



International  
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INTERNATIONAL  
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LABOUR STUDIES

STUDIES ON  
GROWTH WITH EQUITY



**SPAIN**

**QUALITY JOBS  
FOR  
A NEW ECONOMY**

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The International Institute for Labour Studies (IILS) was established in 1960 as an autonomous facility of the International Labour Organization (ILO) to further policy research, public debate and the sharing of knowledge on emerging labour and social issues of concern to the ILO and its constituents — labour, business and government.

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ISBN: 978-92-9014-988-0 (print)  
ISBN: 978-92-9014-989-7 (web pdf)

First published 2011

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Copies can be ordered from: ILO Publications, International Labour Office,  
CH-1211 Geneva 22, Switzerland. For on-line orders, see [www.ilo.org/publns](http://www.ilo.org/publns)

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Graphic design in Switzerland  
Printed in Switzerland

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## FOREWORD

The ILO's Declaration on Social Justice for a Fair Globalization provides scope for assisting Members in strengthening their research capacity, empirical knowledge and understanding of how the strategic objectives of employment, social protection, social dialogue and rights at work interact with each other and contribute to social progress, sustainable enterprises, sustainable development and the eradication of poverty in the global economy.

In accordance with this plan of action, the 304th Session of the Governing Body set in motion a plan to strengthen the ILO's knowledge base through a series of pilot country studies conducted under the aegis of the International Institute for Labour Studies. The purpose of these studies is to examine how employment and social policies can contribute to a more sustainable and equitable growth pattern. Moreover, if policies are well-designed and introduced in a complementary manner, they can be both pro-growth and equity-enhancing. This report on Spain documents how such policy complementarities among the strategic objectives of the ILO can be achieved.

This report has been prepared by Verónica Escudero and Sameer Khatiwada (International Institute for Labour Studies). Excellent research assistance provided by Elva López Mourelo and Byung-jin Ha is gratefully acknowledged. The report has benefited greatly from a background paper prepared by Professor Miguel Angel Malo of the Universidad de Salamanca, Spain. The study has been coordinated by Steven Tobin under the supervision of the Director of the Institute, Raymond Torres. A preliminary draft of the report was presented at a seminar organized by the Spanish Ministry of Employment and Immigration on 10 May 2011 in Madrid. The final report takes into consideration many of the comments received from national authorities, the social partners and other stakeholders during and following the seminar.

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## LIST OF ABBREVIATIONS

ALMP(S)	Active Labour Market Programmes
CTFE	Contrato Temporal de Fomento del Empleo (Temporary Contracts to Perform Permanent Functions of the Firm)
EPL	Employment Protection Legislation
ESADE	Escuela Superior de Administración y Dirección de Empresas
FAAF	Fondo para la Adquisición de Activos Financieros (Financial Asset Acquisition Fund)
FOGASA	Fondo de Garantía Salarial (Salary Guarantee Fund)
FROB	Fondo de Reestructuración Ordenada Bancaria (Fund for Orderly Bank Restructuring)
FTPYME	Fondos de Titularización de Activos para la Pequeña y Mediana Empresa (SME Securitization Funds)
GCI	Global Competiveness Index
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
HCPI	Harmonized Consumer Price Index
ICO	Instituto de Crédito Oficial (Official Institute for Credit)
ICT	Information and Communication Technologies
ILO	International Labour Organization
IMF	International Monetary Fund
INE	Instituto Nacional de Estadística (Spanish National Institute of Statistics)
IPREM	Indicador Público de Renta de Efectos Múltiples (Public Income Indicator with Multiple Effects)
LES	Ley de Economía Sostenible (Law on Sustainable Economy)
MFP	Multi-Factor Productivity
NIES	Newly Industrialized Economies
OECD	Organization for Economic Co-operation and Development
PES	Public Employment Services
RAI	Renta Activa de Inserción (Active Income for Social Integration)
SFEER	Special Fund for Employment and Economic Reactivation
SFLI	State Fund for Local Investment
SME(S)	Small and Medium Enterprises
ULC	Unit Labour Cost
VAT	Value Added Tax



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## EXECUTIVE SUMMARY AND POLICY RECOMMENDATIONS

### *The exceptional increase in Spain's unemployment...*

In the aftermath of the global financial and economic crisis in 2008, the output performance of Spain was similar to that of other large advanced economies: in the second quarter of 2009 real GDP fell by 4.4 per cent compared with the previous year, which is less than the 5.1 per cent contraction in the EU-27. The impact of the global crisis on the labour market, however, has been much stronger than in most other EU countries. In the first quarter of 2011, the unemployment rate stood at 21.3 per cent, that is over 13 percentage points more than in 2008 – the most dramatic increase among advanced economies. Youth and workers with temporary contracts have been disproportionately affected by the increase. For instance, 45 per cent of labour market participants aged 15–24 were unemployed in the first quarter of 2011.

*...reflects the simultaneity of the global crisis and the end of a period of unbalanced growth.*

One factor behind the exceptional increase in unemployment is the twin nature of the crisis in Spain. The country has had to cope simultaneously with the global crisis and the country-specific crisis associated with a growth model which relied excessively on construction and housing. In the decade leading up to 2006, when real GDP in Spain grew more than twice as fast as the EU-15 average, employment grew by more than 50 per cent and the unemployment rate fell from over 22 per cent in 1996 to 8.5 per cent in 2006. However, construction and real estate activities accounted for more than a third of total employment gains over this period. Similarly, residential investment and non-housing-related construction accounted for more than two-thirds of total investment growth in the decade preceding the crisis.

But the domestic crisis had deeper roots. In particular, the unbalanced growth pattern was fuelled by a financial system in search of short-term returns. Many regional banks (the so-called *cajas*) took excessive positions in the housing sector. Also, many of the jobs created during the expansionary period were low skilled: despite significant improvements in educational attainment, close to 15 per cent of jobs in Spain were in low-skilled or elementary occupations, compared with less than 10 per cent in most of the neighbouring EU countries. Despite several reforms, the incidence of temporary employment rose to nearly 35 per cent prior to the crisis, the highest figure among advanced economies. These developments had important implications for overall productivity and competitiveness, which have deteriorated dramatically over the past decade. The model eventually became unsustainable.

*So the challenge is to make a structural transformation of the growth model, while addressing the deteriorated employment situation.*

The challenge for Spain is thus to make a structural transformation towards a new, more balanced economy, while at the same time reducing unemployment. It is indeed crucial not to replicate the same growth patterns which prevailed before the twin crises, which had moved the country away from its true source of comparative advantage.

A transformation of this nature will not be easy – it entails restructuring of firms and jobs associated with the previous growth model. Yet, if accompanied by well-designed macroeconomic, labour and social policies, it can lead to the creation of new dynamic firms and quality jobs commensurate with the prevailing skills levels, especially among qualified young graduates.

*There are early indications of a positive transformation taking place...*

Underlying the overall weak aggregate picture, there are a number of positive developments, which, if properly supported, could lay the foundations for a solid recovery and lower unemployment. GDP growth returned to positive territory in the third quarter of 2010 and is expected to grow at an

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annual rate of 0.8 per cent in 2011 and 1.5 per cent in 2012. Since early 2010, exports have grown at an annual rate of over 15 per cent, driving the recovery. Already at the beginning of 2011, exports were 3 per cent above their pre-crisis levels, with exports of relatively high value-added products – e.g. chemicals, pharmaceuticals, metals and machinery – exhibiting particular dynamism. Likewise, investment in machinery and equipment is starting to pick up. Job gains in sectors where growth can take a firm hold have started to offset the continued job losses in other sectors, such as construction.

These patterns represent a marked departure from pre-crisis growth, which was driven by low-skill-intensive output and debt-led domestic demand – notably housing investment. External competitiveness has also improved somewhat. More generally, counter to prevailing wisdom, wage levels do not seem to be a constraint on the shift to a new growth model in Spain. Nor were wages at the root of declining competitiveness.

*...and this can be accelerated through a coherent policy strategy, including a number of recent measures...*

These positive recent developments will be insufficient for ensuring a successful transition. The Government and social partners have made strides over the past two years to facilitate the structural transformation of the Spanish economy:

- *Law on Sustainable Economy (Ley de economía sostenible)*: the law, which entered into force in March 2011, provides a strategy for a new growth model based on innovation, technology, internationalization of business, product market competition and enhanced efficiency of public administrations in order to enable economic, social and environmental sustainability.
- *Labour market reforms*: Over the course of 2010–11, a series of labour market reforms were undertaken with the aim of promoting job creation while facilitating transition to a new growth model. The reforms: (i) address overly high rates of temporary employment through adjustments in dismissal procedures as well as modifications in the rules governing



temporary contracts; (ii) promote internal flexibility (adjustments in wages and working hours) instead of external flexibility (redundancies, especially of workers on temporary contracts); (iii) increase financial subsidies for firms hiring young people, the less skilled, women and long-term unemployed; and (iv) support labour market intermediation and delivery of employment services.

- *Pension reform*: The pension reform of 2010–11 in Spain is particularly noteworthy in that it highlights the importance of collective bargaining and social dialogue with employers and unions. Furthermore, the new pension reform also requires a review of the parameters to be conducted every five years.
- *Internal flexibility and collective bargaining*: In June 2011, the Spanish Government adopted new labour legislation (Royal Decree Law 7/2011) which aims to reform the collective bargaining structure in Spain and improve internal flexibility. The main features of the legislation are: (i) a widening of the scope of opt-out clauses for firms facing financial and economic difficulty; (ii) provisions to encourage firm-level negotiations, particularly over hours and wages; (iii) possibility for firms to distribute 5 per cent of the total working time in a flexible manner; and (iv) a modification to the “ultra-activity” of collective agreements – where the old agreement remains applicable beyond its expiry if a new agreement cannot be reached. The new law introduces possibilities for arbitration in case of disagreement between social partners and stipulates that new agreements must be implemented within 8 months (for agreements with a scheduled duration of 2 years) or 14 months (for the rest) of the end of old agreements. However, the Government passed this legislation after the social partners were unable to reach an agreement following a lengthy period of negotiation.

*...and hopefully a series of new measures,  
first to facilitate the transition to a more productive economy...*

It is crucial to complement these recent measures with further efforts to support structural transformation. The recent measures represent an improvement over the initial policy response under the so-called *Plan E*, which was

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general in nature – more transfers to local authorities, spending on infrastructure, untargeted cash transfers— and did not address the underlying imbalances. There is now wider awareness of the depth and nature of the crisis. But a more comprehensive strategy, building on recent measures, is now needed to boost recovery and create decent work opportunities.

There is significant scope for making product markets more productive and open to innovation, notably by:

- *Ensuring the financial sector serves the needs of the real economy:* The financial sector bears significant responsibility for the crisis. It facilitated the easy access to credit for households and firms that helped fuel the asset bubble. The Spanish Government has slowly taken some steps to reform the financial sector, notably by encouraging consolidation among savings banks or *cajas* and by raising capital requirements (Royal Decree Law 2/2010). However, many promising enterprises continue to face credit constraints, therefore hampering their job creation and growth opportunities. In the short term, the Official Institute for Credit (ICO) needs to work closely with credit-related institutions to examine ways – in addition to those announced earlier in the crisis – to ensure that firms are able to access financing and take advantage of new growth opportunities. Also, it is surprising that the EU recommendations to moderate remuneration practices in the financial sector have not yet been implemented in Spain – almost four years after the start of the crisis. Such a slow reaction not only delays adjustment in the financial sector, but also creates the impression that the burden of the crisis is unfairly shared.
- *Strengthening export base:* In Spain, exports account for less than 25 per cent of GDP, the second lowest share in the EU following France and well below the EU-27 average of close to 40 per cent. The potential to leverage further the recent growth in exports is significant and there is scope to build upon recent developments. Encouraging further the development of sectors that are more intensive in the use of technology would be an important step in the sustainable development of the export sector. Governmental measures aimed at facilitating the internationalization of firms – within the present multilateral context – would help. Non-EU destinations, where most of the trade growth is happening, currently

account for less than a third of Spanish exports. Diversifying foreign trade relationships, especially with emerging and developing countries, could help leverage additional gains in export shares.

- *Reducing administrative burdens and barriers to business start-up:* Administrative burdens for business start-ups are still significant in Spain and substantially greater than in other advanced economies. Despite progress being made in simplifying and streamlining start-up requirements, Spanish entrepreneurs still have to overcome a large number of administrative burdens to activate a firm.
- *Targeting incentives to foster improved innovative capacity and increased productivity:* The Government has made important strides in this area of late, such as the asset redemption leeway for corporate tax payers. However, promoting investment in high value-added sectors will require better targeting in the form of conditional investment initiatives on activities with significant spillover effects, such as technological advances, renewable sources of energy and green growth initiatives. The recent example of the Republic of Korea's support for its electronics industry is an important case in point.

*...second to align education, skills and training policies to the new growth model...*

While improvements in the educational system have occurred, especially as regards tertiary attainment, the quality of outcomes leaves much to be desired. According to the Programme for International Student Assessment, Spanish students perform significantly below the OECD average in terms of reading, mathematics and science skills, ranking near the bottom in all three categories. Part of this trend might be explained by the fact that many of the jobs created in Spain prior to the crisis did not require higher level qualifications. However, as structural transformation takes place, increased efforts to improve educational outcomes will be called for.

Similarly, there is likely to be a rise in the rate of job transition, as workers move from one sector to another. Future gains in productivity, as well as the chance of re-employment, will depend on workers having the skills and training that match the needs of the new economy. However, although total

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spending on active labour market programmes (ALMPs) is high in relation to the OECD average, a disproportionate share is spent on hiring incentives rather than on skills development.

This calls for the alignment of education, skills and training initiatives with the need for effective and fair employment transitions, through:

- *Ensuring a responsive and quality education system:* Renewed efforts to improve outcomes will be essential as the economy moves towards a new growth path. Also, there is significant scope for strengthening the links between education institutions and labour markets (see below for more details on possible avenues for achieving this).
- *Improving access to high-skilled occupations:* Qualification-related entry barriers are high in Spain relative to other EU countries, and a large number of exclusive rights continue to be granted to professionals in areas such as legal services and accounting.
- *Emphasizing training initiatives in ALMPs:* Less than a quarter of ALMP spending in Spain is on training, considerably less than in other countries. Yet, employment outcomes of training initiatives are relatively high, in some cases closed to two-thirds. Reallocation of resources from existing hiring incentives towards training would be a welcome initiative. Engaging local employers through greater use of public–private partnerships should also improve outcomes. Indeed, positive returns to training results often occur over the longer term and can be quite strong if well designed.

*...third, to promote active policies while supporting jobseekers adequately...*

During the current period of structural transformation, the benefits system will continue to play an important complementary role to activation strategies by providing income support to unemployed workers. In this regard, the public employment service (PES) will be central to facilitating the movement of workers from unemployment into employment. Yet, despite efforts to recruit more staff, the client-to-staff ratio is nearly 450 in the Spanish PES – among the highest in the EU countries with available information. Urgent improvements are thus needed in the design and delivery of benefit support, notably:

- *Reinforcing PES:* Additional resources to the PES are needed to improve staff-to-client ratios and ensure that staff are qualified to provide personal attention to jobseekers, and the partnerships between public and private employment agencies must be made to work better than they have in the past. Currently, spending on the PES as a share of ALMPs is less than 18 per cent, while countries such as Germany spend more than 35 per cent. Meanwhile, the Government has made significant strides in the use of computer-based technology to administer unemployment benefits and subsidies. Going forward, this should free up resources for reinforcing the PES in Spain and activation measures more generally.
- *Improving activation strategies:* Regular interviews between jobseekers and PES officers and opportunities to participate in programmes after a set period of unsuccessful job search are key – consistent with additional resources for PES staff, as per above. Recent efforts to ensure that benefit levels for the long-term unemployed are adequate – which is of particular importance in view of the stagnant employment levels at the macroeconomic level – and to ensure that recipients do not reject suitable job offers or training opportunities are positive first steps.
- *Improving targeting of hiring subsidies:* The existing suite of hiring subsidies is too broad in nature. The effectiveness of targeted measures of this nature is greater when they are aimed at addressing a particular disadvantage, e.g. low-skilled or disadvantaged jobseekers, rather than an entire group.
- *Continuing to improve coordination efforts:* There is a lack of coordination between different regions and no coherent national strategy for providing effective public employment services. The role of the National Council, which has been given the task of coordinating activation policies across regions, needs to be reinforced. Consideration could be given to linking financial transfers to PES offices with their placement performance, as has been done in other advanced economies, such as New Zealand and Switzerland.

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...fourth, a comprehensive strategy to ensure that no youth is left behind...

The onset of the crisis has only exacerbated a number of challenges already confronting Spanish youth. There is an urgent need for a comprehensive and inclusive strategy that centres around: (i) reducing drop-out rates; (ii) keeping youth in contact with the labour market; and (iii) tailoring support to the needs of youth. Ensuring that Spanish youth play a central role in the transition towards a new growth model will have important social and economic implications. To address these challenges, the Government should consider the following:

- *Ensuring that no youth is left behind:* Each young person who is not in school should be offered some form of “activation guarantee”, i.e. the opportunity to work, train or engage in some form of activation measure. The situation regarding youth in Spain represents a major challenge for social cohesion. It requires a comprehensive strategy to ensure that all young jobseekers are offered one of the following opportunities, depending on the specific situation of each young person – continued schooling, job-search support, a reinsertion chance, training, a subsidized job, business start-up opportunities, or even possibilities to acquire work experience in other countries.
- *Improving school retention rates:* The share of youth (aged 18–24) with at most lower secondary education and not in further education or training – at more than 28 per cent – is more than twice the EU-27 average. Efforts are urgently needed to reduce high-school drop-out rates by encouraging young people to stay in school. Another possibility would be to make the preparation of education and training plans compulsory for youth. In Denmark, 15–17 year olds are required to make such plans in collaboration with their parents, school and guidance centre, and the plan needs to cover such areas as further education, training, employment, internship and volunteer work.

- *Enhancing labour market attachment of youth via effective PES:* Since many youth are not eligible for unemployment benefits or subsidies, registration with PES is often low. To help young unemployed workers remain attached to the labour market the Government could consider ways to provide financial incentives for youth to engage and register with PES. This could be complemented by mandating a lower PES client-to-staff ratio and more frequent interviews for disadvantaged youth, as is the case in Germany.
- *Ensuring youth have access to training:* In comparison with other EU countries, fewer youth in Spain have access to training. Yet, labour market integration of training initiatives is highest in Spain among youth. The Government needs to give preferential access to training for low-skilled youth. Existing programmes such as *Escuelas Taller* and *Casas de Oficios* could also be reinforced.

*...and fifth, by continued efforts  
to reduce labour market duality while promoting more and better jobs.*

It will be critical to ensure that the right set of labour market institutions is in place to facilitate adjustment and promote job creation. Yet, keeping in mind the lessons of the past, policies must also consider the quality of the jobs being created. In this regard, the reforms of 2010–11 are significant achievements in their own right. However, as a number of parameters are yet to be defined, it will be important to bear in mind the importance of job quality when moving forward. Although the costs could rise by as much as 3 per cent. Careful consideration must therefore be given to the manner in which the new system is implemented:

- *Extending access to the Workers' Capital Fund to temporary workers:* If the Fund is applied in isolation to open-ended contracts – which is currently the case – it could encourage firms to hire individuals on a temporary contract given the relative increase in hiring costs. Extending access to the Workers' Capital Fund to temporary workers – as is the case in Austria – would equalize the hiring incentives and have the added benefit of promoting mobility and training among temporary workers. This could be achieved by allowing temporary workers to carry forward

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in the fund the same proportion of total severance pay as workers with open-ended contracts.

- *Monitoring the effects of the Fund on employment and job quality:* It will be important to ensure that the Fund does not increase further the cost of hiring, especially for open-ended contracts. This is particularly relevant at a time when the economy needs to bolster competitiveness and create more and better jobs. The system could be evaluated in a year's time to that effect.
- *Improve financial sustainability of the Fund:* As the case of Austria has demonstrated, the conditions under which workers can receive the lump sum payment of 8 days per year of service will have an important impact on how the funds are used. Indeed, Spain should consider introducing a number of incentives should it wish to encourage workers to carry forward the payment for retirement. Finally, the Workers Capital Fund needs to adhere to stringent investment safeguards to protect the fund from excessive fluctuations while ensuring a stable return.

The combination of the introduction of the Workers' Capital Fund, a clearer definition of "economic grounds" for fair dismissals and the gradual closing of the gap in severance pay between temporary and open-ended contracts should help reduce labour market duality in Spain. However, a number of issues require further consideration:

- *Improving rules governing court proceedings for fair dismissals:* Making dismissal procedures and court proceedings as predictable as possible is crucial for effective reduction of duality and to facilitate job creation. The Netherlands provides an important case in point.
- *Strengthening social protection for temporary workers:* Overall, social protection for temporary workers needs to be strengthened. This is especially important as regards pension rights, including for young people who work as trainees during their studies and part-timer job holders – often women who wish to reconcile work with family life. Countries such as Austria and Denmark show that it is possible to provide social protection to temporary workers without institutionalizing temporary work (both countries have relatively low labour market duality).



- *Re-orienting the current incentive structure governing part-time employment:* The recent introduction of hiring subsidies to promote part-time employment among vulnerable groups, especially youth, is well intended. Policy-makers recognise the potential benefits of being able to adjust hours cyclically, as opposed to adjusting employment. Moreover, part-time employment remains low in Spain (11.8 per cent in 2009) compared with other advanced economies (OECD average of 16.2 per cent in 2009) and can, if combined with adequate social protection measures, offer a much need boost to worker and firm flexibility. In this respect, efforts to promote part-time employment should focus on closing the benefits gap between full-time and part-time workers, as other countries in the EU have successfully done (e.g. the Netherlands), rather than providing untargeted financial incentives for hiring on part-time contracts.

*Effective social dialogue is crucial  
for unlocking the economic potential of Spain and avoiding social unrest*

Spain has slowly begun to emerge from a deep crisis – one that has highlighted the inadequacies of the previous growth model. Moving forward, success will depend on developing a vision supported by a clear strategy. Such a strategy needs to be inclusive and consistent with fiscal goals – now is not the time for ill-conceived austerity measures. To this end, as highlighted by recent agreements, reforms achieved through social dialogue can be both fair and comprehensive – increasing the coherence between economic and social objectives. An approach of this nature will be central to developing quality jobs for a new economy and addressing remaining challenges:

- *Factors other than wages were lowering competitiveness:* Real wages grew very little in the period prior to the crisis and at a pace slower than its Euro-zone counterparts. It is price increases that drove nominal wage growth, eroding competitiveness. In addition, the decline in competitiveness was due more to the nature of the job growth and investment patterns, i.e. in low-productive sectors such as construction and real-estate. Keys to improving competitiveness therefore lies not in wage cuts – which would

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perpetuate the unbalanced growth patterns – but in improving the quality of employment and investment through a more comprehensive strategy of aligning economic and labour market policies. Euro-area coordination on wage policies is also crucial to avoid a “race to the bottom”.

- *More balanced wage determination process notably through the set up of a body to monitor income developments:* Social dialogue is the natural remit of the determination of wages and working conditions. Recent reforms have widened the scope of enterprise-level bargaining while amending other important aspects of the collective bargaining process, such as “ultra-activity”. It is unfortunate that consensus on the measures was not possible. However it will now be important to assess their impact in terms of supporting structural transformation – which will require more internal flexibility and job creation in new sectors – while avoiding a spiral of wage cuts. This assessment could be made through the creation of a small monitoring body including experts from government, employers and workers. Similar experiences exist in other countries undergoing structural change. Indeed, discussions on wage-price trends – crucial as they are in view of the need to support structural transformation – have tended to be blurred owing to different perceptions on the trends.
- *Recognition that labour market policies are consistent with fiscal goals is urgently needed:* In some instances, re-orienting policies along the lines discussed will mean shifting priorities in terms of financial resources. It may also mean additional spending in some areas. In this respect, there needs to be a consensus that labour market policies can be highly cost effective and can have important positive spill over effects on future growth and government resources. Cutting active and passive labour spending for the sake of austerity would only derail the current recovery process and prolong the labour market recession. Reaching consensus of this nature will rely heavily on effective social dialogue.

Spain can make a successful transformation to a new economy but it will require placing labour market and social policies at the heart of the recovery. Social dialogue is more important than ever if the vision of a new growth model is to be successfully carried out. It is also vital for averting social unrest.



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## **CHAPTER 1**

# **ECONOMIC AND LABOUR MARKET PERFORMANCE**

### **INTRODUCTION**

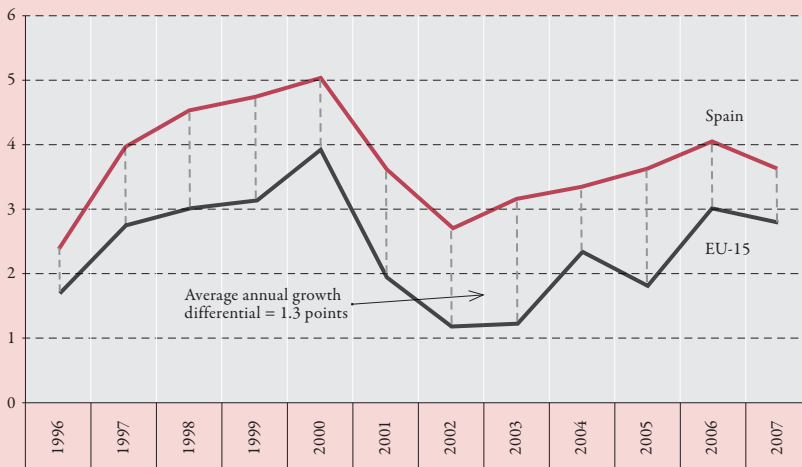
The purpose of this chapter is to shed light on the macroeconomic effects and transmission mechanisms of the financial and economic crisis in Spain and to document recent economic and labour market developments with a view to assessing the nature of the recovery process. Indeed, the crisis that erupted in 2007 has brought severe labour market and social challenges for Spain. In particular, section A reviews the economic developments leading up to and during the crisis, and includes a discussion of the important role of the housing and construction sector. Section B assesses in more detail the labour market impacts stemming from the decline in GDP. However, with growth returning to positive territory after a lengthy recession, section C examines recent trends with a view to improving the understanding of the current structural adjustment process underway in Spain. The final section concludes by discussing a number of considerations and introduces the remainder of the report.

## A MACROECONOMIC DEVELOPMENTS

### 1 A SUSTAINED ECONOMIC EXPANSION CHARACTERIZED THE PERIOD PRIOR TO THE CRISIS

Following the crisis of the early 1990s, the Spanish economy embarked on a long period of strong and sustained growth. In the ten years to 2006, real GDP in Spain – at 3.7 per cent per annum – grew more than twice as fast as the EU-15 average (1.4 per cent) (Figure 1.1). During this boom period, the construction sector was the driving force behind economic growth. Indeed, with an average real annual growth of 5.2 per cent, the construction sector outpaced all other economic sectors during 1996–2006. In comparison, the services sector grew by an annual average of 3.6 per cent,<sup>1</sup> the industrial sector by 3 per cent and agriculture by 2.8 per cent over the same period.

Figure 1.1 Annual real GDP growth in Spain and the EU-15, 1996–2007 (percentages)

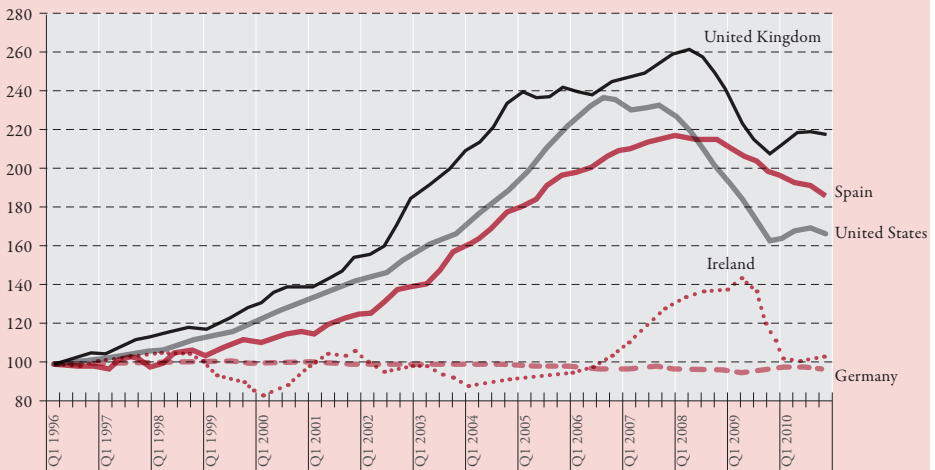


Source: Eurostat.

<sup>1</sup> In nominal terms, this represents close to 12 per cent year-on-year growth.

With growth in construction outpacing growth in other sectors, the share of the construction sector in GDP stood at 12.1 per cent in 2006, which represents an increase of close to 5 percentage points from the 1996 level. As a result, in 2006 the size of the construction sector in Spain as a proportion of the economy as a whole was nearly double that found in other European countries. In the EU-15, for instance, the construction sector constituted only 6.2 per cent of GDP in 2006, little changed from its share a decade before. The strong growth in construction was driven by a robust housing sector: housing prices increased by over 8 per cent per annum on average (close to 117 per cent in total) during the decade, which is comparatively much higher than in other select advanced economies, with the exception of the United Kingdom (Figure 1.2). This strong growth in housing was accompanied by dramatic increases in household debt. In fact, as a percentage of disposable income, household debt in Spain increased by 86 percentage points between 1995 and 2007 (Box 1.1).

**Figure 1.2 Housing boom: Real house prices, Q1 1996 – Q1 2010 (Q1 1996=100)**



Note: Data for the United States is not strictly comparable to the other countries given that the index (Case-Shiller) is constructed in a slightly different manner.

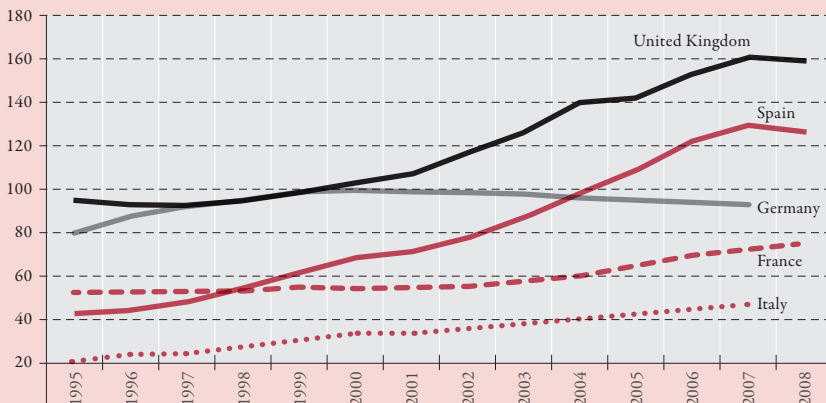
Source: Case-Shiller (United States); Ministerio de Vivienda de España (Spain), OECD (Germany and Ireland); and UK Nationwide statistics (United Kingdom).

### Box 1.1 Household debt in Spain compared with other countries

Over the past decade, household debt has substantially increased in Spain. Between 1995 and 2007, household debt as a percentage of disposable income increased by more than 86 percentage points. This is significantly higher than the change in household indebtedness in other major EU economies (Figure 1.3).

Several reasons seem to be behind the increase in households' willingness to take on debt. First, Spain experienced a fast convergence of income per capita which elevated households' perceptions of future permanent income. This, combined with a desire for consumption smoothing, could explain their higher propensity to incur debt.<sup>2</sup> A second reason behind this trend has to do with the relatively low interest rates that were present over the same period. Indeed, following EU monetary union, real mortgage interest rates in Spain decreased to around zero per cent during the boom years – the Euribor was around 2 per cent, and Spain had a positive inflation differential with other euro countries of around 0.5 to 1 percentage points. Average mortgage durations also increased, from 10–15 years during the late 1980s to 25–30 years in the 2000s, lowering the annual costs associated with a mortgage. And finally, tax deductions associated with housing purchases increases substantially in the 2000s (which have been recently reduced in magnitude). As a result, household debt levels increased from 40 per cent to close to 130 per cent of disposable income between 1995 and 2007 and indebtedness became more widespread.

