Spain: the mixed effects of job market reforms

- **The job market reforms of 2012 are emblematic of the efforts Spain has had to make in recent years.**
- **The reforms aimed to give Spanish companies greater internal flexibility and to restore their competitiveness. They were also designed to reduce the duality of the job market.**
- **Although it is still too early to fully evaluate the impact of these reforms, they already seem to have had direct effects on wages and employment. Nonetheless, companies continue to favour temporary job contracts.**
- **The job market situation is still bad. The unemployment rate is holding at very high levels, especially for the long-term unemployed and youth.**

After GDP plunged by more than 9% between 2008 and 2013, Spain had to undertake major efforts to revive growth and begin creating jobs again. Its labour reforms are emblematic of these efforts. Implemented for the most part as of 2012, these reforms helped get the country back on track to growth and job creations as of 2014 (+938,000 since Q4 2013). Coupled with a shrinking active population -- the combined effect of emigration[1] and an aging population -- these reforms helped bring down the unemployment rate as of summer 2013. Unemployment has declined by six points from its May 2013 peak (to 20.4% in March). Yet the job market situation is still bad. The unemployment rate remains high, especially for young and long-term unemployed *(chart 1)*. The job market is still fragmented, split between permanent jobs on the one hand and temporary jobs on the other.

Ambitious job market reforms

Spain began overhauling its job market as early as 2010. Yet the most ambitious reforms were launched in 2012 under Mariano Rajoy's right-wing People's Party (PP) government. These reforms aimed at giving companies greater internal flexibility and restoring their competitiveness by aligning labour costs with productivity gains. They also tended to reduce the duality of the job market.

[1] *The active population has declined by 618,000 since Q3 2012. With net emigration nearing 102,000 in 2014, after 251,531 in 2013 according to Eurostat, Spain's population has declined by 395,000 since 2012.*

Stubbornly high unemployment

Unemployment rate (%)

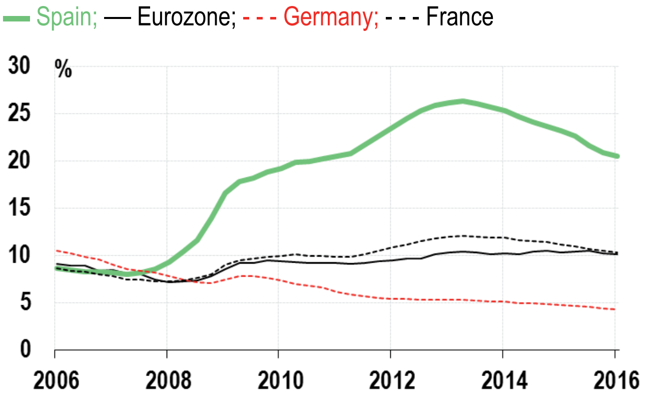

Chart 1 Source: Eurostat

Employment: the main adjustment variable

Change, year-on-year (%)

Chart 2 Sources: INE, OECD

Internal flexibility: a more favourable framework

At the height of the crisis, companies preferred to eliminate jobs rather than reduce wages or the number of hours worked *(see chart 2)*. Hoping to limit the economic slowdown's impact on employment, in 2012 Spain began promoting firm-level collective bargaining agreements (basic wage, supplements and overtime pay, distribution of working hours) to make sure that company specificities were better taken into account. As long as the minimum standards specified in collective agreements were met, companies could now opt to unilaterally modify the labour conditions of their employees (wages, working hours). With the consent of employee representatives, companies could even opt out of collective bargaining agreements negotiated at the national, regional or sector levels. The reform was also designed to encourage labour and management to renegotiate the agreements on a more regular basis. Agreements were only valid for a year after their termination, after which the collective bargaining agreement at the next level up became applicable. The reform also facilitated partial unemployment. Companies were allowed to vary working hours of their employees by up to 10% thanks to a "working hours bank".

