/contratos/index.html), own calculations.

Finally, it should be mentioned that, between the adoption of the reform and June 2013, a total of 118,917 *Contratos de Emprendedores* were registered. According to the Spanish trade unions, in only 18% of those contracts did the employer make use of the tax concessions to which they give entitlement. The government rejected these claims stating that the number was in fact 45% (ILO 2014a: 33). Whichever figure may be closer to correct, the lack of interest in financial incentives shown by a majority of employers is indicative of the predominant motivation present when issuing this type of contract, namely the benefit to be derived from a long trial period during which employers enjoy the freedom to dismiss their workers easily. In other words, employers actually shun the financial incentives designed to create stable employment insofar as these will tie their hands by requiring them to keep on the new recruits for at least three years.

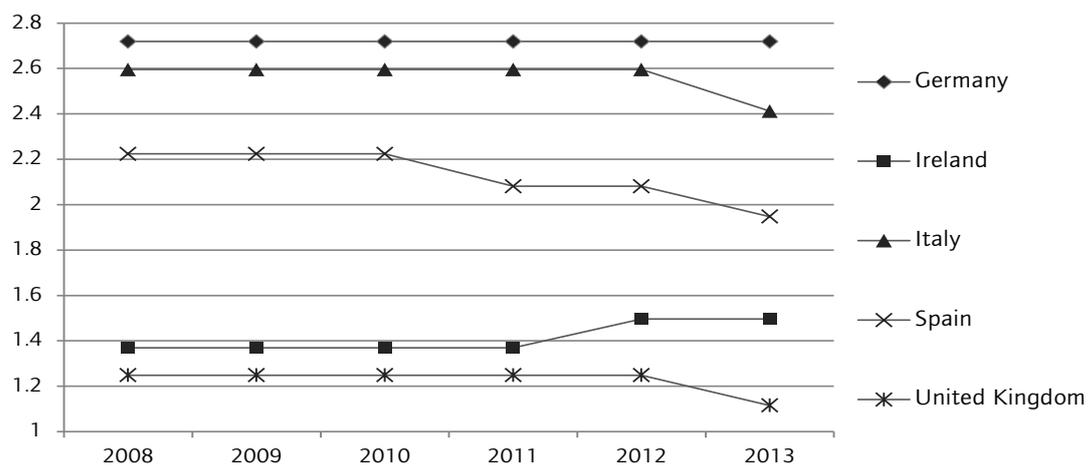
As with the first set of reforms, therefore, it is to be concluded that these further reforms have so far not contributed to any mitigation of labour market duality. Despite the claimed intention of giving employers incentives to hire on a permanent basis, the available empirical data indicates relatively little enthusiasm on the employer side to take up this incentive. One important interpretation of this lack of enthusiasm must be that, generally speaking, in the relatively few cases where employers have chosen to issue *Contratos de Emprendedores*, they show scant inclination to bind themselves to employees for at least three years.

7. Effects of changes to employment protection

To evaluate the impact of the third set of reforms, we will begin by demonstrating how, with regard to employment protection, Spain is now positioned in comparison to other European countries. We will then go on to show how employment and unemployment, including youth and long-term unemployment, have developed since the reforms were introduced.

According to the OECD (2014a), the reduction of the notice period from 30 to 15 days has made the Spanish economy more flexible than the average OECD country in areas such as notification procedures and the length of notice periods. Figure 9, based on OECD statistics, shows that the two reforms of 2010 and 2012 considerably reduced individual dismissal protection in Spain's economy. Compared to the selected comparators, Spain deregulated its labour market earlier, more often and more severely, under the premise that this would increase the efficiency and reduce the duality of the labour market (Government of Spain 2012).

Figure 9 Strictness of employment regulation on individual dismissals in five countries, OECD index