Figure 1.3 Real household debt as a percentage of disposable income, 1995–2008 (percentages)



Source: IMF, 2009; IMF, WEO database; OECD, Olisnet database.

<sup>2</sup> Bank of Spain, 2010; IMF, 2009.

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Given the sizeable construction sector and booming housing market coupled with the reliance on domestic demand for credit, Spain was extremely vulnerable to a crisis when housing prices retreated. These vulnerabilities soon became visible. In mid-2007, credit availability dried up and growth in the construction sector came to a halt. Housing prices started to plummet in the second half of 2007, and by the first quarter of 2011 had fallen by one-fifth from their peak level. Households were confronted with high debt levels, leading to foreclosures and an abrupt end to Spain's decade-long expansion.

## **2 THE MAGNITUDE AND DURATION OF THE DOWNTURN STARTING IN 2008 WAS SEVERE**

The effect of the crisis on the Spanish economy was drastic; both in terms of the magnitude of the decline in GDP and, more significantly, in terms of the duration of the fall. GDP growth started to trend downwards in early 2007, dipping into negative territory in the third quarter of 2008. The strongest impact was felt in the second quarter of 2009, when compared with the same period in 2008, real GDP fell by 4.4 per cent. In comparison, however, the Spanish economic contraction was on par with that in other advanced economies. For example, growth in the EU-27 and the United States fell by 5.1 and 4.1 per cent, respectively (Figure 1.4). However, in Spain the recession persisted for much longer – growth remained negative through all of 2009 and the first half of 2010 – turning positive, marginally, only in the third quarter of 2010 (a full year longer than the recession in the United States and six months longer than that of the EU-27). Moreover, growth is expected to remain weak in 2011 and well below the 2 per cent necessary for new job creation.<sup>3</sup>

In terms of the transmission channels, the construction sector was hit hard, despite government measures to boost non-residential investment.<sup>4</sup> In fact, residential investments have remained suppressed and the construction sector has contracted for more than 12 consecutive quarters – by the fourth quarter of 2010 it had fallen by more than 15 per cent. The financial and

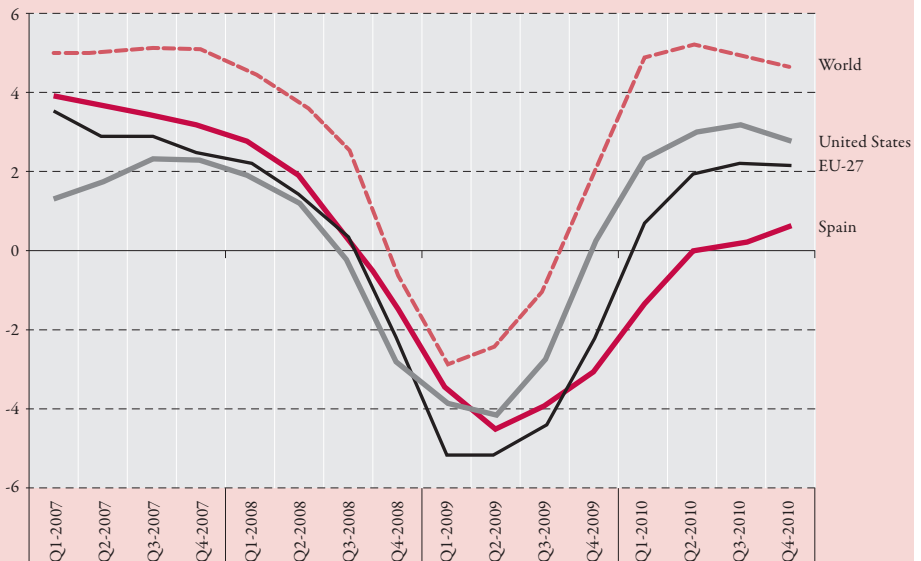
<sup>3</sup> ESADE, 2010.

<sup>4</sup> Such as the State Fund for Local Investment. See Chapter 2 for a detailed explanation of this fund and a list of other such measures.



real estate sector was also affected – although to a lesser extent – contracting by 1.8 per cent during the same period. In comparison, the non-construction part of economy slumped quickly – contracting by 3.6 per cent in the four quarters to quarter three 2009 – but soon returned to positive growth. Trade was the first to be affected by the crisis: total trade fell in Spain by nearly 20 per cent between the third quarter of 2007 and the third quarter of 2009, compared with, for example, 16 per cent in the EU-27 (only in Italy was there a worse effect – with a fall of 20.4 per cent). Private investment, meanwhile, was also deeply affected – by the fourth quarter of 2010 investment had fallen by close to 22 per cent compared with the beginning of 2008. Finally, private and government consumption remained relatively stable, with the former only falling marginally.

**Figure 1.4 Real GDP growth** (quarterly real GDP rate, per cent change from one year earlier)



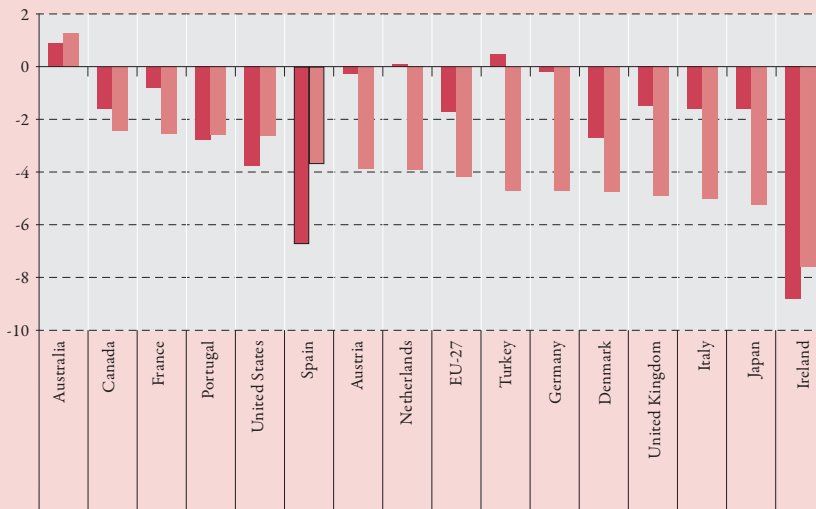
Source: IMF Economic Outlook, October 2010; OECD and Eurostat databases.

## B LABOUR MARKET PERFORMANCE

### 1 IMPACT ON EMPLOYMENT WAS STEEP, WITH NOTABLE DECLINES AMONG CERTAIN GROUPS

The impact of the global financial and economic crisis on employment and growth has varied considerably across countries. Spain, however, was one of the few countries in which the decline in employment outpaced the drop in GDP – the other countries include Ireland, the United States and Portugal (Figure 1.5). Between 2008 and 2009, while the country experienced an economic contraction of about 3.7 per cent (in annual terms),<sup>5</sup> the fall in employment was almost twice as great – 6.8 per cent. Moreover, Spain has been one of the hardest hit countries in terms of the share and number

Figure 1.5 Real GDP and employment growth in selected countries  
(change in 2009 compared with 2008)



Source: Eurostat; WEO, Oct 2010 database; ILO, Global Job Crisis Observatory.

<sup>5</sup> Note that the 3.7 per cent figure corresponds to the annual contraction between 2008 and 2009. The 4.4 per cent decrease in GDP presented in Section A, however, corresponds to the year-on-year change between Q2 2008 and Q2 2009. Both figures correspond to GDP in real terms.

of jobs lost since the beginning of the crisis – in the first quarter 2011, employment levels were continuing to decline, and roughly 2.7 million jobs had been lost since the peak of job creation, in the first quarter of 2008.

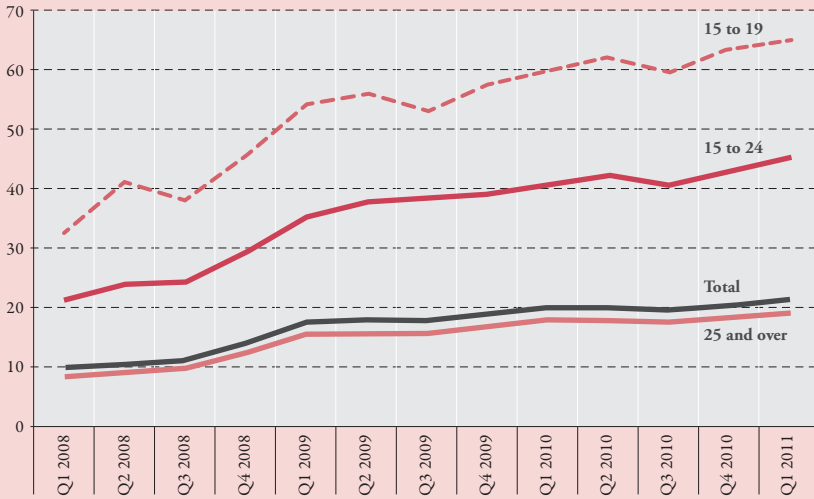
As a result, the unemployment rate has increased by more than 13 percentage points to reach 21.3 per cent in the first quarter of 2011. In addition, more than one in four jobless workers has been unemployed for more than a year, intensifying the risks of skill erosion and complete withdrawal from the labour market. Moreover, employment destruction has taken place alongside growth in the working-age population (persons aged 16–64). As a result, the ratio of employment to working-age population – i.e. the employment rate – fell by close to 6.5 percentage points between Q1 2008 and Q1 2011. This decline has erased more than one-third of the employment gains attained before the crisis. The effects have been particularly acute for some groups and regions:

- *Youth*: The unemployment rate among youth (aged 15–24) increased by more than 24 percentage points between the first quarters of 2008 and 2011. Now, more than 45 per cent of youth are unemployed. And among youth aged 15-19, the problem is particularly acute: for this group the unemployment rate stood at more than 65 per cent in the first quarter of 2011. In comparison, the unemployment rate for people aged 25 and over increased far less and stood at 19.1 per cent in the first quarter of 2011 – an increase of close to 10 percentage points (Figure 1.6, panel A).
- *Migrants*: Another group hit hard by job losses was migrants. Migrant workers accounted for around 14 per cent of total employment between the first quarters of 2009 and 2011; yet, employment losses among migrant workers represented 23.5 per cent of total jobs lost over the same period. Not surprisingly, among migrant workers the most affected are the low skilled (those with only primary and secondary educational attainment). As a consequence, net migration flows have fallen by more than 60 per cent during the crisis, due principally to a decrease in the flow of migrants arriving in Spain (down 32 per cent in 2009 compared with 2008).

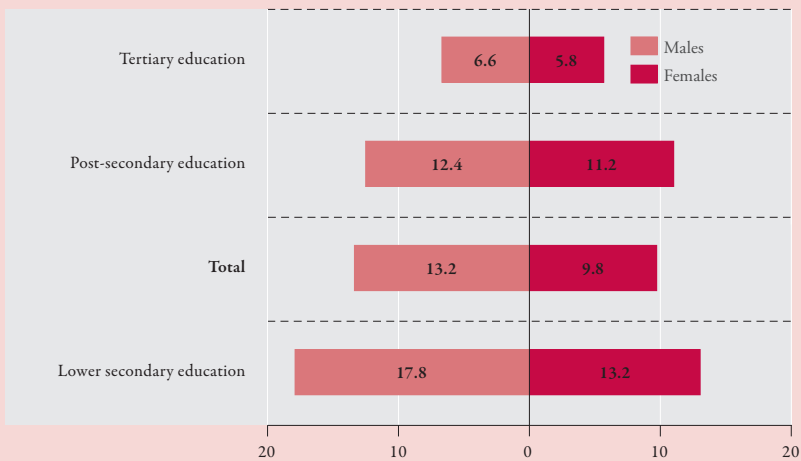
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- *Men:* Male workers were affected more by unemployment than their female counterparts. In fact, the pre-existing gap between female and male unemployment rates was reduced from 4 to just over 1 percentage point (Figure 1.6, panel B). What is more, the impact differential is even more striking when taking into account educational attainment. Male workers with lower secondary education were the most affected, with unemployment rates increasing by close to 18 percentage points for this group.
  - *Regions:* The impact on the labour market has been felt differently across the regions, with some faring better than others (see annex A). For instance, in the first quarter of 2011, Andalucía had the highest total unemployment rate, at just under 30 per cent, compared with only 11.6 per cent in País Vasco. Similarly, the highest rate of youth unemployment, 58.6 per cent, was in Melilla, 28 percentage points higher than in the region with the lowest youth unemployment (País Vasco). The most dramatic increase in unemployment since the first quarter 2008 was seen in Aragón, where the jobless rate for the region tripled, although at 18 per cent it remained below the national average. For youth, the impact was most felt in Cantabria, where the rate rose from just over 14 per cent to 46 per cent – an increase of more than threefold in three years.

**Figure 1.6 Unemployment rates by age, gender and highest educational attainment**  
(quarterly rate, percentage)

**Panel A. Unemployment rates by age, 2008 – 2011**



**Panel B. Change in unemployment rates between Q4 2007 and Q4 2010, by gender and highest educational attainment**



Source: Eurostat and the Spanish National Institute of Statistics (INE).

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## 2 CONSTRUCTION, MANUFACTURING AND TEMPORARY JOBS ACCOUNTED FOR THE BULK OF EMPLOYMENT LOSSES

The acute impact on men (especially men with lower educational attainment) is attributed to the sectoral distribution of employment by gender, i.e. men are concentrated more in sectors that were hit by the crisis, such as construction and manufacturing (men accounted for 90 and 70 per cent of construction and manufacturing employment, respectively, in 2008). Indeed, the construction sector represented on average around 52.3 per cent of total employment losses in Spain between the first quarters of 2008 and 2011, even though the sector accounted for around 10 per cent of total employment on average over the same period (Figure 1.7, panel A). Among the EU countries for which information is available,<sup>6</sup> only in Ireland did the share of construction in total employment fall more dramatically (-6.1 percentage points compared with -4.5 in Spain). Similarly, the industrial sector in Spain accounted for a sizeable share of the jobs lost – over one-third – of which 99 per cent were lost from manufacturing. On the services side, the automobile service sector<sup>7</sup> bore the brunt of job losses. There were also considerable shifts in terms of employment type: more than 90 per cent of the jobs lost between 2008 and 2010 were temporary in nature (Figure 1.7, panel B). Before the onset of the crisis, the Spanish labour market was characterized by a very high share of temporary contracts among total employed – in 2007 this share represented 32 per cent of total employment, compared with 22 per cent in the EU-15.<sup>8,9</sup> Following the dramatic reduction in temporary employment, this share has fallen to under 26 per cent.

The overall effect on employment was felt harder in Spain than in other advanced economies. One reason for this was because average hours per worker did not adjust so as to mitigate the employment impact of the recession. In Germany, for example, where policies promoting the use of

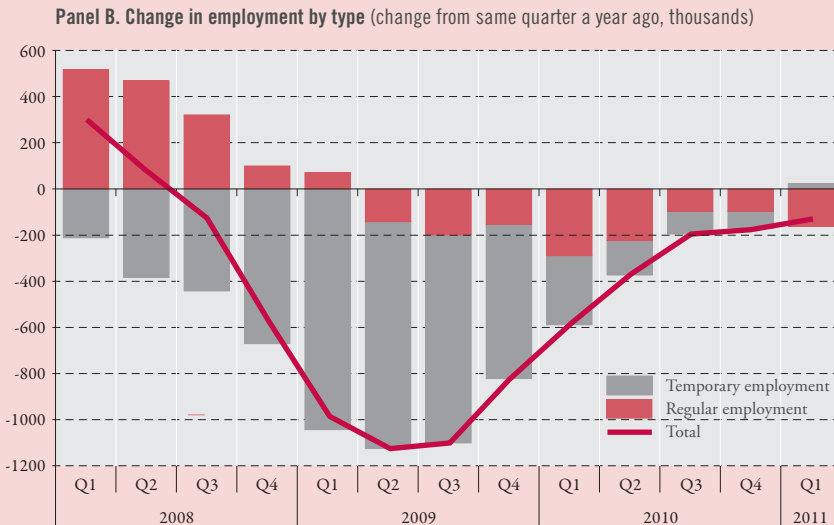
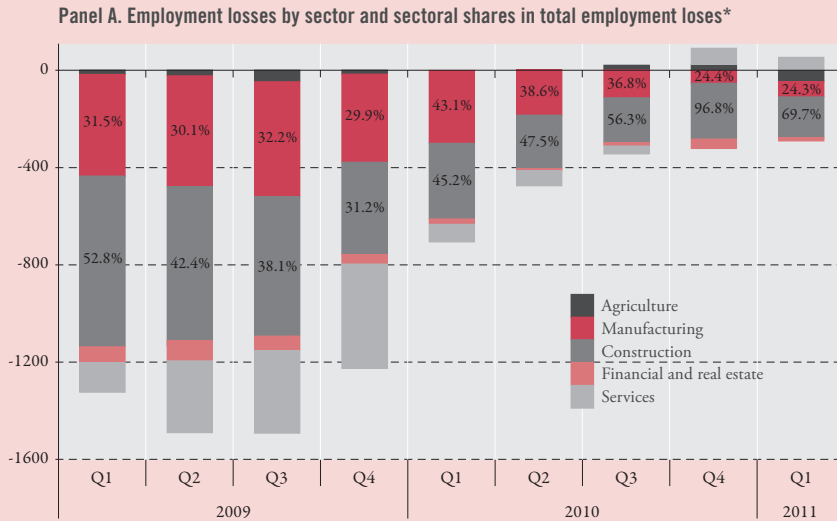
<sup>6</sup> Germany, France, Ireland, Portugal and the United Kingdom.

<sup>7</sup> Repair of motor vehicles and motorcycles (wholesale and retail trade), according to the NACE rev. 2 classification. See Eurostat database.

<sup>8</sup> See Eichhorst et al., 2010.

<sup>9</sup> For a more in depth analysis of employment protection legislation and its role during the crisis, see Chapter 4.

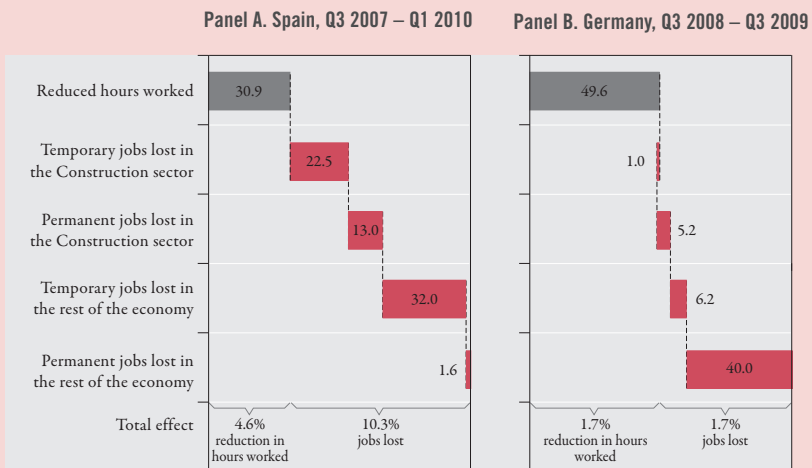
**Figure 1.7 Changes in employment by sector and type**  
(year-on-year changes)



\*Figures in per cent correspond to the contribution of each sector's employment losses to total employment losses.  
Source: Eurostat; National statistics, Spanish Labour Force Survey.

shorter hours were widespread, the reduction of hours worked accounted for half of the reduction in total hours of work in the economy (Figure 1.8). The other half was accounted for by jobs lost. In comparison, reduction of hours of work in Spain only accounted for 31 per cent of the reduction in total hours of work in the economy, and therefore the biggest share of the adjustment was through employment reductions. Jobs lost in Spain reached 10.3 per cent during the whole crisis period.

**Figure 1.8 Factors contributing to reduction of total hours of work during the crisis (percentages)**



Note: The graph depicts the share of each variable's change during the crisis (peak to trough of total employment, by country) in the change of total hours of work during the same period.  
Source: IILS calculations based on Eurostat database.



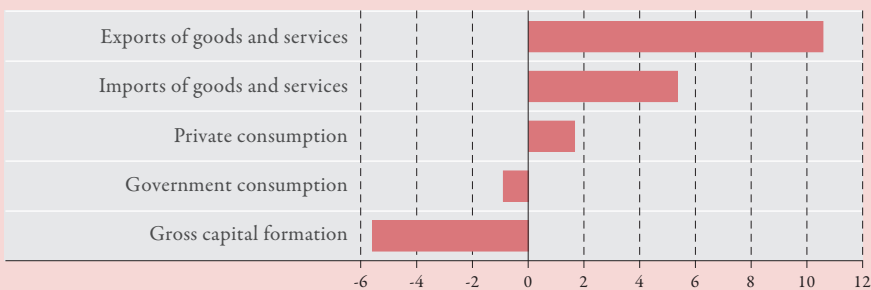
## C THE RECOVERY AND ADJUSTMENT PROCESS

With the onset of the crisis, the Spanish economy and labour market have undergone a significant period of adjustment. The impact of this process has been particularly acute in certain sectors of the economy and in certain segments of the population. However, the economy has shown some signs of recovering – albeit at a slow pace. On the upside, the structural changes have been associated with positive developments in a number of areas, including export growth and employment creation in a number of service sector-related areas.

### 1 EXPORTS HAVE BEEN DRIVING THE REBOUND IN GDP, BUT INVESTMENT CONTINUES TO LAG

Although Spain experienced a more significant reduction in its external market than most of its European counterparts, trade activity had already started to recover in the second half of 2009. In particular, exports rebounded quickly, growing by more than 10 per cent in 2010 alone (Figure 1.9). In fact, external demand has accounted for all of the recent gains in growth. By the end of 2010, exports were close their pre-crisis levels. There have also been some interesting developments regarding the composition of exports (see Chapter 3 for a more detailed discussion). Imports have also shown recovery – albeit more gradually. However, investment, as measured by gross fixed capital formation, continues to lag.

Figure 1.9 Quarterly real GDP by sector: Q4 2010 compared with Q4 2009 (percentages)

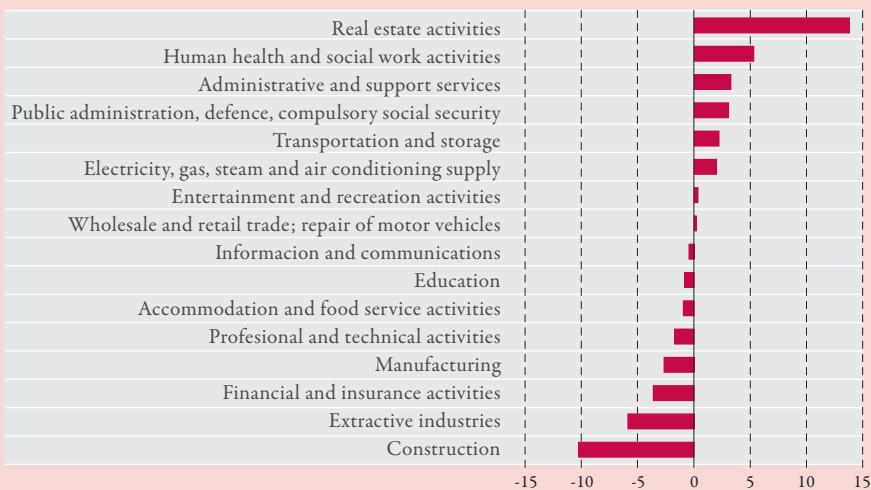


Source: Eurostat.

## 2 EMPLOYMENT GROWTH HAS BEEN WEAK, BUT SOME SECTORS ARE SHOWING SIGNS OF RECOVERY

The unemployment rate has remained stubbornly high as of early 2011. In fact, aggregate employment levels remain close to the lowest levels experienced over the past three years. There have, however, been employment gains in a number of sectors, but these have been offset by the continuing employment adjustment process in other sectors, such as construction and manufacturing (Figure 1.10). In fact, in the year to the first quarter of 2011, employment in these two sectors continued to fall, whereas there was relatively strong growth in a number of service-related sectors. In particular, jobs in health and social work, which account for over 7 per cent of total employment, grew by more than 5 per cent. Likewise, administrative and support service activities, with a share of 5 per cent of total employment, grew by 3 per cent. Importantly, wholesale and retail trade – which accounts for 16 per cent of total employment – is showing signs of recovery, although faintly. Other notable sectors that have witnessed strong job growth include: electricity and gas-related activities with a growth of nearly 4 per cent and transport and storage with growth of 2.3 per cent (although both currently account for relatively small share of total employment, i.e. less than 1 per cent).

**Figure 1.10 Employment changes by sector, Q1 2011**  
(percentage change from previous year)



Source: ILS estimate based on national sources.

## D CONCLUDING REMARKS

Spain was particularly vulnerable to the global financial and economic crisis: economic growth relied heavily on the construction sector and on credit-fuelled domestic demand for housing. With the onset of the crisis in mid-2007, credit availability dried up, growth in the construction sector came to a halt and Spain's decade-long expansion ended abruptly.

The effect of the crisis on the Spanish economy was severe, in terms of both the magnitude and the duration of the fall in GDP: the recession persisted for more than a year – six months longer than the average duration in the EU-27. The impacts were mostly felt in the construction sector and, to a lesser extent, in the manufacturing sector – the former accounted for over 40 per cent of employment losses. Men, youth and temporary workers were disproportionately affected by the fall in employment.

Although growth returned to positive territory in the second half of 2010, it remains fragile; but there have been some encouraging signs, in terms of both external demand and the composition of job creation. These developments are partly due to market forces associated the adjustment process that were already underway, but also to a range of policy measures adopted since the onset of the crisis.

There is concern that as the labour market recession persists, skills will erode and labour market detachment may become widespread – potentially derailing the fragile economic recovery underway. Indeed, there is a sense of urgency about the need to align macroeconomic policies with labour market and social policies. With that in mind, the purpose of Chapter 2 is to shed light on recent policy developments aimed at addressing these challenges. The remainder of the report examines in greater detail how policies in the area of investments and productivity (Chapter 3), employment protection legislation (Chapter 4) and the benefit-support system (Chapter 5) can encourage and facilitate the shift towards a more balanced growth pattern and promote quality job creation.

## ANNEX A

## DETAILED LABOUR MARKET DEVELOPMENTS BY REGION

		Q1 2008					Q1 2011				
		Total	Males	Females	Youth	Adult	Total	Males	Females	Youth	Adult
<b>Employment rate</b>	<b>National</b>	<b>53.6</b>	<b>63.9</b>	<b>43.8</b>	<b>40.1</b>	<b>55.5</b>	<b>47.1</b>	<b>53.4</b>	<b>41.1</b>	<b>24.3</b>	<b>50.0</b>
	Andalucía	48.7	60.3	37.4	39.2	50.2	41.5	48.6	34.7	21.4	44.5
	Aragón	55.4	64.6	46.3	40.3	57.2	47.5	53.7	41.6	23.2	50.3
	Asturias	47.5	56.8	39.0	34.2	48.9	42.1	47.8	36.9	18.0	44.3
	Illes Balears	55.9	65.6	46.1	39.0	58.3	47.2	52.3	42.1	24.2	50.2
	Canarias	51.8	61.6	42.2	34.1	54.6	44.7	49.4	40.0	20.1	48.1
	Cantabria	53.3	64.4	42.8	35.2	55.5	46.3	52.8	40.2	19.8	49.2
	Castilla y León	49.8	60.8	39.0	35.8	51.5	45.4	52.4	38.6	24.8	47.6
	Castilla - La Mancha	51.1	63.7	38.4	44.8	52.1	45.5	54.9	36.0	24.4	48.4
	Cataluña	58.3	67.7	49.1	44.4	60.0	51.1	56.6	45.8	29.4	53.6
	Comunitat Valenciana	55.1	64.9	45.5	43.5	56.7	45.2	50.9	39.7	21.6	48.2
	Extremadura	45.2	58.2	32.6	34.2	47.0	41.2	50.1	32.4	20.8	44.1
	Galicia	49.9	59.2	41.4	34.7	51.7	45.4	51.4	40.0	22.6	47.8
	Comunidad de Madrid	59.1	68.1	50.8	41.1	61.6	54.3	60.5	48.7	27.7	57.6
	Región de Murcia	55.6	67.0	44.0	46.9	57.0	45.6	51.8	39.3	28.6	48.1
	Comunidad Foral de Navarra	57.7	66.5	49.0	39.6	59.9	52.5	59.0	46.1	30.0	55.1
	Pais Vasco	54.2	64.0	44.9	34.7	56.3	51.6	57.5	46.1	25.4	54.2
	La Rioja	55.7	65.4	45.9	42.5	57.4	50.3	57.3	43.5	20.8	53.7
	Ceuta	44.6	61.6	28.5	24.4	48.8	40.7	52.3	28.2	16.1	45.5
	Melilla	42.2	59.9	25.1	21.2	45.8	44.4	53.9	35.9	13.6	49.9
<b>Unemployment rate</b>	<b>National</b>	<b>9.6</b>	<b>7.9</b>	<b>12.0</b>	<b>21.3</b>	<b>8.3</b>	<b>21.3</b>	<b>20.8</b>	<b>21.9</b>	<b>45.4</b>	<b>19.1</b>
	Andalucía	14.8	11.8	19.1	26.8	13.0	29.7	28.1	31.8	53.0	27.1
	Aragón	6.0	5.0	7.4	16.1	5.0	18.0	17.7	18.3	43.0	16.0
	Asturias	8.5	5.8	11.8	22.2	7.3	18.2	17.6	18.9	45.8	16.6
	Illes Balears	10.7	8.9	13.2	21.7	9.5	25.4	24.1	26.9	46.2	23.5
	Canarias	14.7	13.3	16.6	27.4	13.2	28.5	29.1	27.9	52.9	26.3
	Cantabria	6.4	4.1	9.5	14.3	5.7	16.4	17.2	15.3	46.1	14.3
	Castilla y León	8.2	5.1	12.4	19.2	7.1	17.4	15.8	19.3	39.3	15.7
	Castilla - La Mancha	9.6	6.7	14.0	17.2	8.5	21.8	19.1	25.6	47.8	19.0
	Cataluña	7.6	6.8	8.7	17.9	6.5	19.0	19.7	18.2	43.6	16.7
	Comunitat Valenciana	9.6	8.1	11.7	20.4	8.3	24.1	23.8	24.5	50.9	21.7
	Extremadura	14.4	9.6	21.6	28.0	12.5	25.1	22.5	28.6	50.3	22.4
	Galicia	8.4	7.4	9.5	19.5	7.3	17.3	16.7	18.1	41.3	15.6
	Comunidad de Madrid	7.4	6.2	8.9	20.9	5.9	15.4	14.9	16.0	36.6	13.7
	Región de Murcia	9.5	7.9	11.9	16.5	8.5	26.2	26.5	25.7	40.7	24.6
	Comunidad Foral de Navarra	6.1	5.2	7.2	17.6	5.0	13.4	12.6	14.4	28.1	12.3
	Pais Vasco	5.6	4.4	7.3	15.1	4.9	11.6	11.3	12.0	30.3	10.5
	La Rioja	6.3	4.5	8.7	15.7	5.3	15.4	14.9	16.2	44.9	13.4
	Ceuta	16.9	12.6	24.4	40.0	13.4	26.4	21.9	34.1	57.1	22.6
	Melilla	22.7	16.4	34.3	49.8	19.3	22.5	19.7	25.9	58.6	19.1
<b>Participation rate</b>	<b>National</b>	<b>59.4</b>	<b>69.3</b>	<b>49.7</b>	<b>50.9</b>	<b>60.5</b>	<b>59.9</b>	<b>67.4</b>	<b>52.7</b>	<b>44.5</b>	<b>61.8</b>
	Andalucía	57.1	68.4	46.2	53.5	57.7	59.0	67.5	50.8	45.5	61.0
	Aragón	58.9	67.9	50.0	48.0	60.2	57.9	65.2	50.8	40.6	59.9
	Asturias	51.9	60.3	44.3	44.0	52.7	51.4	58.0	45.6	33.2	53.1
	Illes Balears	62.6	72.1	53.1	49.8	64.4	63.2	68.9	57.5	44.9	65.6
	Canarias	60.8	71.1	50.6	47.0	62.9	62.5	69.6	55.5	42.6	65.3
	Cantabria	56.9	67.1	47.2	41.1	58.9	55.4	63.8	47.5	36.8	57.4
	Castilla y León	54.2	64.1	44.5	44.3	55.4	54.9	62.2	47.9	40.9	56.4
	Castilla - La Mancha	56.6	68.3	44.7	54.1	56.9	58.2	67.9	48.4	46.8	59.7
	Cataluña	63.1	72.6	53.8	54.0	64.2	63.1	70.5	56.0	52.2	64.4
	Comunitat Valenciana	61.0	70.6	51.5	54.7	61.8	59.6	66.8	52.6	44.0	61.5
	Extremadura	52.8	64.3	41.6	47.5	53.7	54.9	64.7	45.4	41.9	56.8
	Galicia	54.4	63.9	45.7	43.1	55.8	54.9	61.6	48.8	38.4	56.7
	Comunidad de Madrid	63.8	72.6	55.7	52.0	65.4	64.2	71.1	58.0	43.7	66.8
	Región de Murcia	61.4	72.7	49.9	56.1	62.3	61.8	70.5	52.9	48.3	63.7
	Comunidad Foral de Navarra	61.4	70.2	52.7	48.1	63.0	60.6	67.5	53.9	41.8	62.8
	Pais Vasco	57.4	66.9	48.4	40.8	59.2	58.4	64.8	52.4	36.5	60.6
	La Rioja	59.4	68.5	50.2	50.4	60.5	59.5	67.3	51.9	37.8	62.0
	Ceuta	53.7	70.5	37.7	40.6	56.3	55.3	66.9	42.8	37.5	58.8
	Melilla	54.7	71.6	38.2	42.2	56.8	57.3	67.1	48.4	32.9	61.6

Source: The Spanish National Institute of Statistics (INE).