Easing dismissal regulations

Dismissal procedures were eased (*see chart 3)* and the notion of layoffs on economic grounds was also revised. Companies reporting losses or experiencing three consecutive quarters of year-on-year declines in sales or revenues are now allowed to terminate job contracts on economic grounds. In cases of unjustified dismissals, the amount of compensation was capped at 33 days per year of service and a maximum of 24 months' pay (as opposed to 45 days per year of service and 42 months' pay, previously). Companies no longer have to pay "pending" wages for the period between notification of dismissal and final judicial resolution. Administrative authorisation is no longer required for collective layoffs.

Promotion of permanent job contracts

Temporary jobs were a form of employment widely used by companies when the crisis broke out. Temporary employment as a share of total payroll employment was 31.5% in 2007, compared to a eurozone average of 16.4% for the same period. Temporary employment thus became the main adjustment variable when the economy collapsed. Nearly 60% of the 3.7 million jobs destroyed between late 2007 and late 2013 were temporary jobs. Its share of total employees dropped to a low of 21.9% in Q1 2013.

Alongside efforts to ease dismissal procedures for permanent jobs, labour reforms also sought to curb the use of short-term contracts by increasing the compensation paid when contracts were terminated (12 days of pay per year of service as of 1 January 2015). Companies also benefited from a reduction in employers' charges when training and apprenticeship contracts were transformed into permanent contracts. A new type of permanent contract was also created for companies with fewer than 50 employees. Known as a "company support contract", it provides a 1-year trial period and reduced fiscal and social contributions.

Impact of job market reforms

Boosting companies' competitiveness

Job market reforms had little impact on the number of collective agreements signed at the company level. There was not a very big increase in these agreements, which cover a small number of employees. According to an article by the think tank Funcas[2], the share of company-level agreements rose from 75.7% in 2006 to 77% in 2014. Moreover, these agreements covered 11% of employees in 2006 and 8.4% in 2014. SMEs in particular continued to favour regional sector agreements. Small business leaders do not always have the resources necessary to carry through negotiations, and their employees do not necessarily have employee representatives.

Job protections are scaled back

Strictness of employment protection - Individual and collective dismissals (regular contracts)

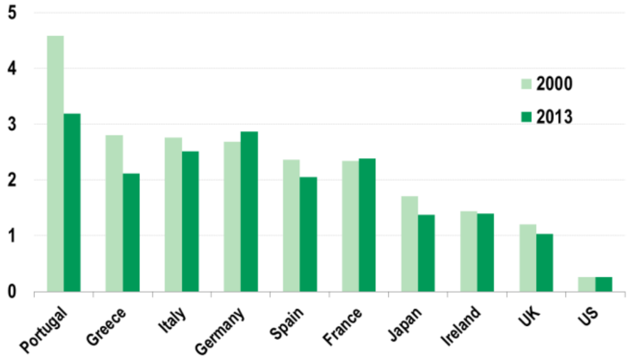

Chart 3 Source: OECD

Wage costs are squeezed

Unit wage costs - 2005=100

— Spain; — France; - - - Germany

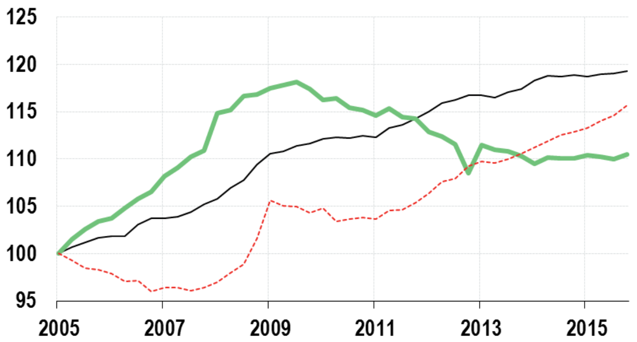

Chart 4 Source: OECD

Nominal unit wage costs, which had increased at an average annual rate of 3.6% between 2003 and 2007 (vs. +1.1% in the eurozone), nonetheless rose 0.3% between 2014 and 2015 (vs. +0.6% in the eurozone). This decline is due to productivity gains and especially to wage moderation (+0.6% in 2015, vs. an average of +3.3% between 2003 and 2007) *(see chart 4)*.