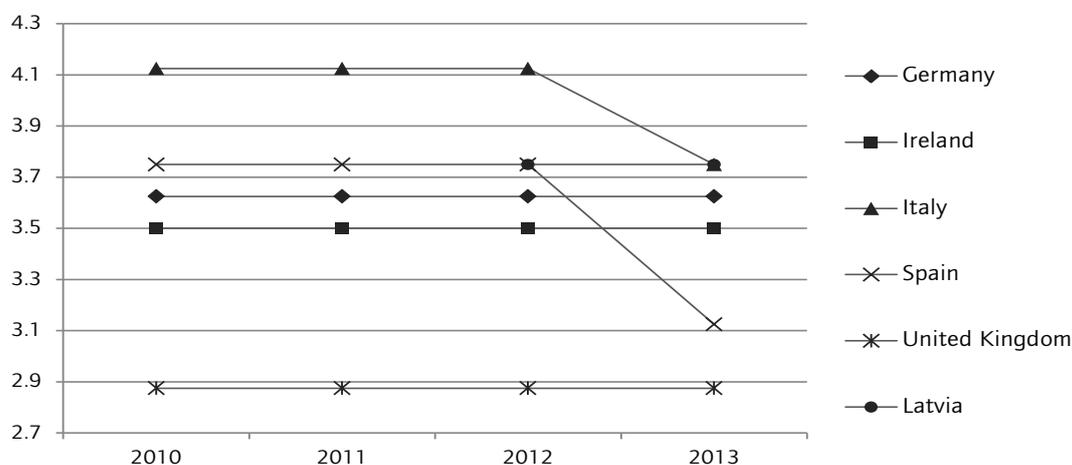
Source: OECD (http://stats.oecd.org/Index.aspx?DataSetCode=EPL_OV), own calculations.

In Ireland, a country faced with a similar economic crisis to Spain, the reform of 2011 led to higher protection against individual dismissal. Severance pay was increased for two categories of worker: those with 4 years of employment and those with 20 years of tenure. Rather surprisingly, this coincided with the time when in Ireland growth in unemployment was at a peak.

Germany, the country hailed as experiencing an ‘employment miracle’ during the recession, has the highest level of protection against individual dismissal among the cases considered here. Neither before nor during the crisis did Germany lower this high level of employee protection. It is thus clear that the rise in employment in that country during the economic crisis cannot have been based on lower employment protection motivating employers to increase hiring. To illustrate: in Germany, a worker cannot be dismissed if the works council or the trade union representatives are opposed to the step; if the employer maintains the decision to dismiss, authorisation of the relevant co-determination body or a court judgment needs to be obtained (Schömann 2014).

Turning to look at protection against *collective* dismissal, as shown in Figure 10, the reforms have resulted in a similar picture, with Spain becoming the second least strict country (after the UK) shown here. Of all OECD countries with available data, Spain enacted the most thoroughgoing reform to deregulate collective dismissals. Accordingly, the share of collective dismissals increased steadily after 2008, from about 5% to a peak of 20% of total dismissals in May 2013. Another reform in August 2013 limited the competence of the courts to reverse collective dismissals in order to reduce the insecurity of firms resorting to the new measures (OECD 2014a). It is realistic to expect that the ease with which collective dismissals can be carried out will further increase in the future.

Figure 10 Strictness of employment regulation on collective dismissals in five countries, OECD index



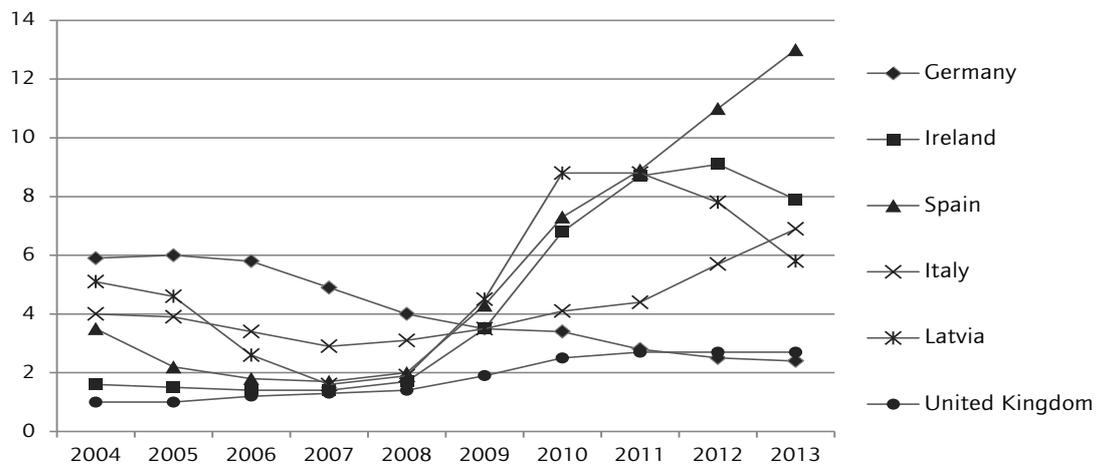
Source: OECD (Strictness of employment protection – collective dismissals), own calculations.