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## **CHAPTER 2**

# **POLICY DEVELOPMENTS TO SUPPORT THE ADJUSTMENT PROCESS**

### **INTRODUCTION**

In order to counter the effects of the financial crisis, Spain – like most advanced economies – took exceptional measures to support its banking system and stabilize the financial sector. At the same time, the Spanish Government announced a stimulus package in the order of €53.4 billion aimed at households and firms (the Spanish Economic and Employment Stimulus Plan, Plan E). Within a year, faced with growing debt concerns, the Spanish Government undertook severe austerity measures, estimated at 8.2 per cent of GDP – among the largest in Europe. These fiscal consolidation efforts, albeit timely and necessary, have limited the scope for additional support to address persistent labour market and social challenges. In parallel, however, Spain has embarked on an ambitious, comprehensive reform process in a number of areas, with the aim of addressing long-standing structural issues while being mindful of encouraging the economic adjustment process.

The aim of this chapter is to examine in more detail these various policy levers. In particular, section A looks at the measures put forth to stabilize the financial markets and provides a more detailed view of the different measures carried out as part of the stimulus plan, including credit-related initiatives. This is followed, in section B, by a comprehensive look at the fiscal consolidation measures put in place by the Government. The section also compares Spain's fiscal consolidation with that in other EU and advanced economies. Section C examines recent policy developments, notably efforts to reform employment protection legislation and amendments to the existing suite of labour market and social policies. The final section summarizes the analysis with a number of policy considerations and conclusions.

## A MEASURES TO SUPPORT THE FINANCIAL SECTOR AND AGGREGATE DEMAND

### 1 RESTORING CONFIDENCE IN THE FINANCIAL SECTOR

In September 2008, with the collapse of Lehman Brothers, credit markets froze and stock indices fell, and almost all major economies, including Spain, put in place measures to restore market confidence. In the case of Spain, the guarantee for private deposits was increased from €20,000 to €100,000. In addition, in October of 2008, the Government allocated €30 billion (later expanded to €50 billion) to the *Fondo para la Adquisición de Activos Financieros* (Financial Asset Acquisition Fund; FAAF). The FAAF was created to supply banks with extra liquidity through the purchasing of high-quality bank liabilities, and to secure funds and provide individuals and enterprises with credit guarantees at reasonable prices.<sup>10</sup> Through the purchase of high-quality assets, the Government of Spain provided financial entities with a new source of financing, both competitively priced and financially sustainable in the long term. While the eligibility criteria for financial guarantees varied between European countries, Spain opted for broad eligibility requirements. For example, the guarantees in Spain were available to “credit institutions” with significant share of the credit market; institutions that qualified included banks, credit cooperatives, financial credit establishments, electronic money companies, consolidated credit institutions and credit entity groupings. Loan guarantees amounted to €100 billion with a time limit of three months to three years, or in exceptional cases five years.

The Government also created the *Fondo de Reestructuración Ordenada Bancaria* (Fund for Orderly Bank Restructuring; FROB) with the aim of restructuring and strengthening the equity of Spanish financial institutions. The first goal of the FROB was to inject liquidity in the banking sector and stabilize the financial system. The fund’s second goal was to address the issue of overcapacity generated by aggressive expansion in the banking sector (especially the savings banks called *cajas*) during the boom

<sup>10</sup> Mayer Brown, 2009.

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period. The FROB was allocated €9 billion of capital (75 per cent provided by the Treasury and 25 per cent by the deposit guarantee funds) and a financing capacity of €90 billion. The State's contribution (first 75 per cent) was funded through FAAF, which legally expired after the creation of the FROB. One of the major challenges was to address the decline in the revenue streams among the small and medium-sized financial institutions, the *cajas*. Revenue among the *cajas* was dramatically affected by rising defaults on mortgages, the tightening of financing conditions in the wholesale money market and the decline in the volume of activity. Hence, one of the main aims of the restructuring efforts was to encourage mergers among the *cajas*, or, in the case of non-viable institutions, to take over the management and act as traditional deposit guarantee funds. In the first year of the FROB's existence, 39 of the 45 savings banks were restructured, which covered 92 per cent of the total assets of the savings banks.

In addition, the recent Royal Decree Law (2/2011), which represents the first stepping stone in a new phase of restructuring, has imposed capital ratio requirements of 10 per cent for financial institutions and 8 per cent for intermediary institutions that rely on interbank and private equity, such as *cajas*.

## **2 FISCAL STIMULUS TO SUPPORT AGGREGATE DEMAND AND THE MOST VULNERABLE**

In November 2008, the Spanish Government approved a stimulus package called the *Plan Español para el Estímulo de la Economía y el Empleo* (Economic and Employment Stimulus Plan, Plan E). Plan E was a comprehensive package comprising €53.4 billion and was aimed at supporting families and companies and raising employment rates. The measures were aligned on two main axes: (i) the fiscal stimulus effort; and (ii) direct financial support (discussed in subsection A.3, below).

The total fiscal stimulus package in Spain is estimated to amount to €30.9 billion, equivalent to close to 3 per cent of GDP in 2009, slightly less than



the average among other advanced economies (close to 4 per cent). In comparison, China had the largest stimulus package at 13.3 per cent of its GDP, whereas Brazil and the Russian Federation implemented the smallest packages, at just over 1 per cent of GDP. Broadly speaking, advanced economies in the G20 focused mostly on tax cuts, while developing and emerging economies placed greater emphasis on infrastructure spending. Meanwhile, advanced economies also spent considerably more on labour market measures than the developing and emerging economies. The Spanish plan centred around three main pillars: (i) raising employment rates – which accounted for close to 35.6 per cent of the total fiscal stimulus effort; (ii) supporting families – 25.5 per cent the total fiscal stimulus effort; and (iii) supporting companies – with 38.9 per cent of the total fiscal stimulus effort (Table 2.1). Overall, more than half of fiscal stimulus spending was concentrated on tax cuts and around one-third on employment programmes.

**Table 2.1 Fiscal support**

	2008 (€ bn)	2009 (€ bn)	2009 (%GDP)	Jobs created or retained
<b>Fiscal support to employment</b>		<b>11.0</b>	<b>1.04</b>	<b>501,577</b>
State Fund for Local Investment		8.0	0.76	426,577
Special Fund for Employment and Economic Reactivation		3.0	0.28	75,000
<b>Direct fiscal support to families</b>	<b>5.0</b>	<b>7.9</b>	<b>0.75</b>	
Tax cuts	5.0	7.8	0.74	
<i>€400 reduction in income tax</i>	5.0	6.0	0.57	
<i>Elimination of the Property Increment Tax</i>		1.8	0.17	
Increase in the budget for scholarships to guarantee access to education*		0.08	0.01	
<b>Fiscal measures to support SMEs</b>		<b>12</b>	<b>1.14</b>	
Tax cuts		9	0.85	
<i>Monthly VAT return</i>		6	0.57	
<i>New progress payment regime for corporate tax</i>		3	0.28	
FTPME action line		3	0.28	

Note: Figures for 2009 relate to Plan E.

\*The increase amounted to 6% of the total budget of €1,281 million for scholarships in 2009.

Source: Government of Spain, 2009.

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### *Raising employment rates*

The stimulus plan put forth a number of direct measures to support employment creation. Budgeted at €11 billion, the support to employment creation was based on two special funds: the State Fund for Local Investment (SFLI) and the Special Fund for Employment and Economic Reactivation (SFEER), as well as a number of new regulatory provisions. According to official estimates, these two special funds would contribute to the creation or retention of over 500,000 jobs.

- *State Fund for Local Investment*: This fund was created in November 2008 with the aim of maintaining employment and creating jobs, establishing partnerships between the central and local Governments and increasing public investment at a local level by financing newly planned public works.<sup>11</sup> Endowment for this fund, which was to be used in 2009, totalled €8 billion, to be distributed among more than 8,000 municipalities according to a strict population criterion. To ensure the immediate use of the fund, the distribution of funds was designed in such a way that for each approved project, 70 per cent of the total amount allocated was transferred after the project was approved – so that implementation could begin immediately – and 30 per cent was to be transferred when the project had been completed. By September 2010, 96 per cent (€7.7 billion) of the total endowment had been used, and 98 per cent of the approved projects were completed. Projects approved by this fund focused on the upgrading and rehabilitation of public spaces (32 per cent), provision of infrastructure facilities related to basic services (29 per cent) and provision of infrastructure facilities for educational, cultural and sporting purposes (17 per cent).
- *Special Fund for Employment and Economic Reactivation*: Endowed with €3 billion, this fund aimed to finance immediate actions in three strategic areas: (i) projects that complement the SFLI projects in the municipalities, notably €705 million was dedicated to carry out activities in the central Government's main quarters and police stations and transport infrastructure; (ii) employment creation projects (€1.5 billion) to support areas of research, development and innovation, social tourism and social

<sup>11</sup> ILO, 2010b.

services, as well as environmental-related activities; and (iii) support for employment retention in the automotive sector (€800 million).

- *Regulatory measures and other actions:* A number of legal provisions were created in order to stimulate the housing market and related employment, including: (i) a new law to promote energy efficiency in buildings; (ii) a series of rules to improve regulation of real estate investment companies; (iii) new regulations to promote in-depth urban renewal and housing refurbishment; and (iv) public bids for land purchases to promote the construction of subsidized housing.

### *Supporting families*

Plan E included a set of direct fiscal measures to assist families, mainly through tax reductions, but also through enhanced youth study opportunities – via increased funding for scholarships. Reduced taxation is estimated to have benefitted 16.5 million taxpayers through the reduction in income tax and 1 million through the elimination of the Property Increment Tax. These measures amounted to €5 billion in 2008 and €7.9 billion in 2009 – almost 1.2 per cent of GDP in the two years.

In addition to direct fiscal measures, the stimulus package included provisions and regulations to protect families being affected by the collapse of the housing sector and to open up opportunities for them. Among these efforts, it is worth underlining the following:

- The expansion of mortgage loan periods: This measure opened the possibility for workers who had acquired housing before the crisis but had since lost their job to postpone their mortgage repayments for two years, without additional charges.
- Extension of the two-year period for selling a usual residence in order to benefit from tax exemptions on reinvestment: This measure was aimed at families who had engaged in housing acquisitions during the 2006–08 period to benefit from the tax exemptions on reinvestment. To be eli-

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gible for this exemption, families needed to buy a new house and sell their usual residence within a two-year maximum period. This crisis-related measure extended the deadline for selling the usual residence to December 2010.

- Extension of the period for subscription for a savings-for-home loan: This loan is a state loan intended for people acquiring their first residence or refurbishing their usual residence.

### *Supporting companies*

The stimulus plan also included efforts to support firms – especially small and medium-sized enterprises (SMEs) – and help them carry out the necessary productive investments to strengthen their operations. Fiscal support to companies reached €12 billion in 2009 – equivalent to 1.14 per cent of GDP. This was implemented mainly through a series of tax cuts aimed at improving the liquidity of firms (e.g. monthly VAT returns and a new progress payment regime for corporate tax). The amount deferred thanks to tax cuts reached €9 billion in 2009.

In addition, the Spanish Treasury extended the so called FTPYME action line (an asset-backed security fund for small- and medium-sized enterprises) until 2010. Through this line of credit, the Government intended to encourage credit entities to grant loans to SMEs as it facilitated fund mobilization through the asset-backed security system. In 2009 and 2010, the funds mobilized amounted to €3 billion per year.

Besides the direct fiscal support made available to SMEs, a couple of regulations were put into force, the most important of which was the asset redemption leeway for corporate taxpayers. This new law stipulates that corporate taxpayers willing to carry out investment in new assets will be allowed to pay them back at will, provided the assets were acquired during a chargeable period between 2009 and 2010 and the company retains staff.

### 3 INCREASED ACCESS TO CREDIT FOR FIRMS AND HOUSEHOLDS

In December of 2008, the Minister of Finance signed an agreement with the Official Institute for Credit (ICO) and the heads of credit-related institutions. The agreement created a number of new credit lines and expanded a number of already existing ones, with the objective of supporting firms and workers during the time of crisis and to provide dynamism to the economic system. The agreement instructs the ICO, in accordance with its rules of action, to be the entity in charge of managing the different measures stipulated. All these actions constitute another axis of the Spanish plan for stimulating the economy and employment, Plan E.

The total amount provided in credit lines by the ICO equalled €30.3 billion in 2009; of this amount, only €22.5 billion – or 2.13 per cent of GDP – represented new funds provided as part of additional or enhanced financial support measures. As with the fiscal measures put forth by Plan E, these financial measures have three different but mutually reinforcing targets: (i) supporting firms (mainly SMEs); (ii) providing direct support for families; and (iii) promoting employment creation:

- *Promoting employment creation:* Two new ICO lines were created by Plan E to promote employment creation. The Tourism Renovation Plan supports SMEs in the tourism sector to improve their infrastructure facilities, especially refurbishments aimed at contributing to energy saving and environmental protection. This ICO line offers credit of up to 90 per cent of the renovation plan (up to €1 million per enterprise) at 1.5 per cent interest, to be repaid over up to 12 years. This financing line amounted to €400 million in 2009. The Housing Renovation Plan allocates €3 billion to enhance and promote real estate development.
- *Providing direct support to families:* The partial provisional deferment for mortgage repayments (€6 billion) allows unemployment workers or

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self-employment workers with earnings below a threshold to request a voluntary reduction of their mortgage payments. The acceptance of requests is subject to agreement by the financial entities which granted the loans, with the deferred amounts being guaranteed by the State.

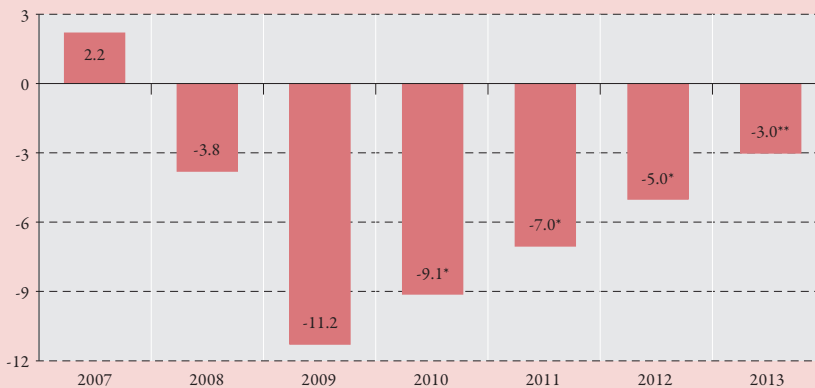
- *Supporting firms:* Two new credit lines were launched: (i) a liquidity line for SMEs, aimed at financing solvent and viable firms' working assets (€10 billion to be funded jointly by ICO and partner financial institutions); and (ii) provisions that allow SMEs that acquired debt through the ICO's so-called Action for SMEs line to defer the payments on their loans during 2009 (€5 billion). In addition, ICO reinforced four other credit lines through agreements with credit institutions, with the aim of ensuring that the self-employed and SMEs have suitable financing to undertake investment projects and related activities. These lines have a total budget of €10.9 billion, which represents an increase of almost 50 per cent over 2008's budget:
  - *Action for SMEs:* Allows, for the first time, SMEs to invest 40 per cent of the received credit in working capital, provided they invest the other 60 per cent in fixed productive assets.
  - *Internationalization:* Aims to increase the presence of Spanish firms abroad by offering preferential investment conditions.
  - *Support to entrepreneurship:* Aims to finance up to 90 per cent of any investments in new productive assets. This credit line is intended for self-employed workers and entrepreneurs engaged in creating new companies or new professional activities.
  - *Increase in business capacity:* Aims to encourage firms interested in developing more ambitious investment projects, by providing adequate financing covering up to 80 per cent of the net project investment.

**Table 2.2 IGO credit lines created or enhanced as part of Plan E (million euros)**

	Total endowment (2009–10)	Increase from 2008	Used in 2009	Beneficiaries
<b>I. Support to employment creation</b>				
Tourism renovation plan	400	400	153	67
Housing renovation plan	3,000	3,000	1,130	553
<b>II. Support to families</b>				
Partial provisional deferment of mortgage repayments	6,000	6,000	73	11,918
<b>III: Support to enterprises</b>				
Liquidity for SMEs*	5,000	5,000	3,451	83,030
Action for SMEs	10,000	3,000	5,168	76,230
Internationalization	200	50	199	257
Support to entrepreneurship	100	28	63	1,992
Increase in business capacity	600	-	815	1,055
Deferment for SMEs	5,000	5,000	11	673
<b>Total</b>	<b>30,300</b>	<b>22,478</b>	<b>11,063</b>	<b>175,775</b>
% of 2009 GDP	2.87	2.13	1.05	

Notes: \*Total endowment for this line equals €10 billion, but half is provided by the Government and half by the credit institutions involved.

Source: (Government of Spain, 2009).

**Figure 2.1 Reduction of the public deficit through the Fiscal Consolidation Plan**


\*Figures for 2010 to 2012 are estimated based on an even deficit reduction per year.

\*\*Figure for 2013 is the objective set by the Fiscal Consolidation Plan.

Source: IMF, WEO October 2010; Malo, 2011.

## B THE FISCAL CONSOLIDATION PLAN

The combination of a slow recovery and the series of fiscal measures put forth caused public deficits to rise dramatically. As a consequence, the Spanish Government launched the Fiscal Consolidation Plan at the beginning of 2010. In line with the requirements of the Stability and Growth Pact of the European Union, the plan seeks to cut the fiscal deficit to 3 per cent of GDP in 2013 (Figure 2.1). To achieve this, the Spanish Government embarked on an ambitious set of austerity measures significantly larger than the original fiscal stimulus plan. Indeed, according to the *World of Work Report 2010*,<sup>12</sup> Spain's fiscal consolidation – aiming to reduce the public deficit by 8.2 percentage points from its level in 2009, or 11.2 per cent of GDP – is among the largest consolidation packages, alongside Greece, Ireland and the United Kingdom (Table 2.3).

**Table 2.3 Fiscal stimulus vs. consolidation packages for the G20 and selected EU countries**

	Amount of announced fiscal stimulus package (billions)	Fiscal stimulus as % of GDP (2008)	Amount of announced fiscal consolidation (billions)	Fiscal consolidation as % of GDP (2009)
Denmark		3.1	DKK24.5	1.5
Estonia			EEK20	9.0
France	€26	1.3	€100	5.1
Germany	€81	3.3	€80	3.3
Greece			€30	13.0
Hungary	HUF3200	12.0		1.6
India	Rs1860	3.5	Rs55	0.1
Ireland			€13.85	8.5
Italy			€24.9	1.6
Latvia			LVL1	7.0
Lithuania			LTL5.3	5.6
Netherlands	€6	1.0	€16.5	2.7
Portugal	€2.18	1.3		3.4
Romania			€1.7	1.4
Slovenia	€0.86	2.3		4.0
Spain*	€30.9	3.0	€84	8.0
United Kingdom	£20	1.4	£128	9.0

Note: Includes 24 advanced economies, 29 developing & emerging economies, and 12 Asian economies. Components of the stimulus spending are shares of the total stimulus.  
Source: IILS based on national sources.

<sup>12</sup> ILO, 2010c.



This fiscal consolidation programme, as approved by Royal Decree 8/2010 of 20 May 2010, is structured around the Immediate Action Plan 2010 and the Austerity Plan 2011–2013. The Immediate Action Plan 2010 includes, among other things, an agreement for non-availability of €5 billion to all Government ministries and a 10 per cent reduction in the vacancies for public employment. The Austerity Plan 2011–2013 seeks to cut public spending across the board; although there are a few exceptions, notably pensions, unemployment benefits, aid for dependency, education, and research and development. The measures focus on reductions in staff costs, operating expenses and investment. In particular, the plan provides for the following:

- *Reduction in public sector labour costs in 2010*: Salaries and benefits for public sector workers were reduced by 5 per cent on average in 2010 (to be maintained during 2011). This reduction includes both base salaries and complementary benefits, and concerns all public administrations. However, in order to minimize its impact on lower earners, wage cuts have been applied following the progressivity criterion.
- *Deferral of pension revaluations in 2011*: In 2011, all expected revaluations of retirement benefits have been suspended, with changes limited to adjustments for inflation. This measure is not applicable to the lowest and non-contributory pensions, which affect the most disadvantaged groups.
- *Elimination of the retroactivity criterion from the payment of dependency benefits*: The dependency law (*Ley de Promoción de la Autonomía Personal y Atención a las personas en situación de dependencia y a las familias*) provides assistance to individuals with a disabling illness or who have had an accident. Until recently, when a beneficiary collected their first instalment, a lump sum was also allocated to compensate for the number of months that had elapsed since the application was made. This retroactive payment of dependency benefits was eliminated under the consolidation plan. Importantly, though, as part of reform process the Government included a clause establishing that applications must be processed within a maximum of six months.

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- *Elimination of all State support for the birth or adoption of a child:* Under this clause of the austerity plan, all income tax deductions and social security allowances for the birth or adoption of a child have been eliminated. Moreover, the €2,500 contribution by the Government for each new child (born or adopted) was abolished from 1 January 2011.
  - *Measures to reduce the deficits of local entities:* Local authorities are obliged to use all the funds saved from the reduction of labour costs to reduce deficits and arrears and for investment financing. In addition, all consultations for long-term debt operations are postponed until 2012.
  - *Additional measures aiming to achieve more effective control of public spending:* These measures include efforts to foster better understanding and closer monitoring of partnership contracts between the public and private sectors, as well as concession contracts for public works by the Ministry of Economy and Finance.

## C RECENT REFORM INITIATIVES TO FOSTER ADJUSTMENT

In parallel with the measures that Spain has embarked on, there is a series of ambitious labour market and institutional reforms to foster economic and labour market adjustment.

### 1 LEY DE ECONOMÍA SOSTENIBLE (LAW ON SUSTAINABLE ECONOMY)

In November 2009, the Spanish Cabinet approved a draft Bill for the Law on Sustainable Economy (LES) – the Government strategy to define the new growth model for the economy based on innovation, technology, internationalization of business, competition and efficient public administration.<sup>13</sup> Parliament approved the LES on 15 February 2011, and the law entered into force 6 March 2011. There are three main areas to the LES, including efforts to: (i) improve the economic environment; (ii) promote competitiveness; and (iii) commit to environmental sustainability. A Sustainable Economy Fund will be created, with provisions worth up to €20 billion for the 2010 and 2011 fiscal years – 50 per cent of which will be co-financed by financial institutions. The fund will be used to support a range of measures, from private sector investment to environmental improvements. Particular initiatives include the following:

- *Promoting innovation and research and development:* Funding will be allocated to encourage the creation of technology-based firms and to foster the renewal of traditional sectors in an effort to improve their competitiveness. For instance, the rate of corporate tax reductions on investments in R&D will be increased from 8 per cent to 12 per cent to foster innovative activities.
- *Streamlining incorporation:* Through the reforms, administrative procedures for incorporating limited companies were improved. For example, the waiting time for incorporation was established at five days where the share capital is between €3,100 and €30,000.

<sup>13</sup> Government of Spain, 2010.

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- *Green transition:* A series of incentives will also be given to sectors linked to renewable energies and climate change. For instance, the new law provides for an 8 per cent tax credit (increased from 4 per cent) for investments in tangible assets to protect the environment, e.g. equipment to prevent air or noise pollution from industrial facilities, to prevent the pollution of surface, ground and sea water, or to reduce, recover or treat the investor's own industrial waste.

## 2 LABOUR MARKET REFORM

As a follow-up to the LES, in 2010 Spain embarked on an extensive series of labour market reforms, one of the principal aims of which was to address the longstanding issue of labour market duality which has characterized Spain's labour market over the past few decades. The reform introduces a wide range of changes to the provisions stipulated in the Spanish Labour Law (the Workers' Charter), including amendments to dismissal costs and procedures, e.g. severance payments for both open-ended contract workers and temporary workers – issues which are taken up in greater detail in Chapter 4.

There were also a series of amendments to active labour market policies, including the introduction and expansion of financial subsidies for the hiring of vulnerable groups, notably youth and women. The reforms also included – in addition to the efforts discussed above – support to improve labour market intermediation. These efforts and the issue of active and passive labour market programmes are discussed in more detail in Chapter 5.

## 3 PENSION REFORM

In 2011, the Government along with social partners embarked on a substantial reform of the pension system as part of the 2011 Economic and Social Agreement. The reform efforts aim to address some of the structural challenges facing the pension system, notably preserving the long-term financial sustainability of the system. The key features of the reform are: (i)

the retirement age will increase from 65 to 67, through a gradual increase from 2013 to 2027; (ii) the number of years of contribution required to obtain full pension benefits will gradually increase from 35 to 37; (iii) workers will have to contribute for 38.5 years to retire at the age of 65; (iv) the percentage of full pension received by a worker will be proportional to the number of years contributed, starting at 50 per cent for careers of 15 years up to 100 per cent for careers of 37 years; and (v) full pension benefit entitlements will be based on the last 25 years of earnings, and increased gradually from the current 15 years. Also, the reform restricts the conditions of early retirement and allows maternity leave to be counted as time at work.

Importantly, the 2011 pension reform is the outcome of extensive consultations between the Government and social partners and thus is viewed as being fair and equitable. Indeed, in the context of the changes in population ageing, the reforms to secure financial sustainability and guarantee adequate income support in retirement are valuable steps in the right direction and should contribute to the viability of the pension system.

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## D POLICY CONSIDERATIONS

Spain, like many other major EU countries, put in place measures to inject liquidity and stabilize the financial system. The Government also introduced the Economic and Employment Stimulus Plan (Plan E) which leveraged primarily existing policy instruments. In this respect, the Government reinforced already existing automatic stabilizers, notably an important increase in resources to Public Employment Services (PES) and improvements to unemployment assistance and pension guarantees.

Another important axis of the Spanish Plan was the package of direct financial support firms and families, carried out by means of an agreement between the ICO and a number of credit-related institutions. Through this agreement, a number of new credit lines were created, and several of those already in existence were expanded, with the objective to support firms and workers during a time of crisis and provide dynamism to the economic system.

These measures were, however, ineffective in addressing the nature of the challenge. Indeed, as Chapter 1 and the following chapters illustrate, the Spanish growth model was unbalanced and singularly focused. The bulk of the measures introduced were thus in many regards an attempt to support this model. And as the crisis deepened, the need to curb public spending intensified and the Spanish Government embarked on austerity measures – fiscal consolidation as a proportion of GDP is estimated to be around 8 per cent, making it one of the largest consolidation packages in Europe. This has limited the extent to which new or additional labour market and social measures can be introduced in an effort to address the persistent employment challenges.

Much of the gains of the past two decades have been erased. Efforts are thus urgently needed to support the transition to a more balanced economy, rather than supporting the model of the past. In this regard, over the past two years Spain has introduced a comprehensive series of reforms to employment legislation, labour market policies and benefit systems in an effort to ensure that the institutional setting is supportive of a more bal-

anced growth and investment pattern and is conducive to the economic transition underway. The reform efforts have also been mindful of the need to support quality job growth and social protection.

However, in a number of these areas the reform process must continue, and there is scope to improve further the progress which has been made of late. The focus of the following chapters is to examine in more detail a number of these issues and to propose, where relevant, policy amendments to support this process.

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## CHAPTER 3

# IMPROVING COMPETITIVENESS AND FOSTERING PRODUCTIVITY

### INTRODUCTION

Spain is ranked 42nd in the Global Competitiveness Index of the World Economic Forum,<sup>14</sup> which is a fall of nine places from 2010 and 14 places from 2005, when the index as defined today was created (Table 3.1). Moreover, Spain's position is one of the lowest among EU countries, just above Italy – placed 48th – and far behind other European countries, such as Germany (5th), Finland (7th), the Netherlands (8th), Denmark (9th), the United Kingdom (12th) and France (15th).

The current macroeconomic environment undoubtedly weighs on perceptions that competitiveness has deteriorated. But the comparably low ranking is also due to a number of systemic factors, notably as regards innovation and the degree of business sophistication. And the fact is that competitiveness trends have been associated with limited productivity gains relative to other European countries (Figure 3.1).<sup>15</sup>

<sup>14</sup> Since 2005, the World Economic Forum bases the construction of its Global Competitiveness Index on a highly comprehensive number of indicators (over 100) that capture the microeconomic and macroeconomic foundations of national competitiveness. In the 2010 Report, the index featured 139 economies (World Economic Forum, 2010).

<sup>15</sup> For instance, approximately 70 per cent of the gap in GDP per capita between the United States and Spain was explained by the gap in GDP per hour worked between these countries. See for example Pilat, 2005.

Table 3.1 Global Competitiveness Index rankings by competitiveness determinant, 2010

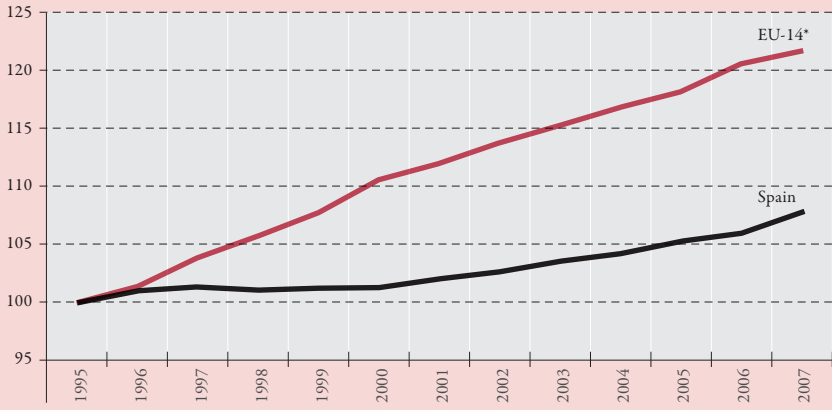
	Germany	Netherlands	United Kingdom	France	Spain	Italy
<b>Index 2010–11</b>	5	8	12	15	42	48
<b>Index 2009–10</b>	7	10	13	16	33	48
<b>Basic requirements</b>	6	9	18	16	38	46
Institutions	13	12	17	26	53	92
Infrastructure	2	7	8	4	14	31
Macroeconomic environment	23	25	56	44	66	76
Health and primary education	25	8	19	16	49	26
<b>Efficiency enhancers</b>	13	8	7	15	32	45
Higher education and training	19	10	18	17	31	47
Goods market efficiency	21	8	22	32	62	68
Labour market efficiency <sup>16</sup>	70	23	8	60	115	118
Financial market development	36	26	25	16	56	101
Technological readiness	10	3	8	12	30	43
Market size	5	19	6	7	13	9
<b>Innovation and sophistication factors</b>	5	8	12	16	41	32
Business sophistication	3	5	9	12	35	23
Innovation	8	13	14	19	46	50

Source: World Economic Forum, 2010.