Several factors had the opposite effect. Changes in the sector structure of employment drove up average wages. During the crisis, numerous unskilled jobs were destroyed, which tend to pay the lowest wages, notably in the construction sector. As a

[2] *Daniel Fernández Kranz, "Spanish wages during the Great Recession: Has the 2012 labour reform had an impact?", SEFO, May 2015*

share of total employment, the weight of young workers also declined, who tend to be less experienced and thus earn less. It is also important to distinguish the impact of measures taken to decentralise wage talks at the company level and to increase internal flexibility from the effects of wage moderation policies introduced as of 2010, which were strongly encouraged in the aftermath of the crisis[3].

According to several studies, however, companies benefited from the job market reforms. Indeed, they opted to unilaterally modify the employment conditions of their employees. According to the OECD, these reforms, combined with the collective agreements, reduced by 1.2 to 1.9 points the annual growth of unit labour costs in the trade sector, or nearly half of the decline observed in the months that followed the introduction of the reform. According to a Funcas study[4], the wages of employees who kept their jobs between 2008 and 2013 declined 1.6% while those who changed jobs during the period saw their wages plunge 17%. The moderate wage decline for those who kept their jobs suggests that companies did not have much bargaining power when it came to renegotiating wages. Since then, in contrast, the 5% decline in wages for the first group over the past two years suggests that the 2012 reform measures have empowered companies to adjust wages. According to a Bank of Spain study [5] on structural changes in employment, wages have also fallen much more sharply since 2012.

The reforms' impact on employment is hard to evaluate

The 2012 reforms aimed at reducing the number of job destructions during crisis periods and facilitating hiring during recovery phases.

Yet the reforms seem to have had a mixed impact on the job content of growth. According to a 2014 OECD study[6], the hiring rate increased 8%[7], but the elasticity of employment to GDP growth diminished slightly. It was 0.9 between Q4 2013 and Q4 2015, down from 1 between Q4 2003 and Q4 2007. Job creations over the past two years must also be looked at in the light of the number of hours worked per employee, which declined by 0.6% and 0.7%, respectively, in 2014 and 2015, according to the OECD. A greater share of part-time jobs was also created (15.7% of employees in Q4 2015, vs 11.6% in 2007).

Evaluating the impact of job market reforms is a difficult task. It is still too early to measure their full effects. Moreover, it is hard to distinguish between their effects on employment and those generated by the recovery. These reforms, the biggest of which took effect in late 2012, have benefited from a more favourable environment since early 2013. Spain managed to avoid falling into a sovereign debt crisis and began to swing back into growth. After shifting its economic equilibrium towards exports, Spain also benefited from a more favourable cyclical environment for its eurozone trading partners [8] and from corporate actions undertaken at the height of the crisis. Facing a slump in domestic demand, Spanish companies sought to develop new market outlets abroad, notably in Asia and the Middle East[9].

This cyclical environment probably helped Spain avoid some of the harmful effects of job market reforms. During economic slowdowns, companies can benefit from less restrictive dismissal terms to more easily reduce their staff size. More alarmed, households are more likely to increase their precautionary savings, to the detriment of consumer spending.

Temporary contracts are still in demand

As a share of total employees, temporary contracts will apparently remain below pre-crisis levels due to structural changes in the Spanish economy. The construction sector is particularly inclined towards short-term contracts (nearly 40% of jobs in the construction sector in 2015), but its weighting has declined to 6% of total employment in 2015 from 13.3% in 2007. It will apparently hold below the 2007 level for some time. Indeed, economic policies aim specifically to favour sectors offering higher value added.