Monthly data for Spain do show changed trends in unemployment and employment. Registered unemployment peaked in February 2013 and then fell continuously as the employment rate increased from 55.5% in Q2 2013 to 56.8% in Q2 2014 (ILO 2014b). However, this is not necessarily linked to the labour market reforms. The highest growth levels in employment were experienced in the aircraft and vehicles-other-than-railway industries, with increases of 16.6% and 15.4% compared to the previous year. This job creation was directly linked to growth in exports and was a simple consequence of economic development.

Another change, more likely to be linked to the reforms, was a substantial increase in permanent employees being laid off. Their numbers reached a total of approximately three million between the first quarter of 2012 and the second quarter of 2014. In relative terms, this represents 60% of the overall job losses within this period (ILO 2014b) and is a striking change from the previous pattern according to which during economic downturns it was predominantly temporary workers who were laid off. The increase could reflect greater ease of dismissal, or simply the reduced scope for dismissing temporary employees after so many had already lost their jobs.

While this new development could be seen as implying a reduction in labour market dualism, the reality is rather a parallel worsening of conditions for both permanent and temporary employees. As a European Commission publication (2014c: 7) points out, temporary employees 'appear to have been penalised twice': not only were they affected by a high level of job losses but they were also disproportionately affected by severe wage cuts because, when their fixed-term contracts expired their wages were re-negotiated under the new contracts in order to adapt to deteriorating economic conditions.

Figure 11 Long-term unemployment as a share of active population in six countries, in %



Source: Eurostat (une_ltu_a), own calculations.

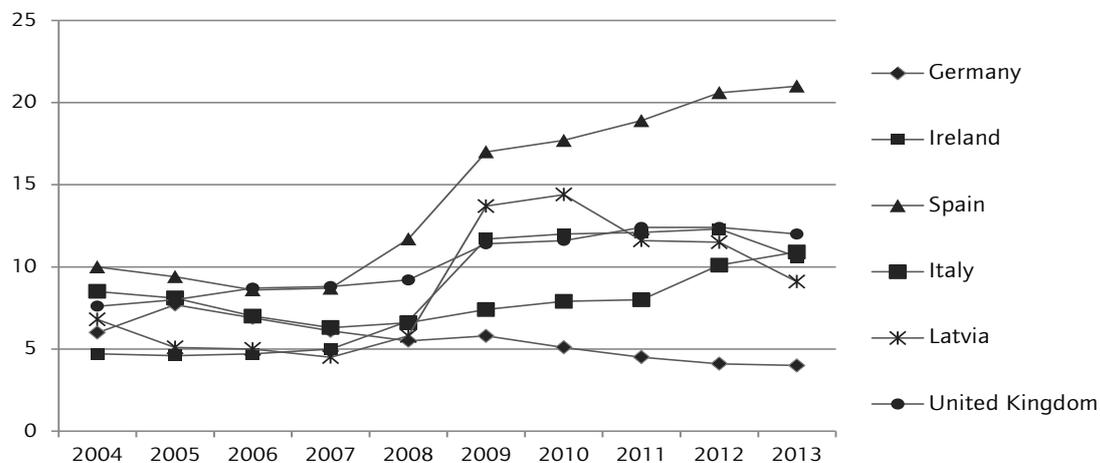
Nor did the long-term unemployed benefit from the reforms. Spain's long-term unemployment levels have escalated since the beginning of the crisis. As a percentage of the active population, long-term unemployment increased in Spain by 650% between 2007 and 2013. Contrary to claims by the Commission (2014a), the reduction in employment protection did not result in a reduction in long-term unemployment; instead, as a share of the active population, it continued to increase sharply independently of the reforms. Among the countries included in Figure 11, Spain has the highest rate of 13%, a staggering 5.1% more than Ireland (in second place). Spain's level is exceeded only by Greece (Eurostat, une_ltu_a, 2014). Simultaneously, the average duration of long-term unemployment has increased. This can be seen by the rising share of those unemployed for over two years: from the last quarter of 2007

to the last quarter of 2013, this rose from 8.7% to 31.5% (ILO 2014b). Such an increase is inevitably accompanied by the imminent risk of an increase in the levels of social exclusion and poverty.