As the economy embarks on a structural transformation there are a number of opportunities to narrow this productivity gap – provided that policies are aligned accordingly. With this in mind, section A discusses the situation in Spain relative to that in other advanced economies in terms of the proximate factors of competitiveness before the housing crisis in 2007, namely wages, prices and labour productivity. Section B examines the underlying drivers of the deteriorating competitiveness before the crisis: multi-factor productivity, job quality and investment. Section C looks at recent developments in a number of these areas with a view to understanding how best to support the ongoing transformation. The final section draws policy conclusions from the analysis.

<sup>16</sup> Note that the level of labour market flexibility as stated in the Global Competitiveness Index has been used in this chapter only for cross-comparison purposes. Flexibility accounts for 50 per cent of the measure of “labour market efficiency” and draws on six indicators: (i) cooperation in labour–employer relations; (ii) flexibility of wage determination; (iii) rigidity of employment; (iv) hiring and firing practices; (v) redundancy costs; and (vi) extent and effect of taxation. Most of these indicators are derived from an Executive Opinion Survey (only rigidity of employment and redundancy costs are not derived from this survey), which diminishes the objectivity and accuracy of the index.

**Figure 3.1 Annual growth of labour productivity in Spain and the EU-14\*, 1996–2007**  
(percentages)



\*Weighted average for the EU-15 without Spain.  
Note: Productivity is measured as GDP per hour worked.  
Source: The Conference Board Total Economy Database.

## A PROXIMATE FACTORS OF EXTERNAL COMPETITIVENESS BEFORE THE CRISIS

### 1 WAGES, PRICES AND LABOUR PRODUCTIVITY DEVELOPMENTS

The strong growth period starting in the early 1990s led to a comparably high level of inflation of consumer prices during the period preceding the crisis (Table 3.2). In the case of Spain, producer prices increased at an average annual pace of 4.0 per cent between 2000 and 2007, whereas in France and Germany it was roughly 2 per cent and 2.2 per cent for the Eurozone.<sup>17</sup> In other words, over the span of seven years, prices in Spain rose much more quickly than its Eurozone counterparts.

Similarly, the increase in nominal labour costs in Spain was well above that observed in other European countries.<sup>18</sup> In Spain, nominal labour costs increased between 2000 and 2007 by an average of 4.4 per cent annually compared with 2.9 per cent in the Eurozone and 1.7 per cent in Germany.

However, the comparably strong levels of producer price inflation in Spain adversely affected total labour cost developments vis-à-vis its European counterparts. In fact, once producer price inflation is taken into account, real product wages barely grew during the period of expansion. In fact, real product wages grew at an average annual pace of 0.1 per cent between 2000 and 2007 – which is significantly below the gains (0.6 per cent per annum) in the Eurozone area and well below productivity gains in Spain.

<sup>17</sup> Eurozone refers to the collective group of countries which use the Euro as their common currency. For the purposes of this Chapter, the Eurozone comprises 15 of the countries due to data availability.

<sup>18</sup> Labour costs are composed of (i) wages and salaries and (ii) mandatory contributions and other non-wage labour costs (i.e. non-wage labour costs).

**Table 3.2 Average annual change in price, cost and productivity indicators between 2000–2007, Spain and the Eurozone (percentages)**

	Spain	Eurozone
GDP price deflator	4.0	2.2
Nominal labour costs	4.4	2.9
Real product wages*	0.1	0.6
Labour productivity	0.9	1.1
Terms of trade**	0.7	0.2

\* Real wages adjusted by GDP price deflator.

\*\*The change in terms of trade refers to the average annual change in the World Bank's net barter terms of trade index. The index is calculated as the percentage ratio of the export unit value indexes to the import unit value indexes, measured relative to the base year 2000.

Note: The Eurozone figure corresponds to the weighted average of the 10 Eurozone countries for which information on this ratio is available (Belgium, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal and Spain).

Source: Eurostat and World Bank.

## 2 HOUSING INFLATION AND NON-WAGE COSTS WERE DRIVING TOTAL LABOUR COSTS

Interestingly, the housing boom also had a deep effect on consumer prices in recent years. In fact, the rapid increase in inflation in Spain was in part driven by housing prices, which increased by an average annual 4.4 per cent between 2000 and 2007 – a full point and a half more than the annual overall inflation rate.

Moreover, the increases in nominal labour costs in Spain were not due to factors related to wages and salaries. These increases were principally driven by non-wage related costs, which rose at an average rate of 2.2 per cent per annum in real terms compared with 1 per cent on average for wages and salaries. Relative to other European countries, the difference is significant. Indeed, real non-wage labour costs in the Eurozone grew by

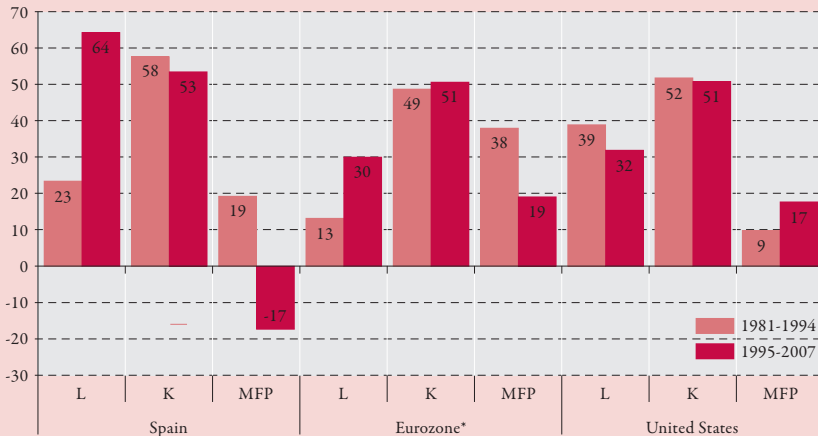
only 0.2 per cent on average and in the EU-27 by 0.8 per cent on average, and in both cases real non-wage costs grew at a slower rate than real wages and salaries. In Spain, the non-wage costs increases were due primarily to steep increases in contributions related to the social security system, such as illness, maternity, work accident and invalidity benefits. These mandatory contingency contributions did not increase much more than other items – around 4 per cent per annum in average – but given their relative importance in total non-wage costs, i.e. around 60 per cent at the end of 2007, they contributed to more than half of the increase. Redundancy costs were another important driver of non-wage costs during this period, recording an impressive annual growth of around 10 per cent on average, with their share in total non-wage costs rising to almost 15 per cent. Finally, the collective bargaining mechanism in place determining labour costs also played a role (see section C).

## B UNDERLYING CAUSES OF COMPETITIVENESS BEFORE THE CRISIS: MULTI-FACTOR PRODUCTIVITY, JOB QUALITY AND INVESTMENT

### 1 MULTI-FACTOR PRODUCTIVITY

A decomposition of value added growth in Spain shows that growth following 1995 was clearly due to a strong increase in the contribution of labour input at the expense of capital (Figure 3.2); a reversal from the period 1980–94. In fact, at 64 per cent, the contribution of labour to value added growth in Spain between 1995 and 2007 far outweighed its contribution in other countries. Moreover, during this period, the contribution of capital fell to 53 per cent, compared with 58 per cent between 1981 and 1994. For a select group of countries in the Eurozone<sup>19</sup> for which available information is, both labour and capital utilization rose during the more recent period of expansion.

Figure 3.2 Contributions to gross value added growth, by input, 1981–94 and 1995–2007 (percentages)



Note: L refers to contribution of labour input growth; K to contribution of capital input growth; and MFP to contribution of multi-factor productivity growth.

\*Eurozone calculations refer to the weighted average of countries for which growth accounting information exists in the EU KLEMS database. These countries are: Austria, Belgium, Finland, France, Germany, Italy and the Netherlands.

Source: EU KLEMS.

<sup>19</sup> Eurozone in this section includes countries for which available information on growth accounting exists in the EU KLEMS database. These countries are: Austria, Belgium, Finland, France, Germany, Italy and the Netherlands.



As a consequence, the contribution of multi-factor productivity (MFP)<sup>20</sup> to growth between 1995 and 2007 in Spain was negative (-17 per cent), driven in part by the fact that the MFP contribution to growth in the two dominant sectors (construction and, to a lesser degree, manufacturing of non-metallic goods) was negative. This stands in stark contrast to the positive MFP contribution of 19 per cent in the period 1980–94. In comparison, while MFP contributions to growth decelerated in the Eurozone, it remained comparably robust at 19 per cent between 1995 and 2007.

## 2 GROWTH IN LABOUR INPUT WAS PRIMARILY IN LOW-SKILLED AREAS

While the shift towards greater labour utilization was associated with strong employment growth, there was a disproportionate increase in the contribution of hours worked compared with labour composition, i.e. quality of the labour input or human capital improvements. In fact, over 50 per cent of the increase in value added was due to the increase in the number of hours worked (Figure 3.3). In contrast, in other countries, such as Ireland – which had a similar employment position over a decade ago – both hours and labour composition contributed positively to overall labour input. In fact, over the period 1995–2007, the employment rate in Ireland increased by 12.4 percentage points, compared to less than 9 percentage points in Spain.<sup>21</sup>

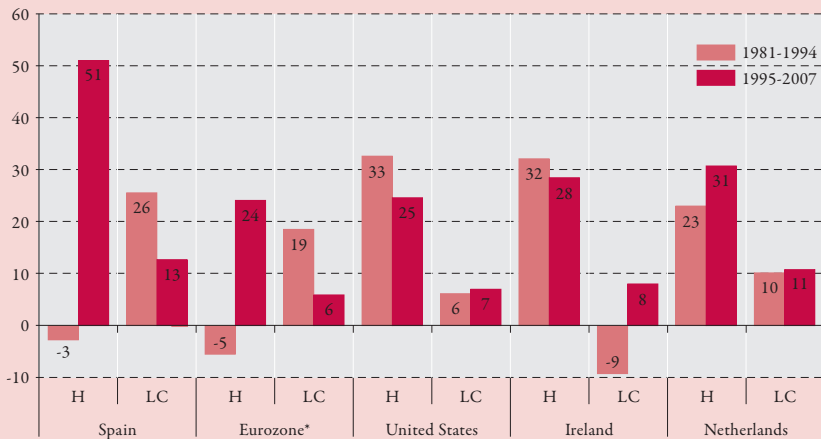
This decline has occurred despite the fact that educational attainment in Spain, like in most advanced economies, has increased dramatically over the past two decades (Figure 3.4). Indeed, among EU-15 countries, the proportion of people who have completed tertiary-level education has increased in all countries – except Germany<sup>22</sup> – when comparing new entrants (persons aged 25–34) with the previous cohorts. For Spain, 38 per cent of persons

<sup>20</sup> MFP indicates the efficiency with which inputs are being used in the production process (Timmer et al., 2007). Although not the subject in this study, it is important to mention that under strict neoclassical assumptions, MFP growth also measures disembodied technological change.

<sup>21</sup> In Ireland, a 13 percentage-point increase in the contribution of labour input was accompanied by a 22 percentage-point increase in the contribution of capital input. Moreover, the contribution of hours worked decreased by 4 percentage points to 28 per cent, despite the 12.4 percentage point increase in the employment rate between 1992 and 1995–2007. The decrease in the contribution of hours worked was largely outpaced by the increase in labour composition in Ireland.

<sup>22</sup> The stagnation in the improvement of intergenerational educational attainment in Germany is due to a fall in the educational attainment among men (ILO, 2011).

**Figure 3.3 Contributions to gross value added growth by factors in the labour input, 1981–94 and 1995–2007 (percentages)**



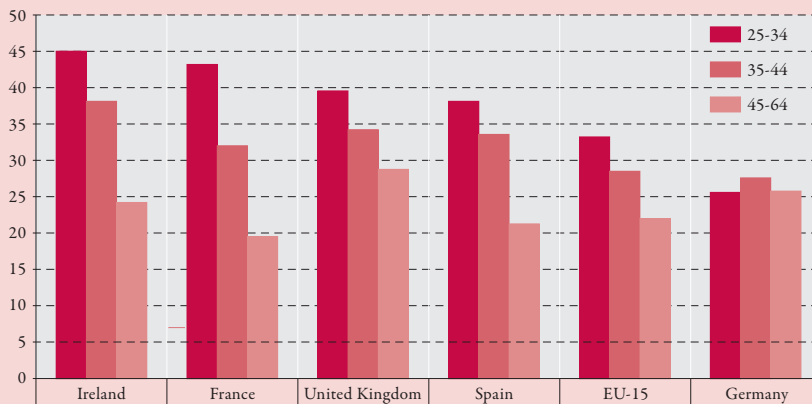
Note: H refers to the contribution of total hours worked; LC to contribution of labour composition or human capital improvements.

\*Eurozone calculations refer to the weighted average of countries for which available information on growth accounting exists in the EU KLEMS database. These countries are: Austria, Belgium, Finland, France, Germany, Italy and the Netherlands.

Source: EU KLEMS.

aged 25–34 have completed tertiary-level education, which is 5 percentage points higher than the EU-15 average. Moreover, compared with previous cohorts in Spain, notably those aged 45–64, the increase from 21 per cent among this group is particularly dramatic.

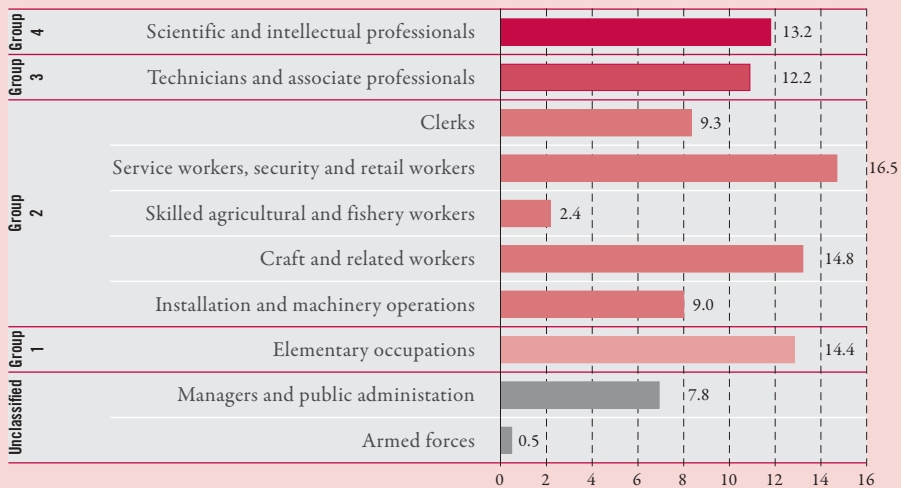
**Figure 3.4 Percentage of the population that has attained tertiary education in 2009, by age group (percentages)**



Source: Eurostat database.

In fact, one of the principal reasons behind labour composition's low contribution to value added growth is that the increase in educational attainment was not matched by an increase in the quality of jobs created. The construction sector accounted for over 19 per cent of total employment growth during the pre-crisis period, rising to more than one-third if employment in real estate activities is included (Box 3.1). Consequently, as of 2008, figures for employment by occupation show that more than 50 per cent of jobs in Spain were concentrated in middle-skilled activities, such as clerks, shop and market sales, craft and related trade jobs; and close to 15 per cent in low-skilled or elementary occupations (Figure 3.5).<sup>23</sup> Only roughly 25 per cent of jobs were high-skilled in nature: 13 per cent of jobs were scientific and intellectual professional activities and another 12 per cent technicians and associated professionals.

**Figure 3.5 Skill composition of employment by occupation\***  
(percentages)



\*Group 4 corresponds to the occupations having the highest skill level and Group 1 to those with the lowest skill level. Some occupations remain unclassified because there are significant skill level differences among the jobs classified within each group.

Note: Figures for employment by occupation were taken from national sources and organized in groups by skill level following the methodology recommended by the International Standard Classification of Occupations (ISCO-88) of the ILO.

Source: IILS estimates based on national sources.

<sup>23</sup> A comparison of similar – but not identical – occupational categories reveals that less than 10 per cent of jobs in the EU-15 were low-skilled or elementary compared with nearly 15 per cent in Spain. Similarly, more than 31 per cent were high-skilled in the EU-15 compared with only 25 per cent in Spain.

**Box 3.1 Employment creation during the pre-crisis boom was based on services and construction sector jobs**

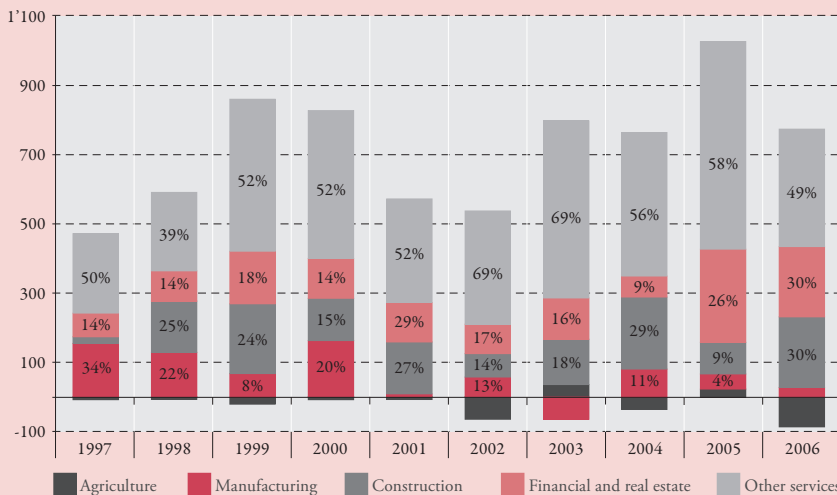
As Chapter 1 highlighted, growth during the pre-crisis period was mainly driven by the boom in the construction sector, which with an average real yearly growth of 5.2 per cent outpaced all other economic sectors during 1996–2006. In comparison, the services sector grew by an annual average of 3.6 per cent, the industrial sector (without construction) by 3 per cent and agriculture by 2.8 per cent over the same period.

Not surprisingly, employment growth in the construction sector also outpaced that in other sectors prior to the crisis. In fact, during 1996–2006 employment in the construction sector increased at an average annual rate of 7.6 per cent, while in the services sector it grew by almost 5 per cent per year and in the non-construction industrial sector by 2.4 per cent, and in the agriculture sector employment decreased on average at an annual rate of 1.3 per cent.

In terms of composition, overall the services sector was the main driver of job creation – contributing close to 73 per cent of the jobs created between 1996 and 2006 (Figure 3.6). Among services activities though, financial and real estate activities were an important source of employment growth – creating 18.3 per cent of the total jobs during the period, 16.5 per cent of which were in real estate and renting activities. Wholesale and retail trade was also an important source of job creation during the period account for 12 per cent of total employment growth.

However, the construction sector accounted for 19.3 per cent of total employment growth during the pre-crisis period, rising to close to 36 per cent if real estate activities are included. On the other side of the spectrum, the manufacturing sector, which was an important source of job creation during the 1990s, lost ground during the pre-crisis decade.

**Figure 3.6 Changes in employment and employment participation, by sector (end of year changes, thousands)**

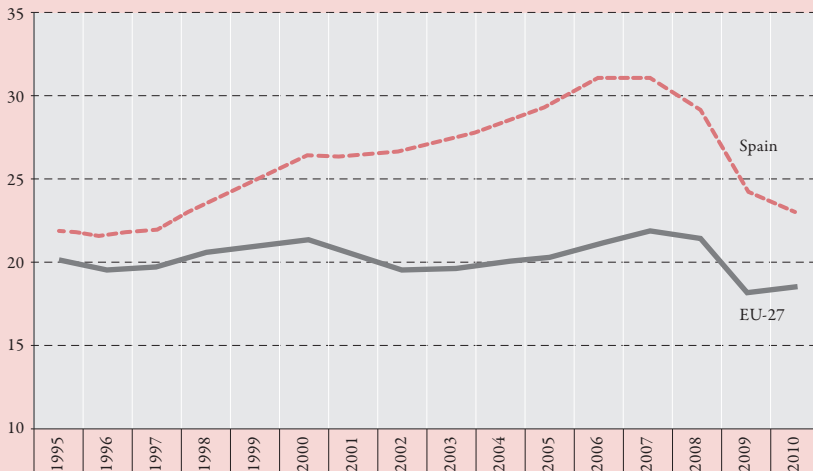


Note: Figures contained within the bars represent the contribution of each sector to total employment in that year. Source: Eurostat and national sources.

### 3 INVESTMENT GROWTH WAS HIGHLY CONCENTRATED IN HOUSING-RELATED ACTIVITIES

Since 1995, investment in Spain grew quite rapidly, rising by nearly 10 percentage points to reach 31 per cent of GDP at its peak in 2007 (Figure 3.7). The average annual growth rate in real investment over this period was an impressive 10 per cent. Even with the onset of the crisis, during which investment fell dramatically, to 23 per cent of GDP in 2010, it was still higher than the EU-27 average of 18 per cent, where investment growth has stagnated since 1995. During the growth period, however, there were important developments with respect to the composition of investment, especially in Spain.

Figure 3.7 Evolution of total investment in real terms and as a percentage of GDP, 1995–2010



Source: Eurostat and BBVA-Ivie Foundation.

In fact, in terms of the weights of the different asset types in total investment flows, residential investment and non-housing related construction accounted for the bulk of the growth in investment, i.e. more than two-thirds of total investment growth between 1995 and 2007 (Figure 3.8).<sup>24</sup> In particular, residential investment – averaging 12.3 per cent growth per annum – accounted for more than one-third of total investment growth over this period. Investment in metal products and machinery also rose dramatically, reaching nearly one-quarter of all investment in 2007 and accounting for approximately 30 per cent of investment growth.

**Figure 3.8 Share of investment by asset type in total investment in 1995 and 2007, and in the change between 1995 and 2007 (percentages)**



\*Around 85 per cent of other products investment corresponds to investment in software and therefore to ICT investment. \*\*ICT investment in metal products and machinery corresponds to hardware and communications-related assets.

Source: BBVA-Ivie Foundation.

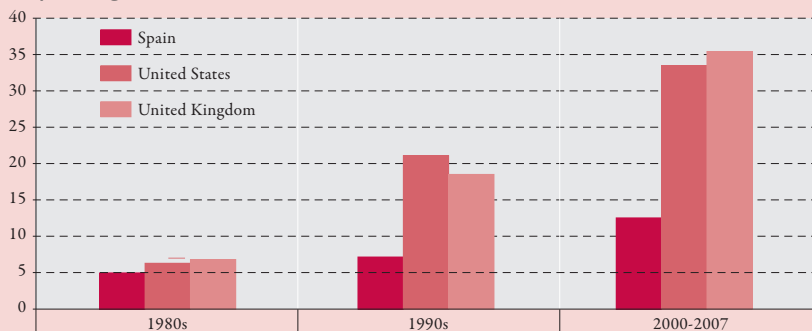
<sup>24</sup> Years for which detailed data are available.

## 4 ICT CAPITAL INVESTMENT HAS LAGGED

In comparison, ICT-related investment in Spain has remained low compared to non-ICT investment (see Box 3.2. In 2007, for example, ICT-related assets represented 13.5 per cent of total investment (Figure 3.8). On a positive note, ICT-related investment within the metal products and machinery asset category recorded strong investment growth over the period 1995–2007, i.e. 40 per cent annually, but as of 2007 it constituted less than 10 per cent of total investment.

Moreover, between 2000 and 2007, ICT capital accumulation accounted for a little more than 12 per cent of the total capital accumulation. While this is higher than during previous decades (Figure 3.9) it remains much lower than in other advanced economies, such as the United States (33.5 per cent) and Germany (22.8 per cent). Thus, as a share of gross fixed capital formation,<sup>25</sup> ICT-related investment in Spain was less than 30 per cent as of 2007. This too is considerably lower than in other advanced economies, such as the United States and the United Kingdom, where the share of ICT assets represented around 50 per cent of gross fixed capital formation.

**Figure 3.9 Increase in ICT capital stock as a share of growth in real fixed capital stock in Spain, the United States and the United Kingdom, 1980s, 1990s and 2000–07 (percentages)**



Note: Capital stock corresponds to real fixed capital stock to ensure comparability.

Source: EU KLEMS.

<sup>25</sup> Gross fixed capital formation (GFCF) measures only the value of net additions to fixed assets, and therefore excludes a number of financial assets, as well as stocks of inventories and other operating costs – which explain why ICT assets have a higher share in GFCF than in total Investment. However, GFCF is the most comparable measurement of investment across countries, which is the purpose of including it in this analysis.

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Indeed, over the past decade ICT has been a dynamic area of investment in many advanced economies – owing to rapid technological progress and the steep decrease in prices of ICT goods – and has been an important source of new growth areas. In a select range of advanced economies analysed, including the United States, ICT investment has grown even faster than GDP – increasing its contribution to economic growth. For instance, during the period 1995–2007, contribution of ICT input to gross value added growth attained 17 per cent in the Eurozone and 25 per cent in the United States.

In comparison, ICT contribution to output growth in Spain has trailed considerably. In fact, it contributed only 13 per cent during 1995–2007. These trends partially explain the lacklustre gains in labour productivity given that ICT-intensive economic sectors<sup>26</sup> exhibit, on average, stronger growth in productivity. For example, from 2000 to 2007 ICT-intensive sectors in Spain experienced an annual productivity growth of 2.4 per cent, compared with 1.5 per cent for non-ICT-intensive sectors. As such, ICT-intensive sectors are raising – or at least sustaining – total labour productivity despite their low share in total output during the period. Moreover, the top two sectors for employment creation in Spain between 2000 and 2007, construction and real estate activities, exhibited weak and negative annual labour productivity growth, i.e. 0.6 per cent and -2.7 per cent, respectively. Therefore, even at a small scale, ICT investment has proven to be an important contributor to labour productivity growth in Spain.

<sup>26</sup> Industries were classified either as intensive users of ICT or as non-intensive users of ICT, following the definitions by Mas and Quesada, 2006. As in their study, two sectors were excluded for this productivity analysis: (i) the agricultural sector, because the very sharp reduction of employment in the sector during the periods analyzed produces an unrealistic extremely fast productivity growth that bias the overall calculation; (ii) the public sector, mainly because it is difficult to interpret properly labour productivity improvements in the public sector.



**Box 3.2 Investment in ICT: Definitions and considerations**

ICT investment refers to all investment in information and communication technology (ICT). It can be broadly defined as all technical means used to promote information and communication. During the late 1990s and early 2000s, ICT investment was the most dynamic component of investment, mainly in advanced and emerging economies, by enabling new technologies in the production process and boosting economic growth. Thus, the concept and measurement of ICT investment have become increasingly important.

***ICT investment covers information technology equipment, communications equipment and software used in production for more than a year:***

Investment is defined in accordance with the 1993 System of National Accounts, the internationally agreed standard on the compilation of economic activity measures as suggested by the United Nations Statistical Division, the OECD, the International Monetary Fund, the World Bank and the European Commission. ICT investment, according to this definition, covers the acquisition of equipment and computer software that is used in the production process for more than one year. ICT investment combines three types of assets: (i) information technology equipment (computers and related hardware); (ii) communications equipment; and (iii) software (acquisition of pre-packaged software, customized software and software developed in-house). As such, investment in ICT encompasses a broad range of goods and devices using electronic controls and also the electronic components forming part of these goods and devices, as defined by the OECD in terms of the United Nations Harmonized System.

***Within national accounts, ICT investment only comprises products that can be physically isolated, which might underestimate its total value:***

In the national accounts, expenditure on ICT is considered investment only if the products can be physically isolated. This means, for example, that ICT embodied in equipment is not considered as investment but as intermediate consumption. Therefore, the size of ICT investment might be underestimated depending on how intermediate consumption and investment are treated in each country's accounts.

Source: OECD, 2008; OECD, 2004; and OECD, 2003a.

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## 5 BUSINESS AND RESIDENTIAL ACTIVITIES WERE DEBT-FINANCED

Debt of non-financial enterprises increased substantially in the period 2000–08 (Figure 3.10). In 2008, business debt amounted to 125 per cent of GDP and 720 per cent of gross operating surplus, an increase of 70 and 190 percentage points, respectively, from 2000. In comparison, in a weighted average of five Eurozone countries excluding Spain, debt amounted to 101 per cent of GDP in 2008 and 543 per cent of gross operating surplus.<sup>27</sup>

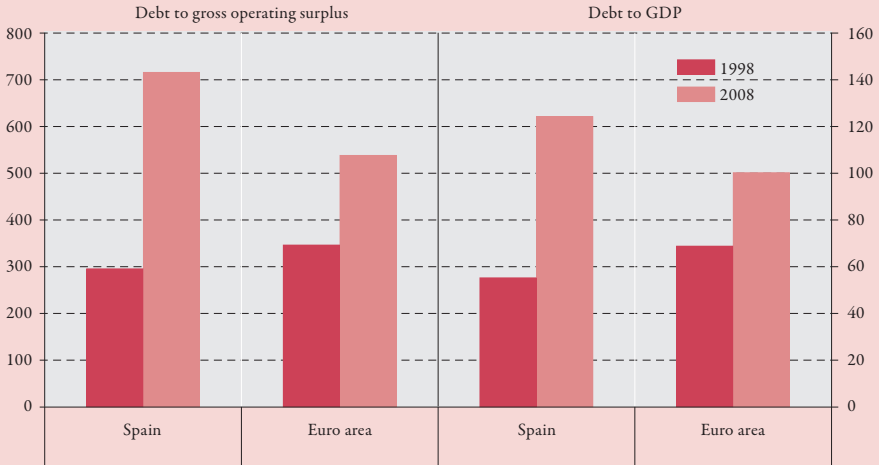
Between 2007 and 2008 there was a rapid increase in the difference in the ratio of debt to gross operating profit between Spain and the five select European countries – the difference increased by close to 590 points. In other words, in 2007 the debt ratio was 178 percentage points higher in Spain, but in 2008 it was close to 770 percentage points higher. This excessive increase in debt ratios can also be observed for the hotels and restaurants sector and, to a lesser extent, for the manufacturing sector.

Moreover, between 2000 and 2008, the ratio of debt to gross operating profit increased in all economic sectors with the exception of the transport, storage and communication sector. Real estate and construction enterprises experienced the steepest increase, especially from 2004, attaining in 2008 a ratio that was 873 percentage points higher than in 2000. The hotels and restaurants sector also experienced a steep increase: its ratio increased 678 percentage points during the period.

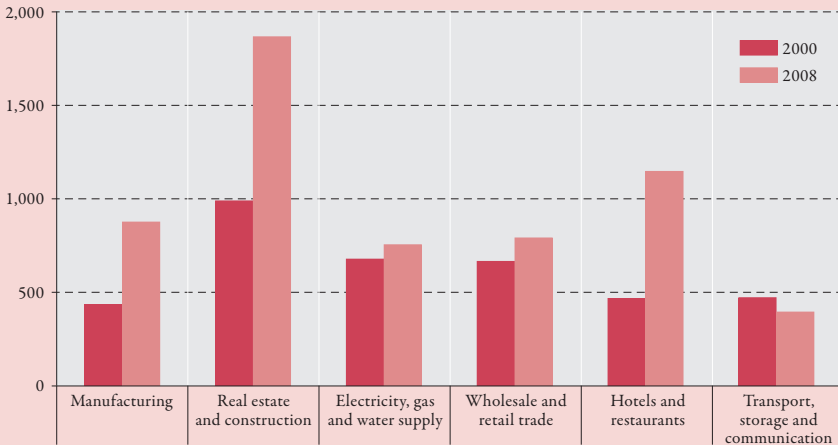
<sup>27</sup> Belgium, France, Germany, Italy and Portugal (see Izquierdo and Martínez Carrascal, 2010).

Figure 3.10 Debt indicators in Spain and a select group of Eurozone countries\* (percentages)

Panel A. Increase in debt of non-financial corporations, 1998 and 2008



Panel B. Debt to gross operating profit in Spain, 2000 and 2008



\* GDP weighted average for Belgium, France, Germany, Italy and Portugal.  
Source: Izquierdo and Martínez Carrascal, 2010.