So far, however, the reforms seem to have had little impact on the hiring behaviour of companies. The increase in employees as of Q3 2013 went hand in hand with an increase in temporary employment. Of the employees jobs created since then, nearly 60% have been temporary contracts (*see chart 5*). As a share of total employees, temporary employment has increased by nearly 3 points since spring 2013, to 25.7% in Q4 2015. Moreover, the transition rate from a temporary contract

Praising temporary jobs

Temporary employees as a share of sector employees (4 quarter moving average) (%)

— Total; — Manufacturing; - - - Construction; - - - Services

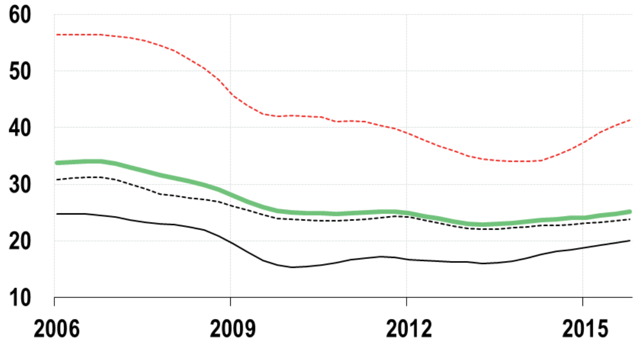

Chart 5 Source: Eurostat

---

[3] *Clauses were introduced to take into account inflation, but wage increases were also recommended under the Agreement for Employment and Collective Bargaining (AENC): 1% in 2010, between 1% and 2% in 2011, 0.5% in 2012, 0.6% in 2013, 1.5% in 2014, 1% in 2015 and up to 1.5% in 2016.*

[4] *Miguel Ángel Malo, "The impact of Spain´s 2012 labour reform on collective bargaining", SEFO, May 2015*

[5] *Mario Izquierdo, Aitor Lacuesta and Sergio Puente, "The 2012 labour reform: an initial analysis of some of its effects on the labour market", Bank of Spain's Economic Bulletin, September 2013*

[6] *"The 2012 Labour Market Reform in Spain: A Preliminary Assessment" (2014).*

[7] *Share of employees working for a company for less than three months.*

[8] *Spain exports nearly half of its merchandise to the rest of the eurozone.*

[9] *In 2015, Asia and the Middle East accounted for 9.6% and 6.1% of merchandise exports, respectively (compared to 6.3% and 4.1% in 2007).*

to permanent employment is low, at only 12% in 2014 (vs. 29.7% in 2006[10]).

This means that job market's duality will probably continue to hurt the Spanish economy. Employees with temporary contracts are less paid. They are more highly exposed to part-time work and benefit from less training than full-time employees. This lack of training in turn undermines their employability and increases the risk of job market exclusion.

A deteriorated situation

Persistently high long-term unemployment

Even though long-term unemployment benefited from the job market rally, it is still particularly high. Indeed, 10.5% of the active population and nearly half of all jobseekers have been out of work for more than a year (*see chart 6).*

An individual's employability declines the longer they are out of work. People currently out of work are also handicapped by changes in the composition of jobs. The return to growth creates new opportunities. Most job creations are now in the services sectors [11], while the construction sector alone accounted for nearly half of job destructions during the crisis (between Q3 2007 and Q1 2014). At the same time, the jobs created today require more and more skills. Only about a third of jobs required a low level of education in 2015[12], down from 43.2% in 2007, according to Eurostat. Moreover, some employees are not mobile enough. They lack sufficient information to find jobs in regions other than the one they live in. Sometimes it is hard for homeowners to move. Indeed they might not be able to recover the value of their property following the sharp drop in house prices in recent years.

Through the mismatching of job offers and demand, the persistently high level of long-term unemployment harms the economy. It risks hampering the decline in the structural unemployment rate, or NAIRU[13], which the OECD estimated at 18.6% in 2015 (vs. 13.8% in 2006) and could eventually strain potential GDP[14].