Also contrary to the expectations of the Commission (2014a), the young labour market entrants did not benefit from these reforms. The youth unemployment rate in Spain reached 55.5%, the second highest (after Greece) within the EU28. What is particularly striking too is that, after 2010 when the first reform – lowering employment protection – was introduced, Spain's youth unemployment rate continued to increase by a further 34%.

However, since many young people are still studying and therefore not part of the labour market, these figures might be misleading. They should be read alongside the youth unemployment ratio, calculated as the share of young unemployed in the overall young population. As shown in Figure 12, Spain's ratio of 21% is not only the highest of all EU28 countries, but is also 4.5 percentage points higher than that of Greece, 16.5%, the country with the second highest ratio. Here too, Spain's ratio has continued to increase, despite the reforms in 2010 and 2012.

Figure 12 Youth unemployment ratio in six countries, in %



Source: Eurostat (lfsi_act_a), own calculations.

In conclusion, analysis of the annual data indicates that the reforms described here have had no beneficial effect on employment, unemployment, youth or long-term unemployment levels in Spain. Only when examining the monthly data – due to the lack of annual data for the year 2014 – can it be seen that since October 2013 there has been some rise in employment creation. Yet insofar as this was mostly driven by industries enjoying rising exports – according to the logic that employment follows economic development – there is no evidence of lower employment protection having contributed to this rise in job creation.

What is more, the employment protection reforms, rather than raising the level of protection of temporary workers closer to that enjoyed by permanent employees, have actually left the former in a still weaker position. Meanwhile, permanent employees too enjoy less protection than previously and are increasingly subject to dismissal. As our analysis has shown, the aim of reducing labour market dualism has not been served or, if it has, this must be merely as a result of a greater reduction in protection for permanent than for temporary employees. It remains unclear why either trend should be viewed as positive.

Conclusion

With the labour market reforms analysed in this paper, Spain has managed to reduce considerably its level of labour market regulation and protection. The reforms implemented by the Spanish government appear very much inspired by the various forms of labour market flexibilisation advocated by international agencies. Setting the reforms against their publicly stated aims, our data-based and analytical findings have shown the various measures to be failures. The alleged structural problem of labour market dualism, with a high proportion of temporary workers suffering from low levels of protection, has not been remedied. Most notably, and contrary to hopes expressed by the Commission, the reforms have not helped to reduce unemployment in general; nor, more specifically, have they contributed to the process of reactivating the long-term unemployed or facilitated the entry of young workers to the labour force. They have instead merely succeeded in reducing security both for those still in employment and for those entering or re-entering employment.

Explaining *why* the reforms failed to achieve their stated objectives is beyond the scope of this paper. Nor is it possible to draw general conclusions on alternative economic policies that might be effective, such as steps to raise demand, investment, education and skills levels and the technological level of the economy in general. However, confining ourselves to the relatively narrow and probably secondary area of the labour market taken on its own, we can point to some specific alternatives. The comparisons with other countries cannot elicit full explanations for Spain's performance: much of the high unemployment must be attributable to the preceding heavy dependence on the construction industry – marking a clear distinction from, for example, Germany.

Nevertheless, it is striking that the so-called 'German employment miracle' was at least to some extent the outcome of cooperation among the social partners, in contrast to the imposition of change by the government as practised in Spain. In Germany, through cooperation on working time entailing a temporary reduction of working hours, more jobs could be created. This outcome was produced not by labour market flexibilisation, which entails a diminution of workers' rights, but by active recourse to institutionalised labour market regulations, namely active cooperation between the employers' associations and labour unions (Herzog-Stein *et al.* 2013).

The path taken in Spain was different. Adjustment to lower demand during and after the crisis was achieved by external flexibility, in other words, reductions in employment. The extent of such recourse is illustrated by the fact that employment fell more than GDP. Despite all the rhetoric about reducing labour market dualism, reforms have left a continuing gap between permanent and temporary employees by reducing, through changes in the law, forms of protection that had existed for both categories and by narrowing the scope of collective bargaining and employee representation. Contrary to the Spanish government's stated expectations, but in line with what would intuitively be expected, the reduction in employment protection has led to less and not more employment. Encouraging internal, rather than external, flexibility depends on cooperation between employers and employees and such flexibility would be fostered by greater security of employment for all categories of employee. The policies pursued in Spain have worked in the opposite direction and have therefore contributed to deepening and prolonging the country's economic depression.

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