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## **C RECENT DEVELOPMENTS TOWARDS IMPROVED COMPETITIVENESS**

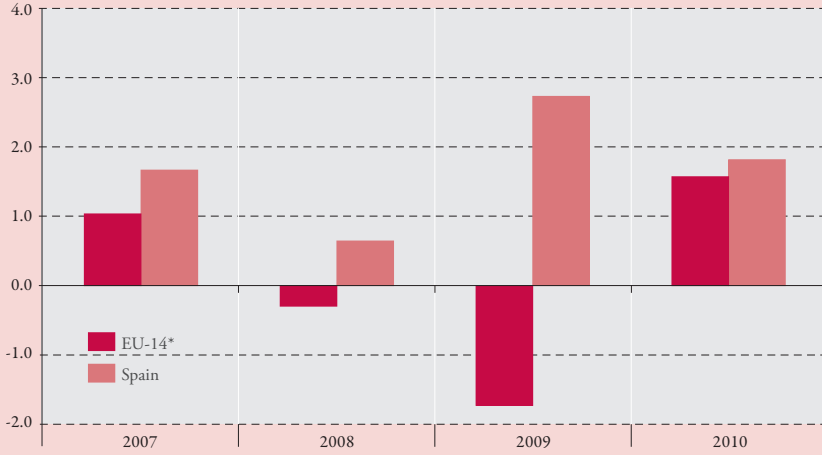
### **1 PRODUCTIVITY AND COMPETITIVENESS HAVE IMPROVED OF LATE**

Since 2007, the productivity gap between the EU average and Spain has started to narrow (Figure 3.11, panel A). The process began moderately in 2007, with labour productivity growth in Spain outpacing its major European counterparts by more than 0.7 percentage points. By 2009, annual labour productivity among EU-14 countries fell on average by 1.7 per cent whereas in Spain the gains were close to 3 per cent. Even in 2010, the gap continued to narrow.

A reversal in the upward trend of price and cost indicators is another welcome development (Figure 3.11, panel B). Core inflation in Spain fell to levels close to the EU-15 average in the course of 2009, reflecting the drop in domestic demand. In addition, unit labour costs in Spain decreased much faster than in the rest of Europe – a decline of 2.5 per cent between the fourth quarter 2008 and 2010, compared with 0.6 per cent in the EU-15. As a result, the gap between Spain and the rest of Europe (previously 4 to 1) in terms of the increases in the cost of labour and in labour productivity has reversed.

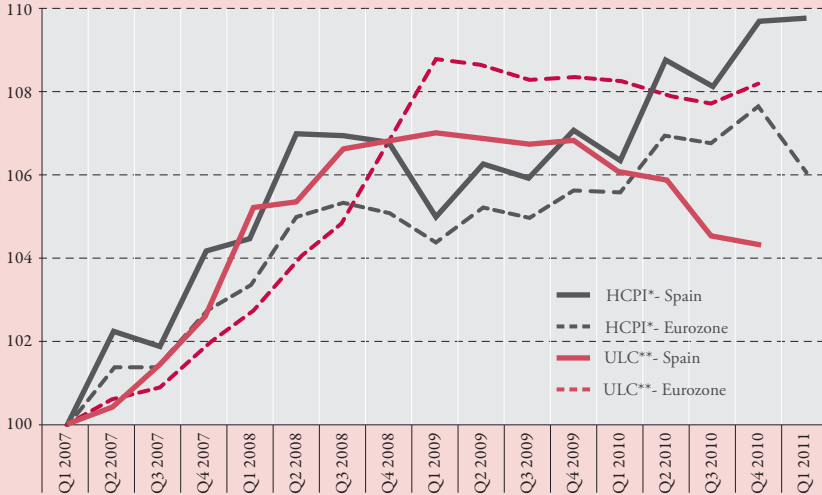
Figure 3.11 Recent trends in price, cost and productivity indicators since the onset of the crisis, 2007–10

Panel A. Change in labour productivity in EU-14\* and Spain, 2007–10 (percentages)



\*Weighted average for the EU-15 without Spain.  
Source: The Conference Board Total Economy Database.

Panel B. Change in labour productivity in EU-14\* and Spain, 2007–10 (Q1 2007=100)



\*Harmonized consumer price index. \*\*Nominal unit labour cost.  
Source: Eurostat database.

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And while the differences in labour productivity trends in since 2008 are principally a function of changes in employment patterns, i.e. employment fell much more steeply in Spain relative to output when compared with other European countries, these developments represent an opportunity for Spain to seize the relative gains in an effort to improve overall competitiveness in a sustainable manner. Between the end of 2008 and 2010, with the declines in price and cost indicators relative to the EU-27 and OECD averages, foreign competitiveness had already improved by close to 3.5 per cent.<sup>28</sup>

## **2 GROWTH IN EXPORTS AND MODERATE CHANGES IN COMPOSITION ARE EARLY SIGNS OF A POTENTIAL SHIFT IN THE RIGHT DIRECTION**

These changes in productivity and competitiveness patterns are already leading to a new pattern of growth in Spain. Indeed, following an unprecedented fall of nearly 20 per cent between the third quarter of 2007 and the third quarter of 2009, the growth rate of exports started to pick up from the beginning of 2010. By February 2011, exports had grown close to 15.5 per cent compared with the same period the year before – 22.5 per cent in nominal terms – and were already 3 per cent above the peak level attained before the crisis. As such, external demand during 2010 was the main – indeed only – engine of economic growth (domestic demand continued to decline). This trend is expected to continue and exports are expected to drive economic growth in 2011.<sup>29</sup>

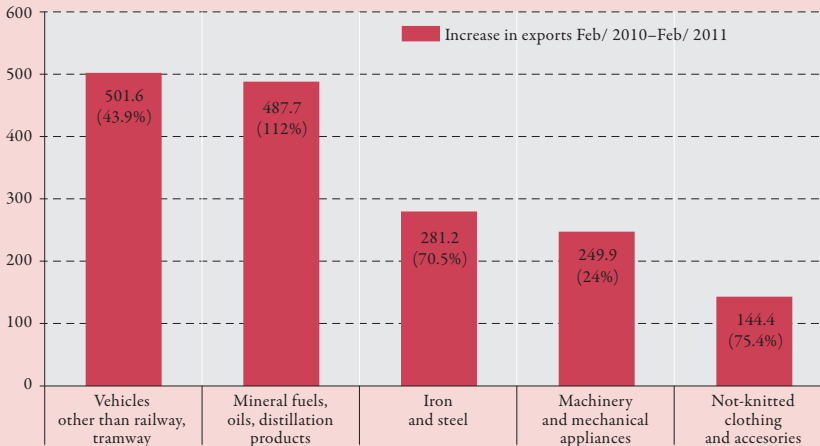
Moreover, during the last year, there have been signs of a possible shift in the composition of exports. Indeed, industrialized products have regained their strength and have grown faster and contributed more to total growth of exports than the durable goods sector (Figure 3.12). The automobile sector was the fastest growing sector during the past year, growing by over €500 million (18.3 per cent) between February 2010 and February 2011.

<sup>28</sup> Calculations for September 2008 to September 2010, which is the latest available information for external competitiveness (trends calculated based on export price indexes rather than CPI).

<sup>29</sup> Banco de España, 2011.

Exports of mineral fuels, oils and distillation products more than doubled over this period. Together, these two sectors accounted for roughly one-third of the overall increase in exports. Semi-manufactured products from iron and steel and the machinery and mechanical appliances sector also showed strong improvements, accounting for close to one-fifth of the gains in exports.

**Figure 3.12 Top five growing export sectors, February 2008–February 2010**  
(millions of Euros and percentages\*)



\*Figures in parenthesis show percentage changes.

Note: Export information comes from TARIC classification.

Source: IILS estimates based upon National sources.

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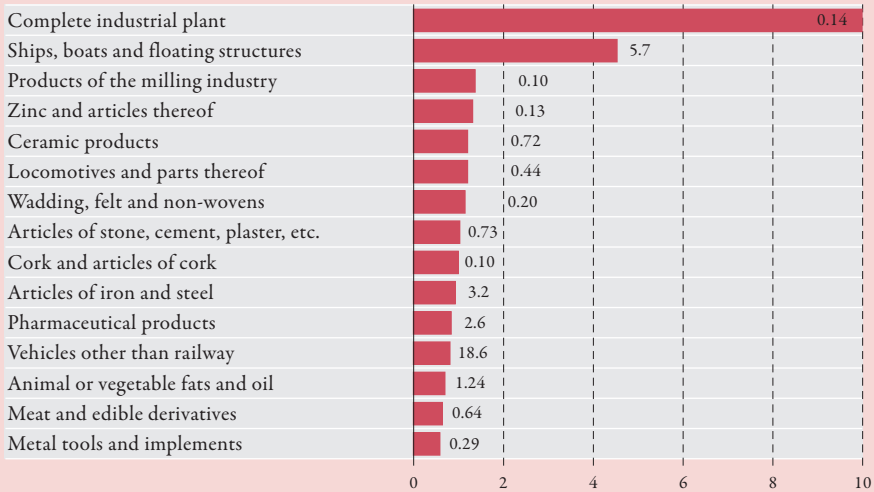
Moreover, a number of these industrialized products showed an important increase in comparative advantage relative to other Spanish products between January 2010 and January 2011. Noteworthy in this regard is the gain in comparative advantage of complete industrial plant sector, which includes industrialization of chemical, iron, steel and timber products, machinery construction and mineral extraction. These sectors gained 10 points in comparative advantage but accounted for a relatively small portion (less than 1 per cent) of the growth in exports over this period (Figure 3.13, panel A). Other sectors, accounting for a larger portion of the export gains, have also shown gains in comparative advantage. For instance, the ships, boats and floating structures sector – which accounted for 6 per cent of total export growth since the beginning of 2010 – gained close to 7 points in comparative advantage. The automobile sector showed an increase in comparative advantage too, as well as the sector comprising the production of articles of iron and steel and the pharmaceutical sector.

In a number of instances the gains in comparative advantage have been a cyclical reversal of previous declines that occurred as a result of the onset of the crisis (e.g. iron and steel articles, zinc and articles thereof, ceramic products, articles of stone, cement, etc. and the automobile sector). More interestingly, though, are the sectors that exhibited their first upturn in comparative advantage, at least since 1996 (when information of this nature first became available). For example, the wadding, felt and nonwovens sector started to show a strong positive comparative advantage in late 2009 (Figure 3.13, panel B) and by January 2011 was ranked seventh highest for internal competitiveness among export sectors (Figure 3.13, panel A). Likewise, the metal tools and implements sector and the pharmaceutical export industry started to gain comparative advantage only in recent years and made noteworthy gains in 2010. These trends reinforce the hypothesis that a sustainable change is taking place in the composition of exports.



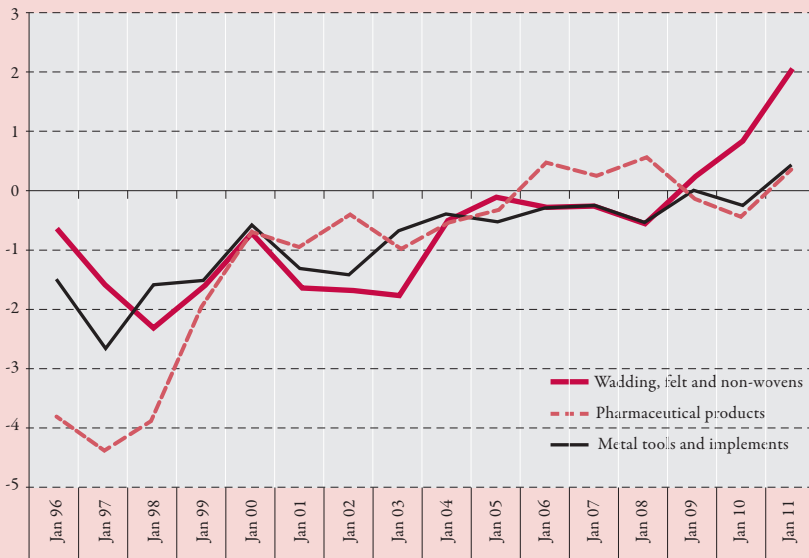
**Figure 3.13 Increase in comparative advantage during the period January 2010–January 2011**

**Panel A. Top ten products in terms of their increase in comparative advantage during Jan 2010–Jan 2011\***



\*Figures in parentheses show the share of the product's growth in the growth of total exports during the period analysed

**Panel B. Sectors showing a first time increase in comparative advantage (Donges and Riedel Measure)**



Note: Calculations are based on the Donges and Riedel Measure ( $DRM = [(X_{ij} - M_{ij}) / (X_{ij} + M_{ij})] / [(\sum X_{ij} - \sum M_{ij}) / (\sum X_{ij} + \sum M_{ij})]$ ) and the Wolter Index ( $WI = (X_{ij} / M_{ij}) / (\sum X_{ij} / \sum M_{ij})$ ). These indicators provide information about the relative export performance of a certain industry or product with respect to other industry groups of the same country. The results of the two different methodologies coincided, giving confidence to the analysis provided.

Source: ILS estimates based on the Taric Database of the Spanish Ministry of Industry, Tourism and Trade.

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### 3 SOME EFFORTS HAVE BEEN MADE TO MODIFY THE COLLECTIVE BARGAINING PROCESS

The main wage-setting mechanism in Spain is collective bargaining; although there are exceptions for chief executive officers and in some other instances, where wages are determined through individual bargaining between the employer and the prospective employee. Collective bargaining has almost full coverage in Spain under the principle of *erga omnes*; i.e. representative unions and employers' organizations bargain above the firm level (principally sectoral level), the resulting agreement then applies to all firms and all workers in these firms. Furthermore, under this principle, the agreement applies even when a firm is not part of the employers' organizations or workers are not affiliated to the unions involved in the bargaining process. Importantly, in order for collective bargaining of this nature to be legitimate, two conditions have to be met: (i) trade unions must represent an absolute majority of workers in the sector and province; and (ii) employers' organizations must have affiliated to them firms covering the majority of workers in the sector and providence. Currently, the vast majority of collective agreements made above the firm level satisfy these requirements.<sup>30</sup> Indeed, in 2007, 81 per cent of the workforce were covered by a collective agreement, ranging from 89 per cent in the financial sector and 85 per cent in the public sector to 56 per cent in the construction sector.<sup>31</sup>

Almost all collective bargaining in Spain takes place at the sectoral level, and sectoral agreements are mainly made at the national or provincial level, with firm-level agreements being rare in Spain. This is not unlike other European economies, with the exception of perhaps France and the United Kingdom (Table 3.3). However, collective agreements in Spain tend to be more centralized than it appears to be on paper because the main trade unions – *Unión General de Trabajadores* (UGT) and *Comisiones Obreras* (CCOO) – and employers' organization – *Confederación Española de Organizaciones Empresariales* (CEOE) – provide extensive guidelines for collective bargaining each year, effectively guiding the decisions and agreements in their branches at the industry and firm levels.

<sup>30</sup> Malo, 2011.

<sup>31</sup> Van Klaveren and Tjstens, 2008.

In the case of Spain there is the possibility of opting out of a collective agreement, referred to as the *opt-out clause*. Under this clause, firms facing financial difficulties can opt out of collective agreements, but there are strict criteria that have to be met. Firms are required to prove that they face serious economic difficulties and the new wage agreement must spell out clearly the maximum duration for which the opt-out clause will apply. Moreover, in some cases, it also requires firms to reimburse workers for their suspended wage increases. As a result, firms rarely take advantage of this clause to adjust wages in the face of economic difficulties.<sup>32</sup>

**Table 3.3 Collective bargaining and wage-setting in selected European countries**

	Inter-sectoral level	Sectoral level	Firm level
Austria	.	XXX	X
Belgium	XXX	X	X
Denmark	XX	XX	X
Finland	XX	XX	X
France	.	X	XXX
Germany	.	XXX	X
Greece	X	XXX	X
Ireland	XXX	X	X
Italy	.	XXX	X
Luxembourg	.	XX	XX
Netherlands	.	XXX	X
Norway	XX	XX	X
Portugal	.	XXX	X
Spain	.	XXX	X
Sweden	.	XXX	X
United Kingdom	.	X	XXX

Note: X = existing level of wage bargaining; XX = important, but not dominant level of wage bargaining; XXX = dominant level of wage bargaining.

Source: European Industrial Relations Observatory (EIRO).

<sup>32</sup> For example, more than 70 per cent of firms tend to dismiss workers instead of trying to maintain employment and reduce wages (Ramos-Martin, 2011).

Multi-year agreements between unions and employers' organizations determine wage policies, and the general guiding framework is that wages should be indexed to the expected rate of inflation, productivity growth and economic fluctuations, with expected inflation being the most important reference.

Similar practices are evident in countries such as Greece, Italy and Portugal (Table 3.4). Other countries, e.g. Belgium, Denmark, the Netherlands and Norway, have focused on remaining competitive relative to their trading partners by linking national wage growth to the average increase in wages in their main trading partner in the region.<sup>33</sup>

**Table 3.4 Wage guidelines in selected EU countries**

Country	General macroeconomic guidelines for wages
<b>Belgium</b>	Based on the assumed average wage increases in its main trading partners (France, Germany and the Netherlands)
<b>Denmark</b>	General guideline that the labour costs should reflect the costs in other competing countries
<b>Finland</b>	Wage rises should be in line with the European Central Bank's inflation target and increases in productivity in the whole economy
<b>Germany</b>	Wage increases in line with inflation and productivity growth
<b>Greece</b>	Nominal wages should rise with inflation and should reflect partly the increases in productivity in the whole economy
<b>Ireland</b>	Promoting non-inflationary growth in wages, keeping in mind the need to stay competitive relative to other economies
<b>Italy</b>	Sectoral wage developments should be in line with planned inflation rate
<b>Netherlands</b>	Wage increases in line with maintaining the competitiveness of the Dutch economy
<b>Norway</b>	Wage increases are calculated on the basis of an evaluation of the competitiveness of Norwegian industry and wage developments in Norway's main trading partners. Also, the tradable sector should form the basis for the national wage growth rate
<b>Portugal</b>	Wage increases in line with expected inflation and increase in productivity
<b>Spain</b>	Wage increases indexed to expected inflation; when actual inflation exceeds expected inflation, wages are adjusted accordingly and employees are reimbursed
<b>Sweden</b>	General guideline that wages should not rise faster than the EU average

Source: European Foundation for the Improvement of Living and Working Conditions.

<sup>33</sup> Schulten et al., 2000.

One of the key features of the Spanish system is the *pay review clause*, which allows correction in wages when actual inflation exceeds expected inflation (wage increases are indexed to expected inflation). Between 2001 and 2008, actual inflation was much higher than expected inflation, hence wages had to be adjusted upwards. In fact, in the case of Spain, nearly half of workers have wage developments linked to past inflation developments (direct or indirect).<sup>34</sup> This is much lower than the average (21 per cent) in the Eurozone (Table 3.5).

**Table 3.5 Extent of wage indexation in the selected EU-countries**  
(percentage of affected workers)

	Spain	Eurozone	France	Italy	Belgium
<b>Automatic link to past inflation</b>	38	16	8	1	98
<b>Automatic link to expected inflation</b>	16	4	2	0.5	0
<b>Indirect relation with past inflation</b>	10	9	21	3	0
<b>Indirect relation with expected inflation</b>	5	5	8	2	0
<b>No link to inflation</b>	29	64	59	94	2

Note: Due to rounding, figures may not add to 100.  
Source: Bank of Spain.

There also exists a significant “time inertia” in the Spanish collective bargaining structure, as illustrated by the *Acuerdos Inter-Confederales para la Negociación Colectiva (ANCs) 2010–12*. This multi-year agreement between social partners includes specific guidelines for bargaining at lower levels, in particular recommended rates of wage increases. But, recent data show that sectoral agreements reflect the recommendations of ANCs with a significant time delay, and most agreements did not follow the guidelines

<sup>34</sup> Interestingly, since the onset of the crisis, actual inflation has been lower than expected inflation, which has created difficulties in the interpretation of pay review clauses. In theory, employers would be refunded for higher wages paid to employees, but the courts have ruled out such a possibility.

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For example, total number of agreements in 2011, covering up to the end of April, was 1,632, affecting 353,295 firms and 3,024,980 workers, but only 59 agreements, covering 172 firms and 40,983 workers, were in fact new agreements in 2011. In addition, there is a system of *ultra actividad* in Spain, where the previously held agreement is used as a floor for any new agreement. In particular, when there is no agreement between social partners, previously held agreements apply without any specific deadline.

### *Ongoing reform, 2010 – 11*

A new labour legislation was adopted in June 2011 by the Spanish Government, after extensive consultations between two main trade unions (CCOO and UGT) and an employers' organization (CEOE) failed to yield an agreement. Key features of the new law are as follows:<sup>35</sup>

- It widens the conditions under which firms can opt out of collective bargaining agreements. In particular, after a firm-level agreement between the employer and employee representatives, a firm is allowed to depart from the wages fixed at the sectoral level when it can prove that the application of those wages would jeopardise the economic viability of the company and would lead to an adjustment in employment levels.<sup>36</sup> Moreover, firms can apply for the deviation from the collective agreements for a maximum of 3 years, and the firm-level agreement needs to stipulate the new wages to be paid to the employees and the schedule for converging them to previously applicable wages.
- It allows for the extension in the usage of the opt-out clause to a period of more than one year, thus giving firms more time to recover from the economic downturn.
- It allows firms to distribute 5 per cent of the total working time in a flexible manner (however, it should be noted that the new law stipulates that national level agreement is necessary for issues related to characteristics of

<sup>35</sup> Royal Decree-Law 7/2011, enacted 11 June 2011.

<sup>36</sup> Ramos-Martin, 2011.

different types of contracts, professional classification, maximum annual hours of work, and work place safety). Higher shares, however, will need to be agreed upon in the collective agreement – something which is already the case across some sectors and firms.

- It expands the scope for firm-level negotiations regarding hours and wages, and stipulates that firms no longer need consent from social partners (trade unions) – an agreement with employees would suffice. But if there is no agreement between the employer and the representatives of employees, then there is provision for arbitration.
- Also, under the new law, the system of *ultra actividad*, where the old agreement remains applicable when a new agreement cannot be reached, has been slightly altered. In particular, the new law introduces a transitory solution based on mandatory arbitration in case of disagreement between social partners. This transitory period of mandatory agreement ends when new agreements stipulate clear procedures to solve disagreements. Furthermore, new agreements must be implemented within 8 (for agreements with a scheduled duration of 2 years) – or 14 months (for the rest) of the end of old agreements.

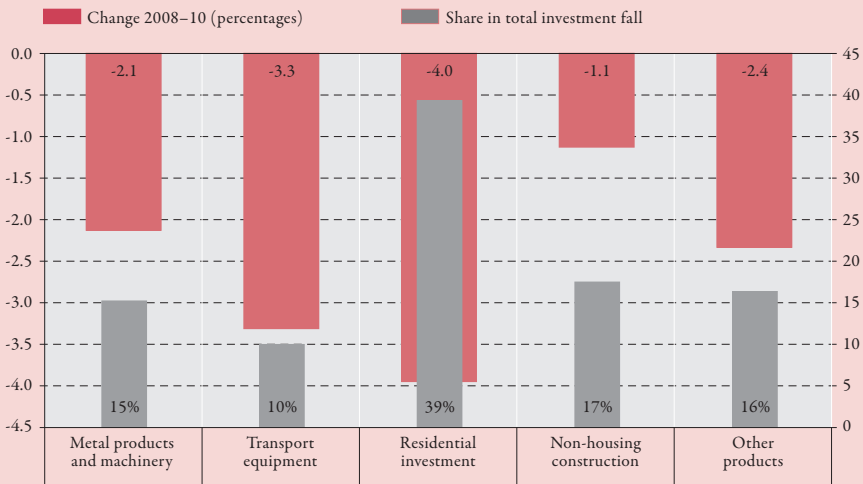
## 4 INVESTMENT HAS NOT YET SHOWN SIGNS OF A SUSTAINED RECOVERY

Investment suffered deeply from the 2008 crisis and has yet to bottom out. In fact, it has been falling continuously since the beginning of the crisis – at an average annual rate of -2.5 per cent – and by the fourth quarter of 2010 real investment had fallen by close to 28 per cent since the beginning of 2008.

Residential investment has exhibited the steepest fall since 2008 – by 4 per cent – followed by transport equipment and metal products and machinery – by 3.3 and 2.1 per cent, respectively (Figure 3.14). The reduction in residential investment is the main driver of the overall fall, constituting nearly 40 per cent of the total decline. The other 60 per cent is comparatively equally distributed between the other four non-residential business

investment sectors – though a little less for transport equipment. By the end of 2010, the situation had altered only slightly and signs of a potential recovery were yet to be seen. Only the metal products and machinery sector had shown minor investment growth – 0.15 per cent. The Bank of Spain estimates that investment in capital goods and other products will start to recover in 2011, although the pace of growth is expected to be relatively modest compared with the recoveries experienced following past crises.<sup>37</sup>

**Figure 3.14 Fall in investment by asset type between Q4 2008 and Q4 2010, and share of the fall in the decrease of total investment (percentages)**



Source: Eurostat database.

<sup>37</sup> Banco de España, 2011.



## D POLICY CONSIDERATIONS

Despite the unprecedented economic growth in Spain over the past decade, overall competitiveness has declined sharply and remains low in comparison to other advanced economies. This is highlighted in particular by a deterioration in labour productivity, which is due to a number of factors, notably: (i) the composition of growth was principally due to an increase in labour intensity (at the expense of capital deepening); (ii) the sectors that accounted for the bulk of growth – principally housing-related – are predominately low-skilled in nature; (iii) investment growth leading up to the crisis was principally in low-productivity areas; and (iv) nominal unit labour costs rose dramatically in relation to productivity, widening the gap between Spain and the rest of Europe and further eroding competitiveness.

There are, however, some encouraging signs with respect to a recent narrowing of the productivity gap, improvements in overall competitiveness and a welcome shift in the contribution of exports to growth – and in their composition. However, investment rates remain – at least for the moment – lacklustre. Therefore, moving forward, to promote and encourage quality employment gains and encourage more balanced growth and investment developments, efforts will be needed to address these shortcomings and build upon some of the successes achieved of late.

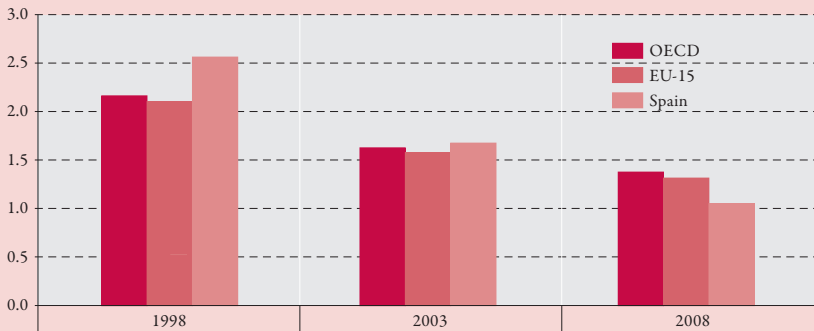
### 1 CONTINUE TO IMPROVE PRODUCT MARKET REGULATION, ESPECIALLY AS REGARDS DYNAMISM OF FIRMS

During the expansionary period, Spain undertook a wide range of reforms that opened a number of markets to competitive pressures (Box 3.3). As a result, major progress has been made in the area of product market competition: the OECD product market regulation indicators show that Spain's ranking rose from 20th place in 1998 to sixth in 2008 (out of the 25 countries with available information over this period). Moreover, new reforms were put forth as part of the stimulus package during the 2008 crisis. For example, the Law on Sustainable Economy (*Ley de Economía Sostenible*) approved by Parliament in 2011, put forth a number of reforms, although modest, in this direction (see also Chapter 2).

### Box 3.3 Product market reforms in Spain

Starting in 1998, Spain undertook a wide range of reforms to promote competition in the product market. According to the OECD's product market regulation indicators, these reforms have been successful in opening markets to competition and reducing stringency. In fact, Spain is the only OECD country to have observed statistically significant moderation of overall regulation during both the 1998–2003 and 2003–08 periods.<sup>38</sup> Spain had a highly restrictive product market in 1998 – with an indicator of 2.55 – far above OECD and EU-15 averages; yet, it succeeded in promoting greater competition and by 2008 it had reduced its indicator to 1.03, below the OECD and EU-15 averages (Figure 3.15).

Figure 3.15 Change in product market regulation, 1998–2008  
(scale of 0–6, from least to most restrictive)



Source: Based on OECD Statistics and OECD, 2010a.

Major areas in which reforms have been put forward to increase product market competition in Spain include the following:

**Legislation geared towards increasing product market competition:** The first step in promoting product market competition was the approval of the competition law in December 1999. This was the first of a series of legislative steps during the 2000s aimed at increasing coordination for all competition tribunals. The Competition Tribunal and Service was also reinforced during this decade through grants that increased resource allocation and gave it budgetary independence. In 2009, a general framework law was approved by Parliament to set the stage for more specific reforms at the sectoral level. Central aims of this framework law are to further ease the process of complying with the legislation and to eliminate barriers to entry to the services market. In 2010, further actions were taken to lower entry barriers to some services. For instance,

<sup>38</sup> Kozluk et al., 2009.

**Box 3.3 Product market reforms in Spain (cont.)**

a Royal Decree Law substantially reduced the number of cases in which professional services providers need to request special licences for service provision. Another recently approved law eliminated the limitations regarding the opening a large retail outlet and removed the requirement for a national licence.

***Liberalizing important network sectors:*** Spain implemented ongoing liberalization schemes for markets in crucial network sectors, such as gas, electricity and telecommunications. EU directives helped to this end, but the Government went beyond the directives and opened up to competition former monopolies in the energy sectors. Other network sectors such as air and road transport have been opened up to competition as well, albeit to a lesser extent compared with other countries in Europe.

***Opening up to trade and foreign direct investment:*** Spain has lifted several barriers to foreign ownership as part of its product market reform. For instance, Spain lowered the limits to foreign acquisition of shares in publicly owned firms and caught up with other European countries in terms of non-tariff barriers to trade, particularly through an increased commitment to international harmonization of regulatory procedures.

To foster competitiveness through product market regulation, the Law on Sustainable Economy included clauses on the following areas:

- simplifying and accelerating the process for enterprise start-ups;
- simplifying the tax regime;
- facilitating public access to real estate;
- opening up access to better quality telecommunications infrastructure (e.g. universal access to broadband for Internet use);
- promoting industrial property rights;
- fostering the internationalization of Spanish enterprises.

Source: OECD, 2001; 2003b and 2010a.

Despite these efforts, further reforms are needed. For instance, price increases in tradable goods (manufacturing producer prices) outpaced those in the rest of Europe by a factor of more than two. In this respect, additional progress in product market regulation in Spain can improve competitiveness, both by strengthening productivity and by lowering prices. First, it

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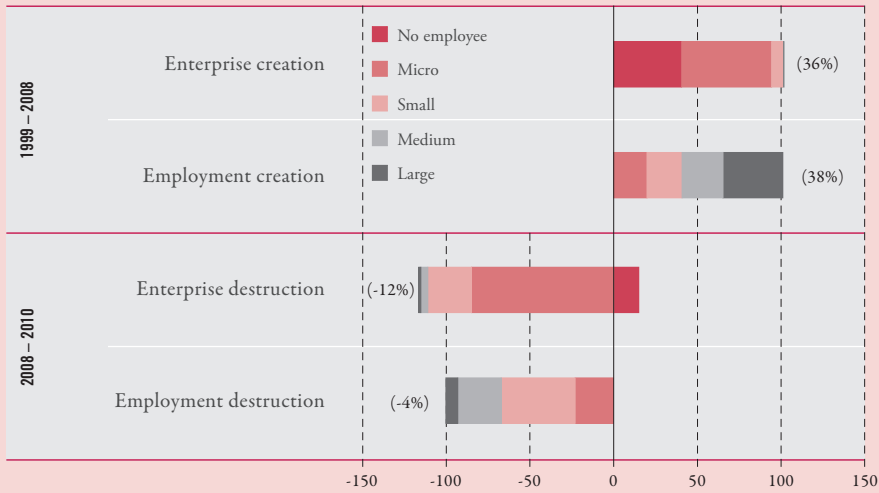
raises incentives to invest and to adopt new technologies. Industries that rely on innovation the most— such as ICT industries — are therefore the first to enjoy the benefits of lower product market rigidities. Second, it reduces entry costs and improves product quality by raising competition. This could allow the reallocation of resources to their most efficient use while also allowing new sectors — such as the export one — to develop further. Several areas for reform could be considered:

- State control remains strong in a number of areas. In particular, independence of sector regulators could be improved: Spain ranks 19 out of 29 in the use of command and control regulation indicators. In some sectors, e.g. airports and water distribution, sector regulators have not yet been appointed, and in others, such as the energy sector, the Government has the power to revoke decisions taken by the sector regulator.<sup>39</sup>
- In Spain, the barriers faced by qualified people wishing to enter certain high-value service professions, such as accounting, architecture, engineering and legal services, remain onerous. Recent reforms by the Spanish Government to reduce legal and administrative entry regulations for certain professional services are a welcome step forward. For example, some restrictions on the joint exercise of certain professions as well as on advertising and prices set by professions are being eliminated.