Nearly half of youth is unemployed

The youth unemployment rate (15-24 age group) has declined in recent quarters, dropping from 54.9% at the end of 2013 to 46.2% in Q4 2015 (*see chart 7)*. Yet it is still extremely high compared to pre-crisis levels (17.8% in Q4 2006) and to the other eurozone countries (eurozone average of 22% in Q4 2015). Moreover, this decline is mainly due to the diminution in the active population. The shrinking active population

A high level of long-term unemployment

Number of long-term unemployment (% of the active population)

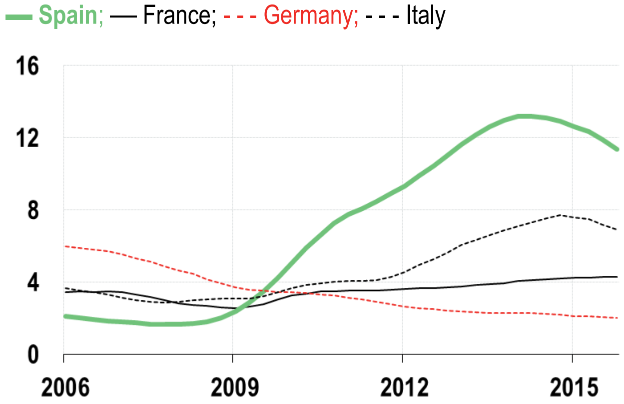

Chart 6 Source: Eurostat

High youth unemployment is a handicap

Unemployment rate among youth (age 15 to 24), 4-quarter moving average (%)

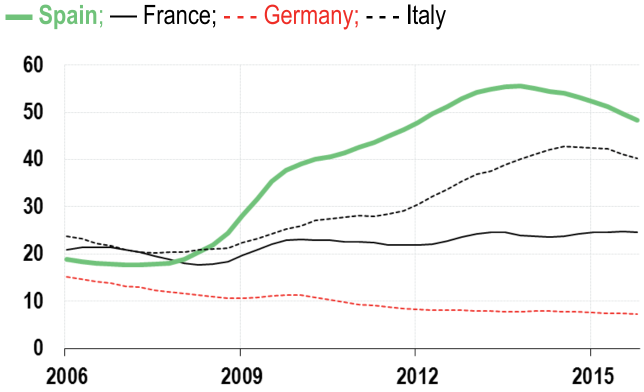

Chart 7 Source: Eurostat

accounted for 75% of the decline in the number of unemployed in the 15-24 age group between Q4 2013 and Q4 2015.

Ongoing economic growth and the upturn in the job market will help reabsorb part of this youth unemployment. Yet it is vital for Spain to invest in its human capital – which includes training young workers – if it intends to develop sectors offering higher value added and to significantly reduce youth unemployment. The education level of Spanish youth is still lower than that observed in many European countries, despite a slight improvement. The share of youth (20-24 age group) with a low level of education was 32.1% in 2015 (compared to a eurozone average of 19.4%).

Catherine Stephan

catherine.stephan@bnpparibas.com

10 *Eurostat data*

11 *Food and hotel services, administrative and support services, healthcare and social welfare activities, and scientific and technical activities.*

12 *Less than a primary education, a primary education and a secondary education. In the eurozone, 20.6% of jobs required a low level of education in 2015.*

13 *NAIRU (Non-Accelerating Inflation Rate of Unemployment) is used to measure the structural unemployment rate. It is the unemployment rate compatible with price stability.*

14 *Potential GDP corresponds to the level an economy could expect to attain if all its productive resources were being used.*

Group Economic Research

- **William DE VIJLDER** — +33(0)1 55 77 47 31 — william.devijlder@bnpparibas.com
  Chief Economist