The period of expansion in Spain was also characterized by strong growth of firms: between 1999 and 2008, the number of active companies increased by close to 36 per cent (Figure 3.16). However, 53 per cent of firms created were micro in composition (with 1–9 employees) and concentrated in housing or real-estate activities. A large proportion of these micro firms comprised individual entrepreneurs, i.e. they had no employees. Small firms (between 10 and 49 employees) accounted for one-fifth of the jobs created, and medium- and large-sized enterprises contributed 25 and 35 per cent, respectively, to job creation.

<sup>39</sup> OECD, 2010a.

Figure 3.16 Change in the number of firms and in employment by enterprise size as a share of total change, before and during the crisis (percentages)



Note: Figures in parenthesis correspond to the total growth rate in the number of enterprises and in employment during the period.

Source: National sources.

As many of these firms, especially micro and small firms, were forced to close as a result of the slowdown associated with the crisis, efforts are needed to re-establish dynamism within firms and to create an environment of enterprise creation and development so that entrepreneurs can take advantage of new productive opportunities and are encouraged to expand and grow.

- Administrative burdens for business start-ups are still high in Spain relative to other advanced economies (ranking 24 out of 29). Despite progress being made in simplifying and streamlining these requirements, Spanish entrepreneurs still have to undergo a large number of administrative burdens to start a firm. New efforts to accelerate the processing time for applications and to reduce the cost of opening small enterprises – as presented in the Law on Sustainable Economy – are welcome steps.<sup>40</sup> The

<sup>40</sup> The law proposes a maximum cost of €100 for enterprises of no more than €3,000 in capital and €250 for enterprises with a capital of up to €30,000.

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Government also recently eliminated limitations regarding the opening a large retail outlet as well as the requirement for a national licence. However, further reforms seem necessary to reduce the barriers to entrepreneurship to a level comparable with other advanced economies.

- One of the principal sources of credit for micro and SMEs in Spain has been the *cajas*. However, the ongoing restructuring of these smaller savings banks, as discussed in Chapter 2, has meant that many promising enterprises continue to face credit constraints. In the short term, the Official Institute for Credit (ICO) needs to work with credit-related institutions to examine ways – in addition to those announced earlier in the crisis – to ensure that firms are able to access financing and take advantage of new growth opportunities. Much of the earlier efforts were designed to keep existing businesses afloat. In parallel, it is critical that the overhaul of the smaller savings banks proceeds quickly and effectively.

## 2 ENCOURAGE INNOVATIVE CAPACITY TO INCREASE PRODUCTIVITY

There have been some encouraging signs with respect to productivity gains in ICT-related sectors. In fact, the already highly productive ICT-related sectors in Spain experienced strong gains since 1995, but these continue to account for only a small share of the overall investment compared with their counterparts. Reform efforts could focus on encouraging further gains both in this area and in other innovative sectors of the economy.

- Measures to foster ICT investment could help to increase the innovative capacity and increase productivity. The Government has made some efforts in this direction already, but only on a temporary basis – e.g. the asset redemption leeway for corporate tax payers.<sup>41</sup> However, promoting investment in high value-added sectors will require conditional investment initiatives that are more permanent and more targeted to specific sectors. Efforts of this nature have been carried out by other countries with successful results. For example, during the 1980s to the early 1990s the Republic of Korea introduced greater research and devel-

<sup>41</sup> The asset redemption leeway for corporate tax payers was put in force as part as the efforts to support firms (see Chapter 2). This new law stipulated that corporate tax payers willing to invest in new assets will be allowed to pay them back at will, provided the assets were acquired during a chargeable period between 2009 and 2010 and the company retains staff.

opment expenditures, with a special focus on new technologies such as semiconductors, new materials development, super minicomputers and biotechnology.<sup>42</sup> Rapid technological progress in the ICT producing industry (especially manufacturing) contributed to rapid productivity growth in the Republic of Korea – of 1 percentage point between 1996 and 2001, which was the highest among OECD countries during that time.<sup>43</sup> However, the ICT-related sector is just one example of how to improve the overall investment climate and to orient incentives towards higher value-added sectors.

- Technological transfer could also be enhanced by moving ahead quickly with the proposal to allow researchers to create innovative firms. Although the present legislation gives incentives for university researchers and professors to work in technology-based companies (promoted and owned by the university), the law has yet to be implemented. The Law on Sustainable Economy is a window of opportunity for unlocking this potential.

### 3 LEVERAGE FURTHER GAINS IN THE EXPORT SECTOR WHILE BEING MINDFUL OF ENVIRONMENTAL CONCERNS

The continued diversification of the existing growth model will be a key component of the adjustment process. There are already some early indications of this transformation via recent developments in external demand, but there is considerable potential to leverage further these gains: the share of exports to GDP in Spain was 26 per cent in 2008, which is low in comparison with the EU-15 average of close to 40 per cent. Moreover, the share of high value-added export products in total exports, at 48 per cent in 2010, is considerably lower in Spain than in some of its European counterparts, such as Germany (72 per cent) and Italy (68 per cent). As

<sup>42</sup> In 1992, the Government of the Republic of Korea pledged over 121 billion won for the “G-7 project” high technology project alone. Furthermore, the Law for the Promotion of Industrial Technology Development was put forth, which required large companies to create research centres and small or medium companies to form research consortia. Private corporations were responsive to these government incentives and they quadrupled operations in research and development throughout the 1980s. Concurrently, the Government administered foreign investment and technologies through redesigned incentive systems, which proved particularly instrumental for the electronics industry. Lastly, to help fuel this growth, the Government invested 1,238 billion won in 1980 and then 5,158 billion in 1990 in technology and science education, increasing the total budget for these activities by 17.1 per cent and 19.6 per cent, respectively. Ho and Shin (1997); Smith (1997).

<sup>43</sup> Federal Statistical Office.

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such, further gains could be achieved by continuing to diversify the export sector, both in terms of composition and destination.

- Industrialized exports products – e.g. mineral fuels and distillation products; vehicles other than railway, tramway; energy products; chemicals, iron and other metals, etc. – have regained their strength and are growing faster and contributing more to total growth of exports than the durable goods sector. Moreover, in a number of instances there have been strong gains in the comparative advantage of a number of emerging sectors, e.g. the metal tools and implements sector and the pharmaceutical export industry started to gain relative export advantage only in recent years. Encouraging the development of sectors that are more intensive in the use of technology would be an important step towards the sustainable development of the export sector. For example, government measures aimed at promoting the internationalization of firms<sup>44</sup> could be better tailored towards promoting greater diversification in goods and services.
- Expanding the export base for Spanish goods and services could also open new markets. During the past decade the proportion of exports going to non-EU destinations has increased, but only moderately – from 28 to 30 per cent. Moreover, the top three export partners (France, Germany and Portugal) still accounted for 40 per cent of total exports in 2009. Diversifying its foreign trade relationships, especially with emerging and developing countries, could open up new opportunities for Spain. This is particularly the case given that growth in developing countries is expected to be more than double that in advanced economies during the next two years – 6.5 per cent in the former compared to 2.5 per cent in the latter.<sup>45</sup> Moreover, a large part of the growth in developing and advanced countries will be driven by growing internal demand, which represent an important opportunity for Spanish exporters.

<sup>44</sup> See Chapter 2 for more information.

<sup>45</sup> IMF, 2011.



Moreover, experience from other countries shows that putting the right policies in place is central to a successful strategy of boosting economic growth through export promotion. Notable examples of these include the newly industrialized economies in Asia – starting first in Hong Kong (China), Republic of Korea, Singapore and Taiwan, and later in Malaysia, Thailand and Indonesia.<sup>46</sup> Despite the difference in their national experiences, it is possible to find common elements in policies aimed at promoting exports. The most important being: (i) adequate price incentives through a competitive real exchange rate and low levels of anti-export bias arising from import protection; (ii) sound physical infrastructure (e.g. ports, roads and power supplies) and social infrastructure (e.g. well-educated labour force); and (iii) access to credit for exporters, either for investment or export trade financing, at favourable interest rates.

A move towards a new economic model, however, should take into consideration environmental changes. Some of the major Spanish sectors are relatively low carbon intensive (e.g. the automobile industry and the electric and electronic equipment sector). Moreover, with the construction sector losing ground as an economic driver and exports gaining pace, Spain has an opportunity for “greening” its growth drivers. However, a number of the industries that have arisen during the last two years are either highly-carbon intensive (e.g. cork and derivatives), highly polluting (e.g. pharmaceutical industry) or highly energy intensive (e.g. those manufacturing zinc, iron and steel, cement and plaster, and ceramic products).

Policies must therefore balance the need for growth with the need to reduce greenhouse gas emissions. This can be achieved by promoting CO<sub>2</sub> reduction within firms or sectors that experience strong growth. Alternately, supporting low-carbon industries that have the potential to be productive and innovative, e.g. the electrical and optical equipment industry has the potential to achieve both objectives.

<sup>46</sup> The proportion of world exports of manufactured goods by the four Asian Tigers (i.e. Hong Kong (China), Republic of Korea, Singapore and Taiwan) increased from 1.5 per cent in 1965 to 5.3 per cent in 1980 and to 7.9 per cent in 1990. This contributed to an impressive growth in GDP of 14.1 per cent annually on average in the period 1980–90 (Weiss, 2005; IMF, 2011).

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## 4 EFFECTIVE WAGE DETERMINATION <sup>47</sup>

A number of factors have been influencing the growth of labour costs in Spain; yet, some were more decisive than others in affecting the variation. To analyse this in more detail, an econometric analysis has been undertaken to shed light on the various determinants of wage and non-wage costs in Spain and their relative importance (see annex A).

### *Inflation*

The model pinpoints inflation as the principal factor explaining changes both in wages and in non-wage costs during the period 1996–2008. In fact, the model illustrates that over this period around 30 per cent of the growth in wages, and more than 21 per cent of the non-wage cost changes were due to rising consumer prices.

Based on these relationships, two alternative scenarios have been simulated to illustrate the effects that different inflation and wage policies could have on the growth of labour costs in the future (Figure 3.17). A number of interesting results arise from the analysis:

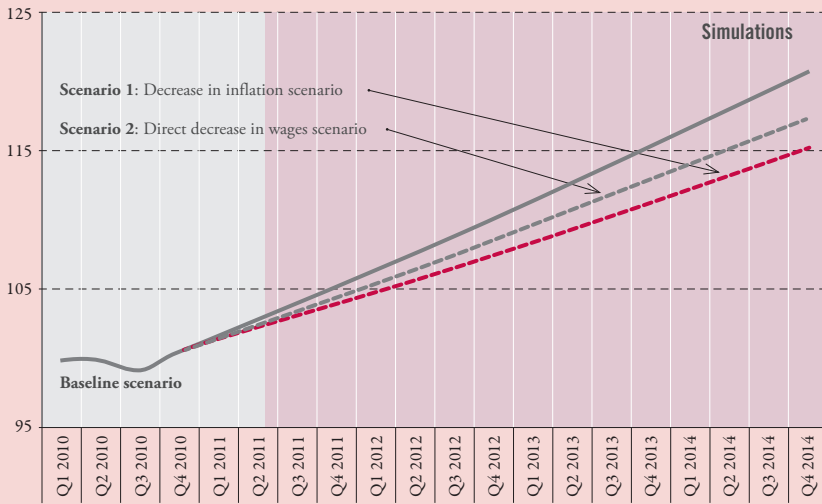
- The first finding is that efforts to reduce inflation – scenario 1 – are the most effective measure in reducing nominal labour costs. According to the analysis, efforts to reduce the average annual inflation from 3 per cent to the target 2 per cent of the European Union in four years<sup>48</sup> would reduce the growth rate of labour costs by an annual 1.1 percentage point – through a decrease in the growth rate of wages and non-wage costs of 1.2 and 0.8 percentage points per year, respectively.<sup>49</sup>
- Moreover, the above is more effective than an imposed decrease in wages, which would adversely affect the well-being of the population and on the

<sup>47</sup> This section was prepared in collaboration with Paola Ballon of the International Institute for Labour Studies.

<sup>48</sup> For this the simulation has assumed a 0.25 per cent decrease per year to attain an inflation of 2 per cent in 2014.

<sup>49</sup> Annual growth rates of nominal wages and nominal non-wage costs during the period 2000–07 equaled 4.1 and 5.5 per cent, respectively.

Figure 3.17 Total labour costs simulations (Q1 2010=100)



Source: IILS estimates using data from Eurostat database and national sources. See annex A for further details on the calculation of the different scenarios.

recovery of internal demand (already prior to the crisis real wage growth was weak). Indeed, the analysis shows that a decrease in the growth rate of wages – scenario 2 – of 1 percentage point – i.e. from an annual 4.2 to 3.2 per cent in nominal terms – would decrease the growth rate of labour costs by 0.6 percentage points.

### *Collective bargaining*

Another finding of the model is the importance of collective bargaining in positively influencing changes in wages and non-wage costs. Collective bargaining has been one of the keys to the recent successful reforms, but it has a number of limitations regarding wage-setting practices. Indeed, moving forward, there are some areas that need further consideration, in particular:

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- *More balanced wage determination process notably through the set up of a body to monitor income developments*: Social dialogue is the natural remit of the determination of wages and working conditions. Recent reforms have widened the scope of enterprise-level bargaining while amending other important aspects of the collective bargaining process, such as “ultra-activity”. It is unfortunate that consensus on the measures was not possible. However it will now be important to assess their impact in terms of supporting structural transformation – which will require more internal flexibility and job creation in new sectors – while avoiding a spiral of wage cuts. This assessment could be made through the creation of a small monitoring body including experts from government, employers and workers. Similar experiences exist in other countries undergoing structural change. Indeed, discussions on wage-price trends – crucial as they are in view of the need to support structural transformation – have tended to be blurred owing to different perceptions on the trends.
  - *Eurozone coordination on wage policies is important to avoid a “race to the bottom”*: It is important to keep wages indexed to productivity at the national level, while being mindful of the developments in competing EU countries. Moreover, wage reductions in other countries should not incite similar reductions elsewhere. In fact, if properly designed through effective collective bargaining, both at the enterprise and sectoral levels, an effective wage-setting mechanism could have positive spillover effects without compromising Spain’s competitiveness.
  - *Need for more flexibility in regards to the usage of the opt-out clause*: The new reforms include a provision that allows the use of opt-out clauses to be extended to more than one year, which in theory should give firms more time to recover. However, two problems persist: first, wage opt-out clauses are only included in 51 per cent of sectoral agreements, which already reduces the likelihood of their usage; and second, the procedural burden for firms wishing to use the opt-out clause is still cumbersome, as they have to prove that they are facing economic losses for two years or more and must verify that with extensive documentation and external auditing.

### *Other factors*

Regarding wages and salary determination, export competitiveness also played a role, although to a lesser degree. Importantly, concerning the determinants of non-wage cost growth, the model shows that efforts to reduce the share of unskilled workers in total employment and to reduce the number of dismissals would encourage a decrease in labour costs, although marginally (issues discussed in later chapters). This would occur through an additional decrease in the growth rate of non-wage costs of 0.3 percentage points (on top of the effect of inflation on non-wage costs of 0.8 percentage points).

## **5 ALIGNING EDUCATION, LABOUR MARKET AND SOCIAL POLICIES WITH THE NEW GROWTH MODEL**

A successful change in the growth and investment model, although necessary, will not foster employment recovery automatically. Changing the allocation of resources is often a lengthy process – and one which may delay job creation. While market forces are driving change, policy initiatives – along the lines of those described above – can encourage and accelerate this process. In the more immediate term, to complement this, proper labour market reforms will become all the more pressing if Spain is to speed up employment recovery significantly. In fact, empirical evidence shows that labour market reforms might support the transition to a new growth model by significantly speeding up the reduction of unemployment, while fostering productivity and real wage growth.<sup>50</sup> With that in mind, Chapters 4 and 5, respectively, analyse the institutional setting in Spain, notably as regards employment protection regulations, and the complementary role that labour market, social and education policies can play in supporting this transition.

<sup>50</sup> The analysis suggests that an all-embracing labour market reform (5 per cent reduction in the Nash parameter; 5 per cent reduction in separation rate; 5 per cent increase in matching efficiency; 10 per cent reduction in the cost of vacancies; and 1 per cent increase in search intensity) could reduce the number of years needed to cut the unemployment rate by 10 percentage points by one-third (a reduction of 6.5 years compared with the baseline). See Andrés et al., 2009 for a full analysis.

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## ANNEX A

### AN EMPIRICAL ANALYSIS OF THE DETERMINANTS OF OVERALL LABOUR COSTS: WAGE AND NON-WAGE COSTS

Section D of this chapter analysed, among other things, effective wage determination. The section provided additional insights for policy-making through two simulations that illustrated the effects that different inflation and wage policies could have on the growth of labour costs in the future. These simulations were constructed on the base of an econometric analysis estimated to shed light on the various determinants of wage and non-wage costs in Spain and their relative importance.

This annex explains how the model was constructed and presents the results of the exercise. The objective of the analysis is to examine the components of overall labour costs – i.e. wage and non-wage costs – in Spain during the decade of booming growth (1998–2008).

Our theoretical starting point is a standard neo-Keynesian macroeconomic model.<sup>51</sup> In its simplest form, standard neo-Keynesian macroeconomic models of wage/non-wage costs take the shape of a wage-setting equation (also called the wage curve) with the form:

$$w_t = \beta_0 + \beta_1 \pi_t + \beta_2 a_t - \beta_3 u_t + \beta_4 \Omega_t + \varepsilon_t$$

where,

$\pi$  represents prices,  $a$  the productivity of labour and  $u$  the level of unemployment. Other relevant variables are featured in the vector  $\Omega$ . In the simplest form of the model, this vector includes a series of labour market institutional variables, which may differ depending on the labour market realities of the country analysed.<sup>52</sup> Generally, the model includes a variable that measures the level of unionization of the country as well as the level of replacement incomes or unemployment benefits. There is also a measure

<sup>51</sup> See Blanchard and Katz, 1999 and Carnot et al., 2005, for a discussion on the different forms that macro-neo-Keynesian models take and explanations of the different explanatory variables that each model adds to take account of a variety of factors.

<sup>52</sup> For simplicity reasons, the analysis assumes that all institutional variables included in the vector  $\Omega$  are in their linear.

of the skill level of workers, and the tax and social contribution wedge (as the difference between incomes received by the worker including social contributions and the cost of labour for the employer). An extended version of this model often includes trade and macroeconomic indicators, such as the terms of trade or even total trade.

### *The variables used*

First of all, the model presented in this annex includes for the estimation of wage and non-wage costs the standard variables mentioned above: prices, productivity and unemployment. Although as it will be seen below, the two latter variables were not retained by any of the two models given their low significance level.

Other variables integrated in the analysis include:

- *Wage costs*: To take account of labour market institutions, an index that measures the extent of union coverage (*uncov*) was included as a proxy for the extent of collective bargaining in the country. The terms of trade (*trade*), measured by the index of the export prices over the import prices, were also included as an explanatory variable.
- *Non-wage costs*: The measure of union coverage was also included in the non-wage cost determination as well as the average replacement rate (*arr*). Moreover, given the importance of the average percentage of dismissals (*dis*), and the share of unskilled workers (*uns*) in Spain's non-wage costs, the model took them into account as part of the determinants.

**Table A 3.1 Definitions and sources of variables used in the regression analysis**

Variable	Definition	Source
Wages	Wages and salaries. Nominal value. Index: 2000 = 100	Eurostat database
Non-wage cost	Labour cost other than wages and salaries. Nominal value. Index: 2000 = 100	Eurostat database
Inflation	Annual average of the Consumer Price Index. Index: 2006 = 100	INE (Spanish National Institute of Statistics)
Productivity	GDP per hour worked. Constant prices	OECD.Stat
Unemployment	Unemployment rate	INE. Labour Force Survey
Average unemployment replacement rate	The ratio of an individual's (average) pension in a given time period and the (average) income in a given time period*	OECD.Stat
Union coverage	The percentage of wage and salaried workers covered by a collective agreement	ICTWSS database**
Unskilled workers	Percentage of employees in unskilled occupations	INE. Labour Force Survey
Dismissals	Average annual number of quarterly dismissals as a share of the number of employees during the previous quarter	Spanish Ministry of Labour and Immigration
Terms of trade	Quotient between exports price and imports price. Index: 2000 = 100	INE. Statistical Yearbook of Spain

\* The average gross replacement rate is measured across two income situations (100 per cent and 67 per cent of APW earnings), three family situations (single, with dependent spouse, with spouse in work) and three different unemployment durations (1st year, 2nd and 3rd years, and 4th and 5th years of unemployment). APW earnings are the estimated full-time earning of an average production worker in a given time period.

\*\* The ICTWSS (Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts) database is provided by the Amsterdam Institute for Advanced Labour Studies (AIAS).



### *The model estimated*

Based on this theoretical framework the analysis of the determinants of wage and non-wage costs was carried out using a system of equations in first differences. Unit root tests (through the augmented Dickey-Fuller test and the Phillips-Perron test) were first run to ensure that variables in levels were non-stationary. Moreover, to facilitate the interpretation of the coefficients, the model used the natural logarithm of the first differences. With this in mind, the following specifications of the wage equation (1) and non-wage cost equation (2) were chosen:

(1)

$$Dln(w)_t = \beta_0 + \beta_1^w Dln(\pi_t) + \beta_2^w Dln(a_t) - \beta_3^w Dln(u_t) + \beta_4^w Dln(LMI_t) + \beta_5^w Dln(trade_t) + \varepsilon_t^w$$

(2)

$$Dln(nw)_t = \beta_0 + \beta_1^{nw} Dln(\pi_t) - \beta_2^{nw} Dln(u_t) + \beta_3^{nw} Dln(LMI_t) + \beta_4^{nw} Dln(diss_t) + \beta_5^{nw} Dln(uns_t) + \varepsilon_t^{nw}$$

where:

$\pi$  represents prices;  $a$ , labour productivity;  $u$ , the unemployment rate;  $LMI$ , a set of institutional variables; and  $trade$ , a set of trade variables. In addition,  $diss$  is the share of dismissals in total employees; and  $uns$ , the percentage of employees in unskilled occupations.

Moreover,  $D$  denotes the first difference or the annual growth rate of the variables.<sup>53</sup> The estimation of (1) and (2) was done through a Zellner's seemingly unrelated regression, controlled for first-order autocorrelation. It could be argued that wages and non-wage costs are mutually influenced, and that wages influence inflation rates – though not contemporaneously. However, the lack of quarterly data regarding labour market institution

<sup>53</sup> Due to the lack of quarterly data on labour market institution indicators, the regression was estimated using annual data from 1997 to 2008, which was the only information available for most of the variables used.

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indicators constrained the efforts to forgo a simultaneous relation between overall labour cost components, as well as to allow for endogeneity of the inflation rate. Therefore, the results of this model should be interpreted with caution; as being more descriptive of the relationships between variables rather than fully causal.

### *The results*

A number of interesting results arise from the analysis:

- The model identifies inflation as the principal factor relating positively and significantly (Table A3.2) both changes in wages and in non-wage costs during the period 1998–2008. In fact, the model illustrates that over this period around 30 per cent of the growth in wages, and more than 21 per cent of the non-wage cost developments were related to rising consumer prices.
- Union coverage growth rates have a positive impact on wage and non-wage cost growth rates as well. This is important, but not surprising given that any improvement in strengthening the bargaining position of workers, *ceteris paribus*, would have an upward influence on wages and on non-wage costs.
- Regarding other less standard relationships in the specification of the wages equation, the terms of trade show a direct relationship with wage costs. On the contrary, unemployment was shown to be negatively related to wages, which is the standard theoretical relationship: an increase in unemployment would result in a weaker position of workers in collective bargaining and therefore would imply lower wages. However, the level of significance of this variable was not sufficiently high and therefore it was rejected by the model. Another variable that did not appear to be significant as a determinant of wages was productivity. This is not surprising given that in Spain empirical evidence shows that neither wages nor non-wage costs growth have been in line with productivity growth during the past decade and a half. Nevertheless, future reforms of the labour market in Spain should relax the strong linkage between inflation and

wages and use other variables, such as labour productivity as a reference for the determination of wages.<sup>54</sup>

- Additional explanatory variables of non-wage costs also show interesting results. Growth in the average unemployment replacement rate impacts negatively non-wage costs. This is logical if one thinks in terms of the compensatory differences that take place: given the additional protection of a higher replacement rate, further improvements to non-wage costs are no longer necessary. Finally, the share of workers in unskilled occupations and the average share of dismissals both have a positive influence in non-wage costs.
- Regarding the magnitude of the effects, inflation turns to be the variable with the highest impact on both wages and non-wage costs. Indeed, a 1 per cent increase in the inflation rate will translate into a 1.24 per cent increase in wage costs and a 1.22 per cent increase in non-wage costs. Moreover, additional efforts to improve the skill levels of workers and to reduce redundancies will have a positive effect in reducing non-wage costs, although marginally. These results provided the quantitative basis for simulating the policy scenarios presented in section D of this chapter.

<sup>54</sup> The body of the chapter explains the empirical relationship between wages and productivity in more detail.

**Table A3.2 Regression results**

	Growth rate of wage costs (Dlnw)	Growth rate of non-wage cost (Dlnwagecost)
Inflation (Dlnp)	1.246 (9.87)**	1.226 (3.94)**
Terms of trade (Dlntrade)	0.063 (2.66)**	
Union coverage (Dlnuncov)	0.525 (6.42)**	0.78 (4.93)**
Average unemployment replacement rate (Dlnarr)		-0.507 (-5.37)**
Share of workers in unskilled occupations (Dlnuns)		0.138 (3.39)**
Average percent of dismissals (Dlndiss)		0.095 (2.41)*
Constant	-0.000 (-0.01)*	-0.011 (-1.04)*

Note: All variables are controlled for stationarity. Absolute value of t-statistics (z-statistics in the tests of autocorrelation) in parentheses. Significance levels: \*significant at 5 per cent; \*\*significant at 1 per cent.

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## **CHAPTER 4**

### **LABOUR MARKET REFORM: OVERVIEW AND POLICY CHALLENGES<sup>55</sup>**

#### **INTRODUCTION**

In 2009, about one-third of all workers hired were on temporary contracts, which is close to three times the OECD average – a figure which has remained relatively stable for the past two decades despite efforts to encourage the use of open-ended (regular) contracts. In light of the disproportionate impact of job losses on temporary workers, however, the share of temporary workers has fallen to roughly one-quarter. But this is still high by international standards. These developments have once again brought the issue of labour market duality in Spain to the forefront. In this respect, the 2010–11 Spanish labour market reform is a welcome and timely initiative. Indeed, in 2010 and 2011, as outlined in Chapter 2, Spain carried out a rather extensive series of labour market reforms, principally in four main areas: (i) regulatory changes to address labour market duality by altering dismissal costs and procedures; (ii) policies to promote internal flexibility (adjustments in working hours) instead of external flexibility; (iii) increases in financial subsidies for firms hiring young persons, less-skilled people, women and long-term unemployed; and (iv) measures to improve labour market intermediation and delivery of employment services.

The purpose of this chapter is to examine primarily the first two elements of the reform in more detail, especially as regards their implications for promoting high-quality job growth and reducing labour market duality (Chapter 5 analyses the latter two components of the reform). In particular, section A of this chapter sheds light on the changes to employment protection legislation, paying particular attention to the issue of dismissal costs and labour market duality. Section B provides a snapshot of issues related working-time arrangements, notably part-time work, paying particular to the international perspective (see Chapter 3 for more information regarding the collective bargaining process). The final section discusses policy issues arising from the findings.

<sup>55</sup> The authors would like to acknowledge excellent research assistance by Chi Kyu Sim and Jamie Boderck.

## A EMPLOYMENT PROTECTION LEGISLATION

Employment protection legislation (EPL), if well designed, balances the need to provide income and job security to workers with the need to allow firms to adjust employment (hours and/or jobs) in response to fluctuations in aggregate demand. In particular, EPL governs recruitment under different contract types (regular versus non-regular) as well as procedures for individual and collective dismissals, notably the notice period and severance pay associated with job separation (usually based on a number of wage days or months per year of service).

Leading up to the 2010–11 labour market reform, Spain's EPL was considered to be among the most stringent, along with that in Turkey, Luxembourg, Mexico and Greece.<sup>56</sup> Meanwhile, countries such as the United States, the United Kingdom and Canada have – according to the OECD indicator – the least stringent EPL. Among advanced economies, regulations regarding employment contracts have been relaxed considerably over the past two decades in an effort to promote job creation, with reform efforts focused almost exclusively on easing the rules governing temporary employment. As a consequence, the share of temporary employment has risen in most advanced economies, exacerbating labour market dualities.<sup>57</sup> The 2010–11 reform in Spain aims to address labour market duality by altering the laws governing both open-ended and temporary contracts.

### 1 LAWS GOVERNING OPEN-ENDED CONTRACTS

#### *Severance pay for individual dismissals with open-ended contracts*

Over the past several decades, employment legislation in Spain has undergone a series of reforms, especially as regards dismissal costs (Table 4.1). Taking into consideration the most recent law (2010), in cases of fair dismissal (objective economic grounds) of an individual, severance pay is 20 wage days per seniority year regardless of the type of open-ended contract. For an unfair dismissal, severance pay varies according to the type of open-

<sup>56</sup> See OECD, 2004.

<sup>57</sup> ILO, 2008; Skedinger, 2010.

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ended contract. In particular, for ‘new’ open-ended contracts (*Contrato Indefinido de Fomento del Empleo*) the unfair dismissal severance payment is different depending on the grounds for dismissal. If the firm alleges economic grounds, then a severance payment of 33 wage days per seniority year is mandated (to a maximum of 24 salary months). However, on the basis of disciplinary grounds, the amount of the severance payment rises to 45 wage days per seniority year. For workers with an ‘ordinary’ open-ended contract, severance pay for unfair dismissal is 45 wage days per seniority year (with a maximum of 42 salary months), regardless of the reason for dismissal.<sup>58</sup> The required advance notice period for fair dismissals on economic grounds is now 15 days, a reduction from 30 days previously, which can be replaced by the payment of corresponding wages. For disciplinary dismissals, advance notice is not required.

Prior to the reform, a fair dismissal on economic grounds was considered too restrictive and few firms opted for this given that the legal definition was subject to different interpretations. This was particularly relevant given that prior to 2002 firms were required to pay intervening wages (and related court costs) during court procedures if a worker claimed that a *fair* dismissal was in fact *unfair* – an important consideration given the length of court proceedings in Spain. In 2002, however, the Spanish Government introduced a law that allowed firms to declare a dismissal unfair and pay the maximum severance and by doing so avoid the court process and related intervening wages. In view of the combination of a restrictive definition and uncertainty regarding the costs associated with court proceedings, firms opted to use unfair dismissals almost exclusively. For instance, for open-ended contracts, the share of unfair dismissals out of total dismissals reached 70 per cent in 2008 (Figure 4.1).

With this in mind, one of the main changes introduced in 2010 was the definition of “economic grounds” for dismissal. The 2010 definition expands the coverage and definition of economic grounds, giving firms the opportunity to broaden the scope and use of fair dismissals. And while there was no change in the stipulation that firms are required to pay inter-

<sup>58</sup> Labour courts cannot render decisions regarding the total amount of severance pay, they can only declare whether a case is ‘fair’ or ‘unfair.’ But, prior to 1980, judges had the power to decide the amount of severance pay (with legislated minimum and maximum amounts) based on the characteristics of the worker and/or firm.