ADVANCED ECONOMIES AND STATISTICS

- **Jean-Luc PROUTAT** — +33.(0)1.58.16.73.32 — jean-luc.proutat@bnpparibas.com
  Head
- **Alexandra ESTIOT** — +33.(0)1.58.16.81.69 — alexandra.estiot@bnpparibas.com
  Works coordination - United States - United Kingdom - Globalisation
- **Hélène BAUDCHON** — +33.(0)1.58.16.03.63 — helene.baudchon@bnpparibas.com
  France (short-term outlook and forecasts) - Labour markets
- **Frédérique CERISIER** — +33.(0)1.43.16.95.52 — frederique.cerisier@bnpparibas.com
  Euro Area - European institutions and governance - Public finances
- **Thibault MERCIER** — +33.(0)1.57.43.02.91 — thibault.mercier@bnpparibas.com
  France (structural reforms) - European central bank
- **Caroline NEWHOUSE** — +33.(0)1.43.16.95.50 — caroline.newhouse@bnpparibas.com
  Germany, Austria, Ireland - Ageing, pensions - Consumption
- **Catherine STEPHAN** — +33.(0)1.55.77.71.89 — catherine.stephan@bnpparibas.com
  Spain, Portugal - World trade - Education, health, social conditions
- **Raymond VAN DER PUTTEN** — +33.(0)1.42.98.53.99 — raymond.vanderputten@bnpparibas.com
  Japan, Netherlands, Scandinavia - Energy, climate - Potential growth, productivity

- **Tarik RHARRAB** — +33.(0)1.43.16.95.56 — tarik.rharrab@bnpparibas.com
  Statistics and Modelling

BANKING ECONOMICS

- **Laurent QUIGNON** — +33.(0)1.42.98.56.54 — laurent.quignon@bnpparibas.com
  Head
- **Céline CHOULET** — +33.(0)1.43.16.95.54 — celine.choulet@bnpparibas.com
- **Laurent NAHMIAS** — +33.(0)1.42.98.44.24 — laurent.nahmias@bnpparibas.com

EMERGING ECONOMIES AND COUNTRY RISK

- **François FAURE** — +33.(0)1 42 98 79 82 — francois.faure@bnpparibas.com
  Head - Russia
- **Christine PELTIER** — +33.(0)1.42.98.56.27 — christine.peltier@bnpparibas.com
  Deputy Head - China, Vietnam, Methodology
- **Stéphane ALBY** — +33.(0)1.42.98.02.04 — stephane.alby@bnpparibas.com
  Africa (French-speaking countries)
- **Sylvain BELLEFONTAINE** — +33.(0)1.42.98.26.77 — sylvain.bellefontaine@bnpparibas.com
  Latin America,Turkey, Methodology
- **Sara CONFALONIERI** — +33.(0)1.42.98.74.26 — sara.confalonieri@bnpparibas.com
  Africa (English and Portuguese speaking countries)
- **Pascal DEVAUX** — +33.(0)1.43.16.95.51 — pascal.devaux@bnpparibas.com
  Middle East, Scoring
- **Anna DORBEC** — +33.(0)1.42.98.48.45 — anna.dorbec@bnpparibas.com
  CIS, Main Central European countries
- **Hélène DROUOT** — +33.(0)1.42.98.33.00 — helene.drouot@bnpparibas.com
  Asia
- **Johanna MELKA** — +33.(0)1.58.16.05.84 — johanna.melka@bnpparibas.com
  Asia

- **Michel BERNARDINI** — +33.(0)1.42.98.05.71 — michel.bernardini@bnpparibas.com
  Public Relation Officer

OUR PUBLICATIONS

CONJONCTURE

Structural or in the news flow, two issues analysed in depth

EMERGING

Analyses and forecasts for a selection of emerging economies

PERSPECTIVES

Analyses and forecasts for the main countries, emerging or developed

ECOFLASH

Data releases, major economic events. Our detailed views…

ECOWEEK

Weekly economic news and much more…

ECOTV

In this monthly webTV, our economists make sense of economic news

ECOTV WEEK

What is the main event this week? The answer is in your two minutes of economy

You can read and watch our analyses
on Eco news, our iPad and Android application

http://economic-research.bnpparibas.com

Prepared by Economic Research – BNP PARIBAS
Registered Office: 16 boulevard des Italiens – 75009 PARIS
Tél : +33 (0) 1.42.98.12.34
Internet : www.bnpparibas.com - www.economic-research.bnpparibas.com

Publisher: Jean Lemierre
Editor : William De Vijlder