Table 4.1 Timeline of labour market reform: Dismissal costs for individual cases

Year	Permanent contract	Temporary contract	Consequences
1980	<i>Disciplinary</i> Fair: 0; unfair: 45 days <i>Economic</i> Fair: 20 days; unfair: 45 days (Advance notice required)	No severance pay	Workers' Charter enacted Before the Charter, labour courts decided severance; Dismissal under economic grounds rarely used and almost only through collective dismissals
1984	No change in pay	Severance: 12 wage days; Minimum contract period: 6 months (increased to 12 in 1991) and maximum 36 months	Use of temporary contracts allowed for permanent needs of the firm ( <i>Contrato Temporal de Fomento del Empleo</i> , CTFE); as a result, massive increase in temporary employment
1994	No change in severance pay, but the pre-existing restrictions on the use of economic grounds for dismissals was removed (Advance notice: 30 days)	No change in severance pay for contracts under CTFE; For contracts other than the CTFE, 0–8 days	Severe restrictions placed on the use of CTFE, such as allowing temporary contracts only for the temporary needs of the firm; In practice firms replaced the use of CTFE by other types of temporary contracts (mainly the per-task contract)
1997	A new open-ended contract introduced with substantial financial incentives for certain groups of workers ( <i>Contrato Indefinido para Fomento de la Contratacion Indefinida</i> ) and the definition of economic grounds was modified Lower severance pay for unfair economic dismissal: 33 days	CTFE is eliminated; use of temporary contract for starting a new business is also eliminated	The legal definition of "objective economic dismissal" still not clear
2002	Firms could opt to pay the maximum severance payment (33 or 45 days depending on reason) for unfair dismissal and avoid court proceedings and the risk of having to pay intervening wages	No change in severance pay Added restrictions to the use of temporary contracts for a worker who is already working in the firm	Led to an exponential increase in the use of "unfair" dismissals; firms preferred to resolve a case by just making payment as an unfair dismissal, thereby avoiding going to court and paying intervening wages
2006	No change in pay Financial incentives for firms to use open-ended contracts	No change in severance pay	
2010	Fair: 20 days; unfair: 33 or 45 days depending on reason); Definition of economic grounds expanded; Employers have the option of applying for the reimbursement of 8 wage days per seniority year; Temporarily, the existing wage insurance system (FOGASA) will reimburse these amounts (Advance notice: 15 days)	Severance pay increased to 12 wages days – but the increase will be gradual, reaching 12 days in 2015; e.g. in 2012 it will be 9 wage days, and 10 wage days in 2013	The broader definition of economic grounds aims to eliminate the "forward-looking" nature of "fair" dismissal, but the exact wording of the law is still not clear

Source: Malo, 2011.

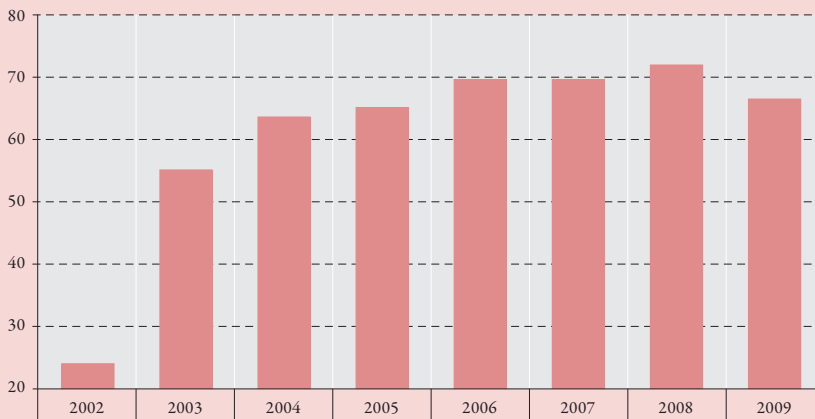
vening wages during a dispute over whether a dismissal was fair, preliminary evidence from the last quarter of 2010 shows that there has been a slight increase in the use of fair economic dismissals. The new regulations also make it easier to terminate employment due to persistent absenteeism, i.e. if the rate of absenteeism exceeds 2.5 per cent (prior to the reform, this rate was set at 5 per cent).

### *Severance pay for collective dismissals*

As in many other OECD countries, there are special rules governing collective dismissals, as they tend to have larger economic and social impacts than individual dismissals. In case of collective dismissals, the severance is 20 wage days per seniority year, but it can be increased through negotiations between the employer and workers' representatives at firm level.

One of the most important features of collective dismissals in Spain is the requirement of authorization from the public administration office, with the bargaining process focusing on two main issues: the number of work-

**Figure 4.1 Unfair dismissals of permanent contracts as a share of total dismissals (percentages)**



Source: ILS based on national sources.

ers to be laid off and the amount of severance payment. This is probably why firms reportedly tend not to use collective dismissals even when faced with economic downturns, i.e. collective dismissals are “individualized”. For example, in 2009, in the midst of the financial and economic crisis, the number of workers laid off via individual dismissals was 12 times the number of workers laid off through collective dismissals.

The reform of 2010–11 has modified some of the administrative rules associated with collective dismissals. For example, the maximum period bargaining period between employers and workers for collective dismissal is now 45 days. Here, too, there was a modest increase in the incidence of collective dismissals in the last quarter of 2010. In addition, the negotiating process for collective dismissals must now include, in addition to the number of workers and amount of severance pay, issues related to the potential (re)employment of dismissed workers, i.e. allocation and availability of training and other employment support measures. This is an important positive innovation.

### *Workers' Capital Fund*

An important element of the 2010–11 reform is the establishment of a Workers' Capital Fund, which is planned to take effect in 2012. This system, at least in its initial design, is similar to the Austrian individual savings account that went into effect in 2003. Under the Austrian system, employers are required to contribute 1.54 per cent of an employee's salary each month, starting in the second month, into an individual, non-taxed fund. Upon the termination of employment (voluntary or involuntary), an employee has several options regarding access to the fund (see Box 4.1 for details on the Austrian system and its effectiveness).

In 2003, as part of a wider attempt to broaden occupational pensions and reform the labour market, Austria's severance payment system underwent a number of modifications. Under the old system, employers paid severance (up to a maximum of one year's salary) to employees upon dismissal (for workers with tenure of at least three years). There were three main problems with the system in place prior to 2003: (i) it excluded workers on short-term contracts; (ii) it entailed an incentive for employers to hire under short-term contracts; and (iii) it inhibited labour mobility as employees would forgo their severance payment if they were to leave their jobs voluntarily.

The new system of individual savings accounts was put in place in 2003, in which the employer is required to contribute 1.54 per cent of each employee's salary every month to a corresponding *severance fund*. Payment begins on the employee's second month of work and is untaxed. Upon the termination of employment, the employee has the right to choose between: (i) leaving it in the fund until retirement; (ii) transferring it to the new employer's fund; (iii) investing it into a pension scheme; or (iv) receiving it as a lump sum. Removal of lump sums before retirement is taxed at a one-time rate of 6 per cent.

These new changes have allowed workers to accumulate severance pay uninterrupted by job changes, thus helping to encourage job mobility. In addition, the contributions are intended to act as a supplementary pillar to the pension system.

The overall impact of the 2003 reform was positive:

- *Low labour market duality*: The share of temporary employment in total employment, at around 10 per cent, is relatively low in Austria.
- *Worker mobility*: The new system has facilitated mobility among workers, thereby opening up new career opportunities.
- *Continued labour market resilience*: Unemployment rates have remained remarkably low (around 4 per cent), even during the recent crisis. The new severance pay system has been consistent with job-retention policies, which have made it possible to reduce layoffs in sustainable enterprises facing the crisis.

Meanwhile, there are specifics regarding the operation of the severance fund that Spain should be mindful of:

- *Most people take the payout*: Although the fund was partially meant to act as a supplement to retirement savings, 88 per cent of participants that had the option to take out their money did so in 2006.
- *Relatively low returns*: Originally, returns were predicted to be about 6 per cent, but were consistently lower, i.e. less than 4 per cent in 2003, 5 per cent in 2004, 5.5 per cent in 2005 and 3.6 per cent in 2006. Nevertheless, these returns still imply real income gains for the workers.
- *Employees hired before 2003 less likely to go into the new system*: Workers who began their employment relationships prior to the 2003 start date have predominantly chosen to stay with the old system. It has been speculated that this may be due to the nature of the transfer from the old to the new system.



In the new Spanish system the Workers' Capital Fund follows a similar principle, where a portion of severance pay can be deferred by the employee to a future date under certain conditions – a number of details are yet to be determined. It is applicable to all open-ended contracts signed after 18 June 2010, and includes both individual and collective dismissals. A tripartite expert panel is in the process of bringing the new fund into operation (see Box 4.2). The current law intends that of the total eligible severance pay per year of service, 8 wage days per year of service are paid out of the fund. Workers could make use of the money received through the fund at the time of job separation in a number of ways including potentially: (i) carrying it forward to the new employer; or (ii) withdrawing at retirement; or, (iii) receiving in the form of a lump sum; or (iv) using it to aid geographic mobility; or (v) financing training.

## 2 LAWS GOVERNING TEMPORARY CONTRACTS

Prior to 1984, firms in Spain could hire workers on temporary contracts to carry out the temporary needs of those firms (the so called “causality principle”). The reform of 1984 abolished this and effectively made it possible for firms to hire workers on temporary contracts to perform permanent functions of the firm (known as *Contrato Temporal de Fomento del Empleo*, CTFE). The severance pay for workers on temporary contracts was set at 12 wage days per seniority year, given the minimum and maximum contract periods of 6 and 36 months, respectively. The Spanish Government viewed this reform as an attempt to facilitate entry into employment, but employers started using it as the chief mechanism of adjusting employment to fluctuations in demand since the severance pay was considerably lower in comparison with that for open-ended contracts (20 days) and workers were not allowed to file for a suit claiming “unfair” dismissal. As a result, temporary employment became widespread and, as a share of total employment, rose to 30 per cent by the 1990s. The share of women with a temporary contract rose to 40 per cent by the mid-1990s.

The 2010 Act stipulated that the Worker's Capital Fund would be in operation in 2011, while the existing wage insurance system (FOGASA) would carry out its functions regarding dismissals and severance payment until it became operational. However, as of June 2011, the details regarding the functioning of the Fund is still being debated. In the meantime, as stated in the 2010 law, only open-ended contracts signed after June 2010 and with at least one year seniority, can apply for funds through FOGASA. This basically means that first applications to FOGASA could be made only in June 2011.

There are several pending issues concerning the fund:

- *Worker reaching retirement:* A key issue is whether or not a non-dismissed worker entering retirement is eligible to receive monies accumulated in the fund. But it is likely that this would be allowed; if not, it would provide incentives for firms and employees to manufacture a false dismissal few days or weeks prior to the retirement date.
- *Voluntary severance:* Another issue unresolved is whether a worker who quits voluntarily can have access to the fund. In the Austrian reform of 2003, for voluntary dismissals, open-ended contracts signed after 1 January 2003 have access to the fund. Presumably, this would be the case in Spain for contracts signed after June 2010; if not, the potential for increased labour mobility would be reduced.
- *Financing:* Although it appears that the existing FOGASA would finance, at least initially, the costs associated with putting the fund into place, it is not clear whether this would require additional contributions from employers – as was the case when the Austrian system was put in place – and if so, whether the contributions would be offset by reductions elsewhere.

The Spanish Government created an expert group in March 2011 to examine the process of bringing the new fund into operation. This group comprises two experts from the Spanish Ministry of Employment, two from trade unions and another two from employers' organizations. This group submitted its report to the government in June 2011 with the following key recommendations or considerations:

- First, the Fund should have a mixed system of capitalization (with no individual accounts), and should focus primarily on the funding part of the severance pay, leaving aside other considerations such as, facilitating geographical mobility etc.
- Second, the design of the Fund should closely follow the 2003 Austrian model.
- Third, continuation of the current transitory situation through FOGASA until the Fund becomes fully operational.

In general, the experts highlighted that given the current economic situation and as stipulated in the 35/2010 Act, it is important not to put further financial burden on firms by increasing social contributions. Moreover, firm contribution to the Fund should be offset by commensurate decrease in social contributions in other areas. Also, the experts underscored the need to use the Fund primarily to close the severance pay gap between open-ended and temporary contracts.

In an attempt to address these shortcomings, in 1994 the Government restored the causality principle, i.e. workers on temporary contracts would only do temporary work for firms. Meanwhile, severance pay was reduced to between 0 (end of contract) and 8 wage days per seniority year, but for workers hired through temporary work agencies, it remained at 12 wage days. These reforms did not prevent a further increase in the use of temporary contracts.<sup>59</sup> Rather than switching to open-ended contracts, firms replaced the use of CTFE contracts with the use of a different type of temporary contract (the per-task contract).

One of the primary objectives of the recent reform is to bridge the severance pay gap between permanent and temporary workers, and in turn to reduce labour market duality. According to the reform, severance payment for temporary workers would increase gradually from 8 to 12 wage days by 2015. For example, workers hired in 2011 will have severance payment of 8 wage days, while workers hired in 2012 will have severance payment of 9 wage days, until it is capped at 12 wage days in 2015 for all temporary workers, including those hired through temporary work agencies.

As such, the severance pay gap between workers with open-ended and temporary contracts in 2015 would be 8 wage days per seniority year for fair economic dismissals (see Table 4.2 for the evolution of the severance pay gap). But considering that 8 wage days per year of service are pre-funded, the cost of a fair dismissal at the time of job separation for an open-ended contract would in fact be 12 days, thus reducing the gap to 0. Meanwhile, if firms opt for the unfair dismissal route, the gap in 2015 would remain between 13 and 25 wage days per seniority year, depending upon the type of open-ended contract.

<sup>59</sup> Malo and Toharia, 1997.

**Table 4.2 Severance pay gap between open-ended and temporary contracts**  
(wage days per year of service)

Year	Unfair dismissal*			Fair dismissal		
	Open-ended	Temporary	Gap	Open-ended	Temporary	Gap
1994	45	8	37	20	8	12
1997	45 (33)	8	37 (25)	20	8	12
2006	45 (33)	8	37 (25)	20	8	12
2010	45 (33)	8	37 (25)	20	8	12
2012	45 (33)	9	28 (16)**	20	9	3**
2015	45 (33)	12	25 (13)**	20	12	0**

\* Figures in parenthesis refer to “new” open-ended contracts, i.e. Contrato Indefinido de Fomento de la Contratación Indefinida, introduced in 1997.

\*\* Figures for 2012 and 2015 assume that 8 wage days per year of service are funded through the new Workers’ Capital Fund.

Note: Years indicated in the table correspond to years in which reform of EPL was undertaken in Spain.

Source: Malo, 2011.

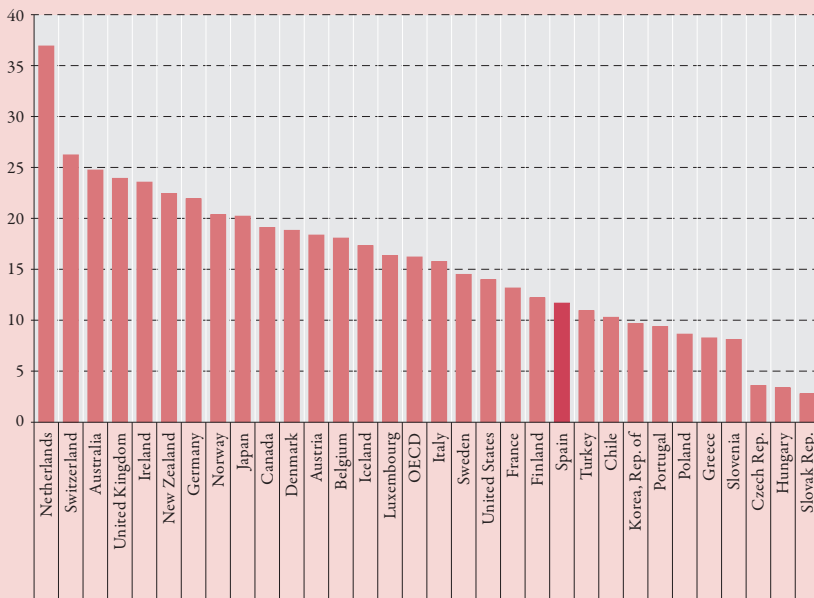
Meanwhile, prior to the recent reforms the maximum duration of a temporary contract depended on the reason for which the contract was used. In particular, if the temporary contract was used to perform temporary increases in output, the maximum duration was 6 months in any 12-month period, which could be extended to 12 months in any 18-month period through collective bargaining. However, there were no specific limitations on the maximum duration of temporary contracts for other reasons, such as for a specific task or project or as a replacement (in general, all regular work). The new law changed this by establishing a maximum duration of three years, which could be extended to four years through sectoral collective agreement. After this period, if the worker continues to provide services, he or she will transfer to permanent status. Also, in regards to successive temporary contracts – applicable to temporary workers doing regular tasks of a firm – an employee who has been in the same position doing the same task for more than 24 months in a 30-month period is entitled to become permanent. Furthermore, according to the new law, this provision applies even if the worker is not engaged in the same task.

## B PART-TIME EMPLOYMENT

There are potential benefits to part-time employment from both the employee's and employer's perspective. Part-time employment can help to promote labour force participation of marginalized groups of workers, and in some instances gives workers more flexibility in terms of work–life balance. The possibility of adjusting working hours can help to reduce job losses during downturns. On the other hand, there are potential downsides, such as limited access to certain benefits, and a risk of getting trapped in part-time employment paths, which have more limited career prospects than full-time employment.

The incidence of part-time employment in Spain is comparatively low: in 2009 it stood at 11.8 as a per cent of total employment, compared with 25 per cent or more in countries such as the Netherlands, Switzerland and Australia (Figure 4.2).

Figure 4.2 Incidence of part-time employment across selected OECD countries, 2009 (percentages)



Source: OECD.

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A number of factors are likely to be behind the relatively low incidence of part-time employment in Spain. As illustrated in Chapter 3, the vast majority of employment created in the past decade has been in micro- and small enterprises, which tend to hire full-time (often temporary) workers. Additionally, the collective bargaining process has not succeeded in balancing the need for flexibility and social protection.

## **1 REGULATIONS GOVERNING WORKING TIME AND PART-TIME CONTRACTS**

In Spain, the laws that regulate open-ended part-time and temporary part-time contracts are the same as those governing open-ended full-time and temporary full-time, respectively. As such, social contributions (for firms), severance pay, unemployment benefits and pensions, are related to the contract type, except that obligations and benefits are proportional to hours worked by each employee. This is also the case in most other advanced economies (Table 4.3).

Generally, access to benefits related to childcare, maternity leave and health benefits tend to be limited for workers on part-time contracts. But there are exceptions to this rule, namely the Netherlands, which provides equal benefits in these areas to part-time workers as it does to full-time workers. With the 2010–11 reform in collective bargaining, the Spanish Government aims to make it easier to change working time. In particular, part of the 2010–11 reform efforts seeks to improve working-time arrangements by allowing firms and workers more flexibility to adjust working time. For instance, the new regulation allows firms to distribute 5 per cent of the total working time in a flexible manner. Higher shares, however, will need to be agreed upon in the collective agreement – something which is already the case across some sectors and firms. This is a welcome step, which opens up new opportunities for social dialogue.

Spain has relied on hiring subsidies to promote part-time employment (see also Chapter 5). For example, the recent labour market reform introduced social security reductions for firms that hire vulnerable workers (youth, women and long-term unemployed) on a part-time basis (on open-ended contracts).<sup>60</sup> Studies show that measures of this nature are largely ineffective as they often lead to deadweight losses. Instead, one approach that merits particular attention and has proven to be more effective is simply to bridge the gap between various forms of employment – including between full-time and part-time – notably as regards access to social security. Moreover, countries with high incidence of part-time employment tend to employ a combination of direct and indirect measures to promote part-time employment (Table 4.3). For example:

- *Ensure minimum wages, social security rights and childcare:* The Netherlands, which has the highest share of part-time employment among the OECD countries (36.6 per cent in 2009), supports part-time employment by guaranteeing minimum wages and social security for jobs with working hours below one-third of a normal working week. Furthermore, childcare access has been enhanced, which facilitates the entry of women to the labour market through part-time employment.
- *Improve social dialogue at the firm level:* Firm-level collective bargaining between the employer and workers' representatives makes enterprises better able to endure economic downturns. For instance, countries such as Denmark have regulations that encourage enterprises and workers to negotiate part-time work at the firm level.
- *Laws against discrimination, and acceptance of part-time work:* Meanwhile, countries where part-time employment has been common for decades have laws that protect part-time workers from discrimination (e.g. Germany).

<sup>60</sup> See Chapter 5, Annex A for more detailed descriptions of recent employment measures.

**Table 4.3 Regulation of part-time work in selected European countries**

<b>Country</b> (share of part-time workers in 2009)	<b>Stringency of EPL</b> (OECD index)	<b>Social security benefits and rights for part-time workers</b>	<b>Government policies to encourage part-time contracts</b>
<b>Austria</b> (18.5)	2.41	Unemployment benefits (UB) and pensions based on hours worked.	No direct policies, but passive acceptance of rising trend in the use of part-time contracts among women.
<b>Denmark</b> (18.8)	1.91	UB and pensions based on hours worked. Additional restrictions on UB benefits for part-time workers, which has discouraged part-time work.	Yes. In 2002, a new law made it easier to make agreements about part-time work at the enterprise level, irrespective of collective agreements already in place. However, even before 2002, most collective agreements facilitated the use of part time working arrangements.
<b>Germany</b> (21.9)	2.63	UB and pensions based on hours worked. Health and maternity included.	Yes. Since the 1990s, part-time work has been viewed as an opportunity to balance work and life. In 2000, the right to work part time was strengthened. The Government has also introduced restrictions on the use of part-time work.
<b>Netherlands</b> (36.6)	2.23	UB and pensions based on hours worked. Health and maternity leave included.	Yes. In 1993, minimum wage and social security were granted for part-time jobs. In 2000, a law established the right to work part time. In 2001, tax reform resulted in some women reducing their working hours.
<b>Spain</b> (11.8)	3.11	UB and pensions based on hours worked.	Yes. Indirect: The 1994 and 1997 legislation tried to promote working hours arrangements related with non-regular distribution of working hours. Direct: In 2010–11, with a view to encouraging the use of part-time contracts, the Government announced reductions in social security contributions for firms. For example, firms receive 100 per cent reduction when hiring youth or long-term unemployed.
<b>Sweden</b> (14.6)	2.06	UB and pensions based on hours worked. However, the possibility of receiving UB benefits has been reduced, thus increasing pressure on part-time workers to find a full-time job.	Yes, the reform process started in the 1970s, when the Government put in place measures to boost employment of women. Since the 1990s, attempts have been made to reduce involuntary part-time work and increase the share of voluntary part-time work.
<b>United Kingdom</b> (23.9)	1.09	UB based on hours worked.	Yes. For example, Part-time Workers Regulations 2000 ensured equal rights concerning pay, pensions and employment protection. The Employment Act 2002 introduced the rights of parents with young children to have flexible working hours.

Note: Social security contributions rates are the same for both part-time and full-time employment in most countries.

Source: ILS based on Eurofound, April 2010.



## C POLICY CONSIDERATIONS

While it is too early to gauge its effectiveness, the Spanish labour market reform of 2010–11 represents an encouraging step in the right direction. In particular, it aims at attenuating labour market duality, which is widely regarded as an obstacle to promoting decent work for all. Yet, there are a number of areas where further reform is merited.

### 1 FURTHER MEASURES ARE NEEDED TO ADDRESS EXCESSIVE LABOUR MARKET DUALITY

The combination of (i) the introduction of the Workers' Capital Fund, which requires pre-financing of 8 days' severance pay per year of service, (ii) the gradual increase of severance payment for temporary workers and (iii) the broadening of the definition of "economic grounds" for fair dismissals (previously, firms used *de facto* unfair dismissals, which have significantly higher severance payment) should narrow considerably the prevailing severance pay gap between contract types (open-ended vs. temporary) at the time of dismissal. The introduction of the fund should also help to improve employment mobility of workers with open-ended contracts – a key consideration given that the current structural transformation underway in Spain is likely to be associated with job turnover.

However, first, there is still a risk that firms will continue to have recourse to temporary employment in order to avoid onerous court proceedings in the event of unfair dismissal of workers on open-ended contracts. Introducing measures to streamline court proceedings and administrative procedures for disagreements regarding fair versus unfair dismissals should reduce the incentives for using the costlier *de facto* unfair dismissals – thereby also facilitating recruitment on open-ended contracts. This could be achieved by, for instance, streamlining paperwork and increasing the number of judges when there is a high backlog. For example, Ireland has put in place a combination of these measures and has managed to establish a relatively predictable and efficient court process (Table 4.4). Likewise, a predictable, fast and efficient court process exists in the Netherlands.

**Table 4.4 Length of court process in selected OECD countries**

Country	Length of the procedure	Percentage of cases won by workers
<b>Australia</b>	Usually 6–7 months	90% of all claims were resolved by conciliation and only 5% by formal arbitration 57% of all formal arbitrations were resolved in favour of the employee
<b>Finland</b>	Usually 6–8 months	30% of all cases heard by courts
<b>France</b>	About 1 year (average for all types of dispute)	75% of all heard cases (average for all types of dispute)
<b>Germany</b>	3–4 months on average	
<b>Ireland</b>	2–6 months on average	66% or 53% of all heard cases, depending on type of court
<b>Italy</b>	About 2 years (average duration of lawsuits)	55% of all heard cases; the majority of cases were settled by the parties themselves, without being brought before courts
<b>New Zealand</b>	Determinations issued within 8 months of the application being made	About 50% of claims in the last quarter of 2002, for which a determination was issued, were resolved in favour of the employee
<b>Norway</b>		51% of all cases brought before courts in 2003
<b>Spain</b>	Few cases even go to court (20% in 2008); unfair dismissals commonly used and settled within 2 days	40% of cases in 2008
<b>Sweden</b>	1–2 years	42% of “guiding decisions” among all judicial decisions 47% of “guiding decisions” with explicit reference to Employment Protection Act in judicial decision
<b>United Kingdom</b>	In 2002/03, 86% of all employment tribunal decisions were issued within 4 weeks of the final hearing	In 2002/03: 22% of cases went to a hearing in an employment tribunal, of which 44% were resolved in favour of the employee
<b>United States</b>	Average of 3 years or 182 days, depending on type of court	19% or 83% of heard cases, depending on type of court

Source: Based on: table 2.1 in OECD (2004) and labour force statistics from OECD StatExtracts (<http://stats.oecd.org>) for other countries.

Second, even with the most recent reforms, for fair dismissals the gap in severance pay (between temporary and open-ended contracts) at the time of dismissal is only zero in 2015 once the 8 days financed from the Workers' Capital Fund are taken into consideration. Otherwise, the gap remains at 8 days. This raises the questions of (i) how to finance the Workers' Capital Fund; and the (ii) what impact will the fund have on labour market duality, given that as the current proposal stands, temporary workers would be excluded. In this regard, the detailed features of the Workers' Capital Fund – which have yet to be determined – will play a critical role. Nevertheless, for the fund to be more inclusive and effective in other areas (e.g. training), a few modifications to the current proposals could be considered:

- The Government should give careful consideration to extending – as is the case in Austria – access to the Workers' Capital Fund to temporary workers. The amount of days of severance pay that a temporary worker could carry forward in the fund could be the same proportion of total severance pay as for workers with open-ended contracts, e.g. 40 per cent (8 days of severance pay out of a total of 20 days per year of service for a fair dismissal). In this scenario, the total severance pay for a temporary worker in 2015 would be 12 days – as stipulated in the current legislation – of which roughly five days could be carried forward for other purposes, such as training. Not only would this equalize the hiring incentives, but it would have the added benefit of also promoting mobility and training among temporary workers.
- Allowing temporary workers access to the Workers' Capital Fund would, however, reverse to some extent efforts to narrow the effective severance pay gap between open-ended and temporary workers. This means that efforts to ensure the effective use of economic grounds and fair dismissals and accelerating court proceedings will be even more important.
- It will be important to ensure that the Fund does not increase further the cost of hiring especially for open-ended contracts. As Chapter 3 demonstrated non-wage costs, including dismissal costs, are important considerations to bear in mind, especially at a time when the economy needs to bolster competitiveness and create new jobs. In this regard, more

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consideration could be given to lowering overall severance pay, especially for fair dismissals of open-ended contracts to a level similar to those prevailing in the rest of Europe. This would be the most effective means of reducing the severance pay gap between contract types.

- Finally, given the importance of up-skilling and labour mobility, the regulations governing the use of the fund will be of the utmost importance. And, as the case of Austria has demonstrated, the conditions under which workers can receive the lump sum payment of 8 wage days per year of service will have an important impact on how the fund is used. Indeed, Spain should consider introducing a number of incentives should it wish to encourage workers to use the fund for training, mobility or retirement. In any case, if payment is to be received as a lump sum, the tax and benefits implications need to be carefully thought out. For instance, the lump sum could be taxed at the individual's marginal tax rate. Similarly, the Workers' Capital Fund needs to adhere to stringent investment safeguards to protect it from excessive fluctuations while also ensuring a stable return.

## **2 IMPROVED SOCIAL PROTECTION FOR NON-STANDARD WORKERS**

Despite the onset of losses of temporary jobs, the share of temporary employment in Spain – at nearly 25 per cent in 2010 – remains high. And while the 2010–11 reform goes a long way to addressing labour market duality, the Government can further address duality by bridging the gap in social security and other benefits between permanent and temporary workers. For example, countries such as Austria and Denmark show that it is possible to provide social protection to temporary workers without actually institutionalizing temporary work (both the countries have relatively low labour market duality, see Box 4.3). An approach based on closing the gap in benefits between workers of different categories should also be extended to full-time and part-time workers. This is likely to yield better results for workers and firms seeking to balance employment, protection and flexibility than the current system, which is dominated by hiring incentives.

**Box 4.3 Social protection for temporary workers: Examples from selected countries**

*Austria:* In Austria, the employment of temporary workers is regulated by the Temporary Employment Act (AÜG). The Act obliges the temporary work agency to register temporary workers with the relevant social insurance institution, such that workers are covered by the same basic rights as permanent workers in terms of pay, working time and other conditions of work. However, a prevailing legal opinion on receiving social security benefits paid by the employers is that employers bear no legal obligation to treat temporary workers equally as the permanent workers.<sup>61</sup> Temporary workers can receive medical and unemployment benefits if they have made sufficient contributions. For example, the insured person must have at least 28 weeks of contributions in the past 12 months if they are to qualify for unemployment benefits.<sup>62</sup>

*Denmark:* In Denmark, temporary workers usually come under the protection of the country's social security schemes. Temporary agency workers have access to secure wages, basic social rights, right to a pension, holiday benefits and sickness and maternity benefits.<sup>63</sup> All major social security schemes, including pensions, healthcare and unemployment benefits, are provided to temporary workers through universal coverage, though some benefits may come at a reduced rate. For example, part-time employees receive less unemployment benefit, at the rate of 66.7 per cent of the maximum unemployment benefit.

*France:* In France, temporary agency workers are covered by the general social security schemes (e.g. health insurance, invalidity, maternity, accidents at work, unemployment and pensions) and a sector-wide agreement supplements the general scheme for employees.<sup>64</sup> Despite the same coverage of temporary workers under the general social security schemes, it appears that temporary workers may have far more difficulty in receiving social security benefits.

*Sweden:* In Sweden, temporary workers are covered under major social security schemes, including pensions, healthcare and unemployment benefits, as the country offers universal coverage for most of these social schemes. Additional benefits are provided depending on the contributions that have been made prior to receiving benefits. At a minimum, temporary workers are offered pensions, universal medical care and basic unemployment benefit. In addition, earnings-related pensions and income-related unemployment benefit are provided depending on the contributions previously made. For instance, in the case of income-related unemployment benefit, 80 per cent of an insured's previous income is paid for the first 200 days and 70 per cent of the insured's previous income is paid for the next 100 days.

<sup>61</sup> Institute for Labour and Family Research, 2008.

<sup>62</sup> SSA & ISSA, 2010.

<sup>63</sup> Andersen & Hansen, 2008.

<sup>64</sup> Michon, 2008.

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## **CHAPTER 5**

# **THE ROLE OF EMPLOYMENT AND SKILL POLICIES IN SUPPORTING STRUCTURAL TRANSFORMATION<sup>65</sup>**

### **INTRODUCTION**

Well-functioning employment policies will be needed to prepare workers, especially young graduates, for employment in the new growth sectors. Similarly, during the current period of structural transformation, the benefits system will be critical for ensuring adequate transitions. In this respect, an effective public employment service (PES) will be central to administering the benefits system and for facilitating matching between new vacancies and job seekers. Taking into account the 2010–11 Spanish labour market reform – which includes an increase in financial subsidies for firms hiring young people, less-skilled workers, women and long-term unemployed, along with measures to improve labour market intermediation – the purpose of this chapter is to examine the role of employment policies in supporting both quality jobs and a successful structural transformation of the Spanish economy. Section A analyses the current suite of labour market policies designed to promote employability, paying close attention to the fact that Spain has placed considerable emphasis on hiring subsidies for firms. Section B considers specific policies for youth and section C takes stock of the current benefits system in Spain and the extent to which it is aligned with labour market and social objectives. Section D looks at the role of PES in delivering activation policies, especially in light of the new intermediation measures put in place by the Government. Section E draws policy conclusions from the analysis.

<sup>65</sup> The authors would like to acknowledge excellent research assistance by Chi Kyu Sim.



## A ACTIVE LABOUR MARKET POLICIES

### 1 GENERAL OVERVIEW

The main components of active labour market policies (ALMPs) in Spain are labour market intermediation services, training programmes and subsidies for job creation (mostly for specific groups, such as women, youth and people with disabilities). In 2008, total spending on ALMPs amounted to 0.73 per cent of GDP, well above the OECD average of 0.46 per cent of GDP (Figure 5.1, panel A). Compared with other countries, the spending on subsidies for job creation is relatively high in Spain. Other countries put more emphasis on intermediation services through effective PES and training.

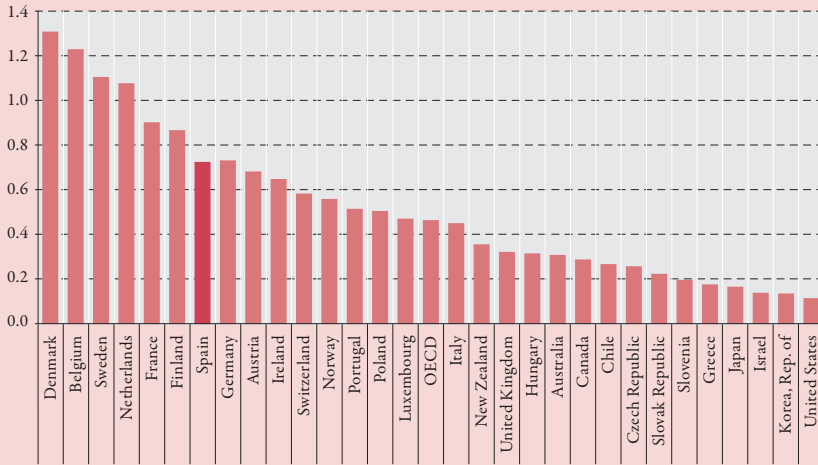
One of the main features of the Spanish system is that the regional Governments are responsible for the management of ALMPs, while the central Government is entrusted with the management and operation of the unemployment insurance system. Meanwhile, the eligibility criteria for participation in ALMPs are contingent upon registration with PES. The PES in Spain is run by National Public Employment Services and Regional Public Employment Services, which disburse unemployment benefits and subsidies and provide intermediation services for unemployed people.

Leading up to 2007, participation in ALMPs increased significantly, i.e. to more than 15 per cent of the labour force, driven principally by an increase in the number of participants taking part in employment incentives (Figure 5.1, panel B). There was also a strong increase in the number of participants in start-up business schemes (rising from 30,795 in 2003 to 392,020 in 2008), whereas the number of participants in training programmes declined considerably.

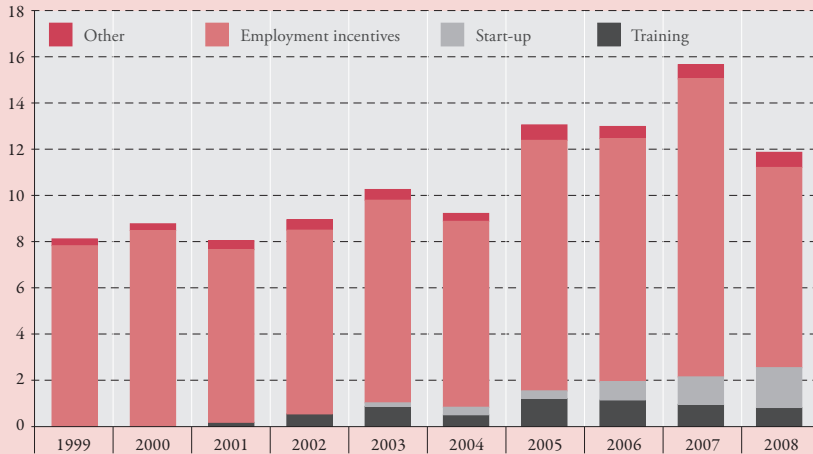
Despite early government efforts to mitigate the effects of the crisis, as unemployment rose to historic levels throughout 2010, Spain introduced the Economic and Social Agreement of 2011 in an effort to augment the

Figure 5.1 Spending on ALMPs and number of participants

Panel A. Spending on ALMPs as a percentage of GDP, 2008



Panel B. Participation in ALMPs by programme type, 1999–2008 (percentage of the labour force)



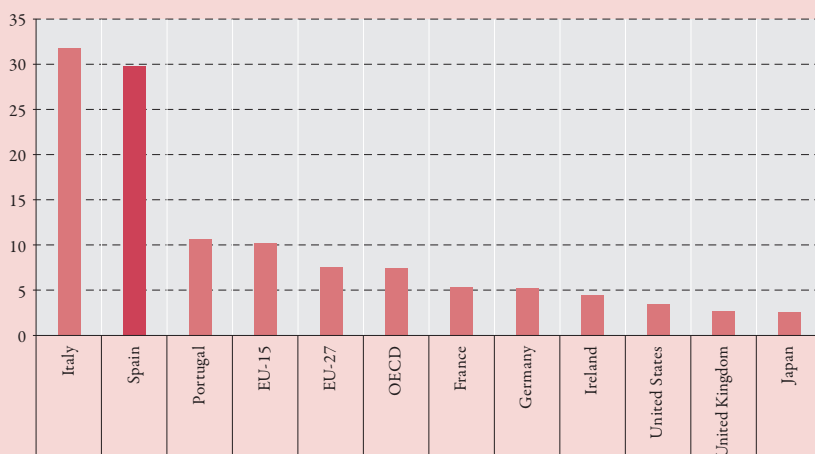
Source: IILS estimates based on data from OECD, Eurostat and national sources.

range of existing measures. This Agreement comprised: (i) financial incentives for hiring disadvantaged workers; (ii) a new programme that combined income transfers with activation measures; and (iii) joint measures of labour market orientation and training.<sup>66</sup> The purpose of this section is to examine in more detail the range of measures available and their effectiveness.

## 2 EMPLOYMENT INCENTIVES

Employment incentives include hiring incentives, which in Spain are often directed at promoting the use of full-time open-ended contracts.<sup>67</sup> Only Italy spends more on employment incentives: more than a third of its total spending on ALMPs goes to employment incentives, compared with more than one-quarter in Spain and the average in the OECD area of closer to 15 per cent (Figure 5.2). Countries such as France, Germany and the United Kingdom only spend 12.5, 9.3 and 3.9 per cent, respectively, on employment incentives. Indeed, in other countries (e.g. Japan, the United States and the United Kingdom), PES and training tend to be the largest areas of spending, with the former often accounting for more than 50 per cent.

Figure 5.2 Spending on employment incentives as a share of total spending on ALMPs, 2008



Source: ILS based on the OECD and national sources.

<sup>66</sup> See Annex A for information regarding labour market and social measures included as part of Plan E.

<sup>67</sup> See Chapter 4 for a discussion of similar measures introduced to promote open-ended contracts for part-time workers.

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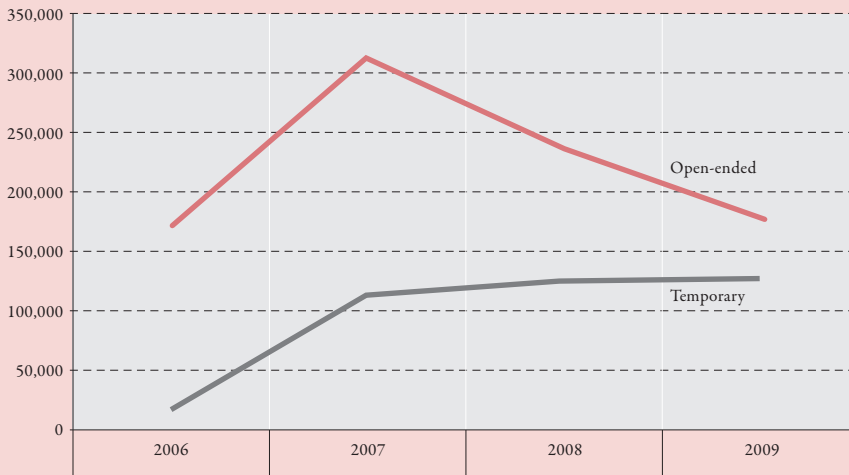
These financial incentives have often taken the form of broad-based reductions in social security contributions for Spanish employers, as illustrated in Chapter 4. However, more recently efforts in Spain have moved away from this broad approach and have instead focused more on incentives for certain groups of workers (e.g. women, youth, unemployed persons over the age of 45 and disabled). For instance, recent measures include: (i) a 100 per cent reduction in social security contributions for firms hiring unemployed workers who have been registered with PES for three years or workers with disabilities; (ii) a 50 per cent reduction in social security contributions for self-employed workers for the first hiring made on an open-ended contract; (iii) a lump-sum subsidy of €1,500 for hiring on an open-ended contract an unemployed worker with dependants; and (iv) increased reduction in social security contributions for hiring part-time workers who work less than one-third of full-time hours (see annex A).

Similarly, in an effort to stabilize employment, the Government provided fiscal incentives for small businesses and self-employed workers for not reducing their staff numbers (a 5 percentage point reduction in taxes on profits for three years).

In some cases, these incentives have been less effective than intended, especially as regards cuts in social contributions for open-ended contracts. For instance, following the 2006 labour market reform – aimed principally at creating open-ended contract jobs through subsidies – the use of open-ended contracts increased briefly, but soon returned to its pre-2006 levels (Figure 5.3). There also tends to be a significant deadweight loss associated with such measures.<sup>68</sup>

<sup>68</sup> OECD, 2008.

Figure 5.3 New contracts with employment incentives 2006–09, by type of contract

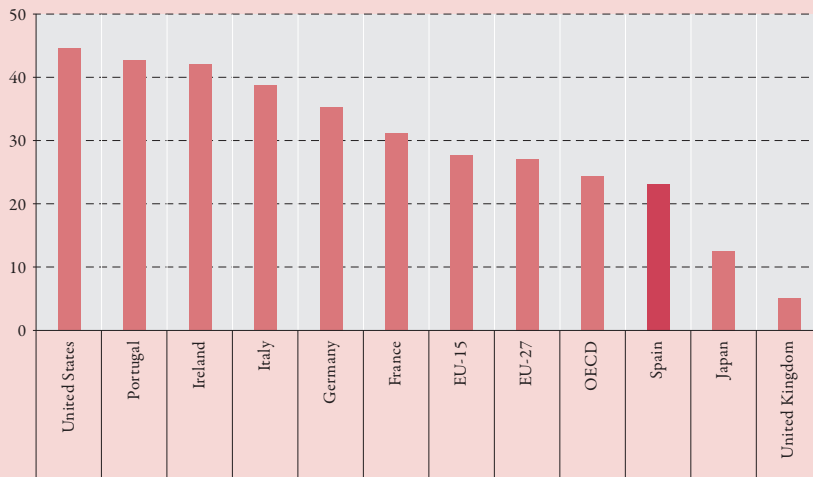


Source: IILS based on the Spanish Ministry of Employment.

### 3 TRAINING PROGRAMMES

Spain spends relatively less on training measures than do most other advanced economies (Figure 5.4). Training programmes in Spain are part of a national system of training for both employed and unemployed individuals. This unified system was introduced in 2008 in following the 2006 tripartite agreements. The system comprises: (i) training provided by firms for firm-specific tasks (partially or wholly funded by the Government); (ii) training programmes devoted to promote employability of the unemployed; and (iii) programmes that combine training with employment. Unemployed persons registered with a PES office can partake in these programmes at no cost. For some groups with low employability (as determined by PES staff), training is mandatory.

Figure 5.4 Spending on training measures as a share of total spending on ALMPs, 2008



Source: IILS based on the OECD and national sources.

In terms of effectiveness, the labour market integration rates of training participants, i.e. percentage of those finding a job following participation, were close to 70 per cent for most groups in 2008, with the exception of workers aged 45 and over (Figure 5.5). The employment outcomes of training seem to be best among young workers and men. In 2009, with the onset of the crisis, integration rates declined across all groups, but remained above 60 per cent for young and prime-age (age 25–45) workers.

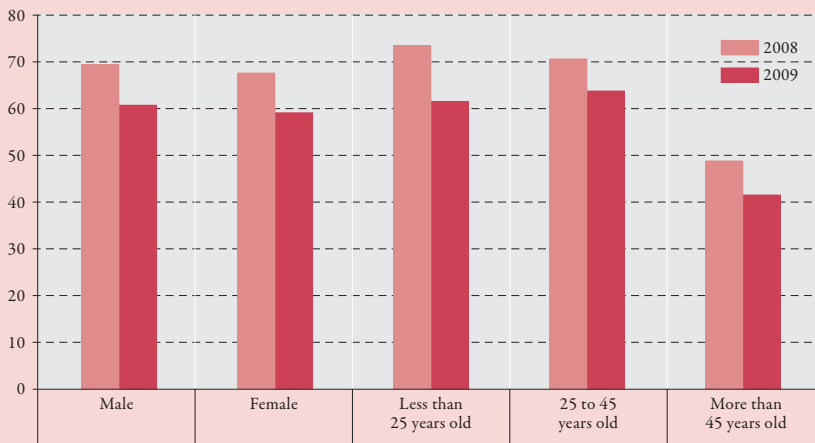
However, with respect to content, training programmes offered by PES in Spain tend to be generic in nature, with the focus sometimes placed on the courses provided rather than on the trainees themselves.<sup>69</sup> In terms of delivery, in the context of the current labour outlook characterized by limited job creation, it will be critical to ensure that the content of courses on

<sup>69</sup> Malo, 2011.

offer is aligned with the skills and knowledge demanded by firms. Indeed, in the face of rapidly changing economic and labour market conditions, training programmes must become more flexible and adaptable. Engaging local employers and workers in identifying the areas in which training is needed will improve outcomes further. This needs to be balanced against the need to tailor programmes to address the employment challenges confronting participants.

To help identify the training needs for certification in various professions, the Government adopted a new regulation in 2008 entitled *Certificados de Profesionalidad*, which are official certifications of different qualifications as outlined in the National Catalogue of Qualifications. This should improve labour market visibility of job seekers, to the extent that a nationally valid certificate can act as a signalling mechanism for prospective employers.

**Figure 5.5** Share of trainees who found a job after training, by group (percentages)



Source: IILS based on CES and National Public Employment Services.

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## **B TRAINING AND EMPLOYMENT POLICIES FOR YOUTH**

### **1 A HIGH INCIDENCE OF EARLY SCHOOL LEAVERS**

In Spain, more than 28 per cent of youth aged 18 to 24 with at most lower secondary education and not in further education or training (early school drop out), which is more than twice the EU-27 average. The incidence of early school drop out has remained high and stable during the past decade, while it has tended to decline in most other EU-27 countries (Figure 5.6). Meanwhile, there are significant differences by region and gender (see annex B for details). For example, for men in the Madrid region, the drop-out rate increased by 8.1 percentage points in ten years, from 24.7 in 1999 to 32.8 per cent in 2009. Other regions have also experienced strong increases among young men, e.g. Castilla y León (by 5.24 percentage points), País Vasco (by 3.5), Ceuta y Melilla (by 2.6) and Cataluña (by 2.3). For women, while the rates are much lower, they remain high in comparison with other EU-27 countries (second only to Portugal).

Leaving school early to enter a weak job market can have long-lasting consequences. There is a heightened risk that young workers will exit the labour market entirely if they encounter difficulty finding employment.<sup>70</sup> Moreover, prolonged spells of joblessness without training or education can lead to social exclusion, poverty and skills erosion – all of which have consequences for potential future earnings and can adversely affect growth.

<sup>70</sup> ILO, 2010.



Figure 5.6 Share of population aged 18–24 who leave high school and do not continue with other education or training (percentages)

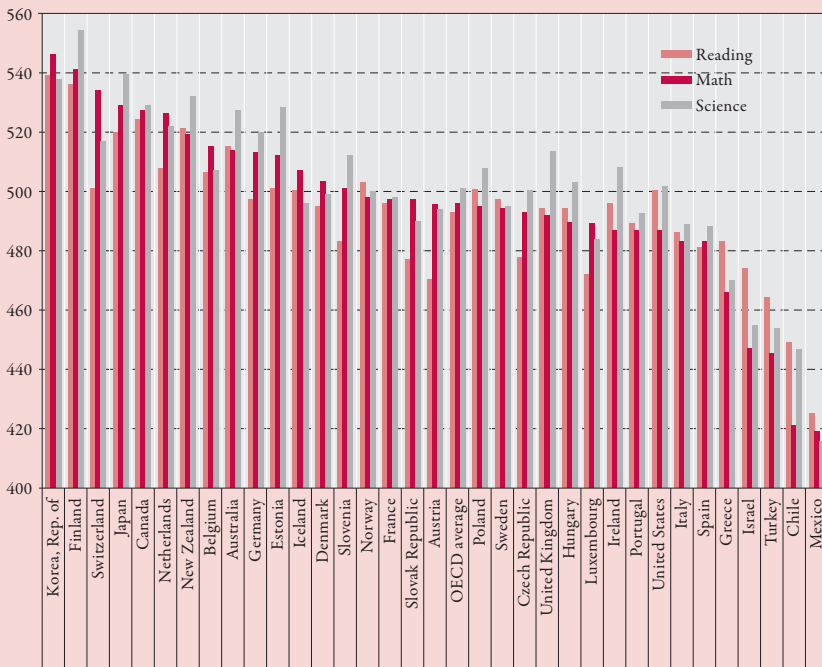


Note: Figures refer to the percentage of the population aged 18-24 with at most lower secondary education and not in further education or training.  
 Source: Eurostat.

## 2 IMPROVED EDUCATIONAL OUTCOMES, BUT NOT IN TERMS OF QUALITY

Even for those who stay in school, there are concerns regarding the quality of student outcomes. According to the Programme for International Student Assessment (PISA), Spanish students perform significantly below the OECD average in terms of reading, mathematics and science skills, ranking near the bottom in all three categories (Figure 5.7). Greece is the only country in Europe that ranks lower than Spain. Careful consideration must be given to the content and quality of educational programmes and the implications for the labour market. Unless efforts are made to improve the basic skills of young people, this sub-standard education will compromise future labour market prospects of a large proportion of the labour force and have important negative consequences on overall productivity and competitiveness.

Figure 5.7 International PISA scores for 2009



Note: Countries are ordered according to the math scores in descending order.

Source: OECD PISA 2009 database.

### 3 MEASURES TO TACKLE YOUTH UNEMPLOYMENT

The onset of the crisis has only exacerbated the challenges already confronting youth. And with youth unemployment rates above 40 per cent nationally (and higher in some regions), the aforementioned labour market reform of 2010 contained a specific set of measures aimed at young people:<sup>71</sup>

- *Financial subsidies for use of open-ended contracts:* For hiring unemployed workers under the age of 30 with only a primary education and at least 12 months in unemployment, firms will benefit from a reduction of €800 per year for three years in their social security contributions.
- *Conversion of temporary contracts:* Firms that convert temporary contracts into open-ended contracts of apprenticeships held by young workers will receive €500 per year for three years.
- *Trainees:* New traineeship contracts will be exempted from all social security contributions for the entire duration of the contract. In order to facilitate the entry of young people into the labour market, the new set of measures included increased flexibility in terms of the nature of work and duration of traineeship.

In an effort to address some of the skills deficiencies and to improve the employability of young people, there are training programmes that combine training with employment, with a particular focus on youth. Among the programmes offered are: *Escuelas Taller* (Workshop Schools), and *Casas de Oficios* (Professional Centres), for which the upper age limit is 24. Studies highlight the benefits of these two programmes for young people in general, and for low-skilled youth in particular.<sup>72</sup>

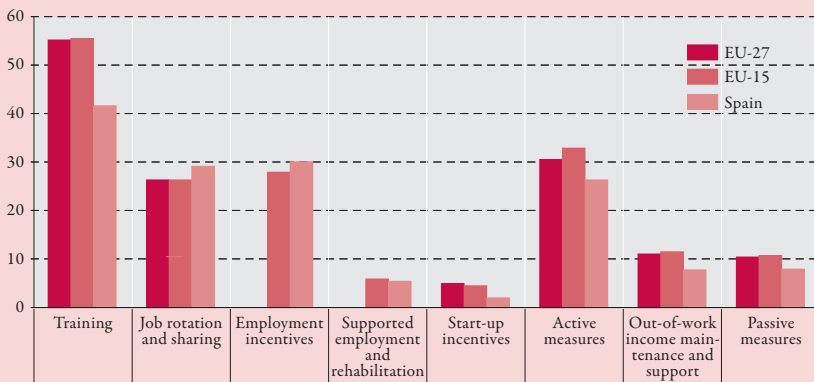
However, the participation of youth in active labour market programmes remains low by EU comparison (Figure 5.8). In 2008, the share of youth (under the age of 25) participating in active programmes in Spain was 26 per cent, while it was close to one-third in the EU-15. The largest gap occurs with respect to participation in training – in both the EU-15 and the

<sup>71</sup> A number of these programmes were also extended to women (see Annex A).

<sup>72</sup> Rocha, 2010.

EU-27, youth participation in training courses in 2008 was around 55 per cent, while it was only 40 per cent in Spain. One problem in Spain might be a mismatch between the programmes on offer and those in demand, as discussed above.

**Figure 5.8 Youth participation in labour market programmes, 2008**  
(share of participants under 25)



Source: ILS based on the Spanish Ministry of Employment.

## C UNEMPLOYMENT BENEFITS AND LABOUR MARKET OBJECTIVES

### 1 GENERAL OVERVIEW

In Spain, income maintenance for workers who have lost their jobs exists through two channels: unemployment benefits and unemployment subsidies. Benefits are related to previous experience in the labour market and the level of contributions made by the worker, while subsidies are means-tested and depend on family circumstances.

In terms of unemployment benefits, the replacement rate and duration of benefit receipt are in line with those in other EU countries (see Table 5.1). In the first 6 months, earnings are replaced at 70 per cent, falling to 60 per cent thereafter, up to a maximum based on family circumstances. For instance, in 2010, the minimum was €497 per month and the maximum was €1,087 per month for workers without children, increased to €665 per month (minimum) and a maximum of €1,242 per month for a recipient with one child. The duration of benefit receipt is a function of work history, rising up to a maximum of 24 months for a worker with 72 months of contribution history.

With respect to subsidies, an unemployed worker with labour market experience below the minimum threshold can apply for a subsidy. The amount depends again on family circumstances, e.g. it is €426 per month for those with one child or those without dependants and higher depending on the number of children. Unemployment subsidies can last between 12 and 36 months, depending on age and family circumstances. For workers over age 52, the subsidy may last up to the retirement age.

Workers who have exhausted their entitlement to unemployment benefits can subsequently apply for unemployment subsidies. As such, depending upon work history, an unemployed worker could be eligible for up to 60 months or 5 years of unemployment benefits or subsidies.

**Table 5.1 Unemployment benefits system in selected EU countries**

Country	Benefit replacement rate	Coverage period
<b>Austria</b>	55% of net earnings	20–52 weeks (30 weeks, with at least 156 weeks of coverage in the previous 5 years; 39 weeks, if aged 40 or older with at least 312 weeks of coverage in the previous 10 years; 52 weeks, if aged 50 or older with at least 468 weeks of coverage in the previous 15 years)
<b>Denmark</b>	90% of average earnings in the previous 12 weeks	Up to 4 years
<b>France</b>	Between 57.4% and 75% of the average daily wage during the previous 12 months	Up to 24 months to 36 months (if aged 50 or more), depending on the insured's contribution period
<b>Germany</b>	67% (60% if no children) of the insured's net earnings	6–24 months, depending on the length of the covered work period and the claimant's age
<b>Italy</b>	60% of the insured's gross daily wage for the first 6 months; 50% for the 7th and 8th months; for beneficiaries aged 50 or more, 40 % up to the 12th month	Up to 8 months; up to 12 months if aged 50 or older
<b>Spain</b>	70% of the insured's average earnings for up to 6 months; 60 per cent of the earnings thereafter	4–24 months (4 months for 12 months of contributions to 2 years for 6 years of contributions)

Source: ILS based on national sources and the OECD.

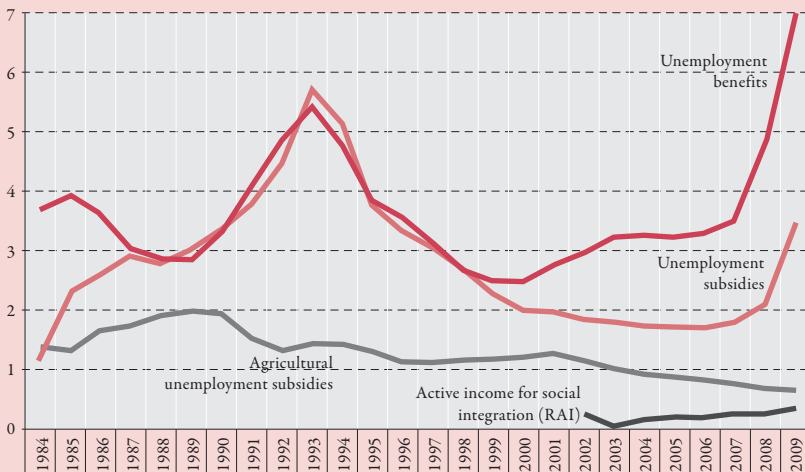
In addition, a special programme called *Renta Activa de Insercion* (RAI) exists for workers without any access to unemployment subsidies. RAI provides income support to workers who are 45 years or older, who have registered for at least one year at a local public employment office and who have an income lower than 75 per cent of the minimum wage. Younger workers with similar attributes can also access RAI under certain conditions, e.g. if they are disabled or victims of domestic violence. For Spanish migrants that have returned to Spain, the one-year registration requirement with PES is waived. The most notable feature of the RAI is that it combines both passive and active labour market policies. Besides providing income support to special groups of vulnerable workers, it also provides a set of active

measures comprising training and specialized labour market intermediation services. Besides the RAI, there is another special subsidy for seasonal workers involved in agricultural activities, which takes into account employment experience and is means-tested, taking age into account.

## 2 COMBINING INCOME SUPPORT WITH ACTIVATION STRATEGIES

With the onset of the crisis and the associated job losses, there was a significant increase in the incidence of workers receiving unemployment benefits (Figure 5.9). However, the incidence of workers receiving unemployment benefits (as a share of the labour force) had already been rising uninterrupted since 2000 – a period of strong job creation and rapidly declining unemployment rates. There are some indications that the increase in temporary employment – associated with shorter periods of employment – had been driving this increase.<sup>73</sup>

Figure 5.9 Recipients of unemployment benefits and other replacement incomes in Spain (percentage of the labour force)

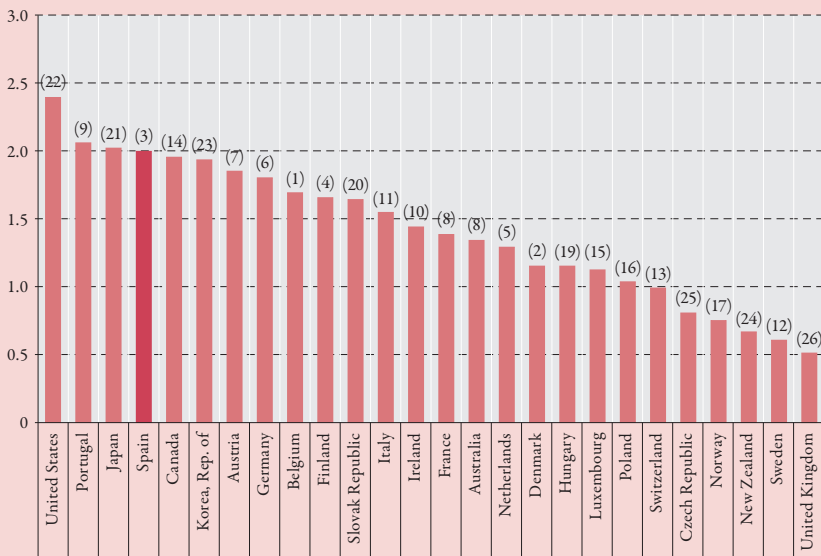


Source: IILS based on the Spanish Ministry of Employment.

<sup>73</sup> Malo, 2011.

In the year preceding the crisis, when unemployment rates were historically low, the Spanish Government spent considerably more on benefits and subsidies (income support) than on the active measures. For example, in 2007, Spain spent almost twice as much on income support measures than on activation policies (see Figure 5.10). Moreover, in the same year, Spain ranked third among selected OECD countries in terms of expenditure on income support measures as a percentage of GDP. The overall emphasis of labour market policies in Spain during the unprecedented period of job creation was therefore on income maintenance, rather than on activation and increasing employability of unemployed workers. This reflects both the relatively limited extent of activation policies and the high incidence of temporary employment, and the associated high labour market turnover rates – which have entailed significant employment–unemployment flows, thus exerting upward pressure on spending on unemployment benefits.

**Figure 5.10 Ratio of spending on income support to spending on active labour market measures, 2007**



Note: The numbers in parentheses represent the ranking of countries based on total expenditure on unemployment benefits and subsidies as a percentage of GDP.

Source: IILS.



During periods of slack demand, however, unemployment benefits and subsidies play an important role in supporting incomes and keeping workers tied to the labour market (if combined effectively with employment support). In this regard, the Government took steps to ensure that benefits were extended in a number of situations. For example, workers affected by temporary lay-offs and reductions in working hours were allowed to extend their benefit period. Also, a special subsidy was created for people who had exhausted both unemployment benefits and subsidies. This programme expired in February 2011, but it has been replaced by a programme that combines income transfer with concrete activation policies. The primary objective of the new programme is to improve the capabilities of low-skilled workers who were formerly employed in industries with a high incidence of temporary employment, such as construction and hospitality.

In January 2010, further changes were made to the unemployment benefits and subsidies system. First, it was stipulated that unemployed workers could not reject suitable job offers or training opportunities without risking the loss of unemployment subsidies. Second, conditions for obtaining unemployment benefits as a lump-sum transfer were made more flexible to promote entrepreneurship and new business start-ups. Furthermore, a new regulation was adopted in August 2010 that extended unemployment benefits to self-employed workers who had lost their economic activity involuntarily and who have a contribution history of at least 12 months.

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## **D PUBLIC EMPLOYMENT SERVICES: ROLE OF EFFECTIVE DELIVERY**

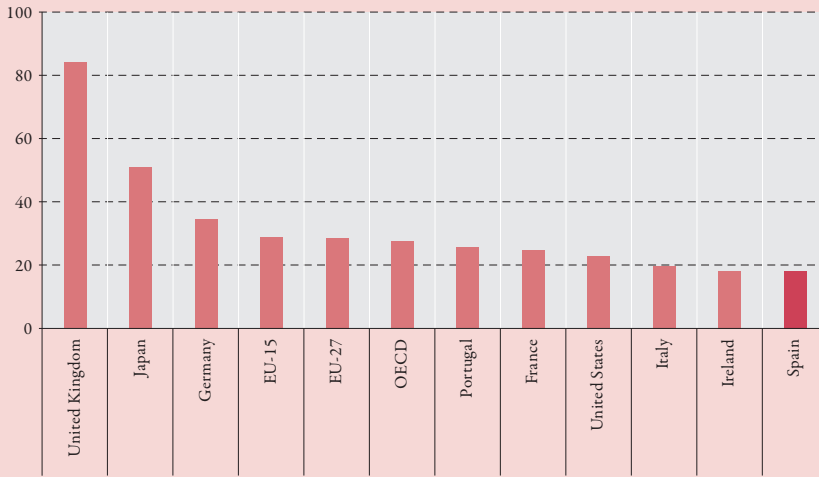
With the bulk of Spain's ALMP budget focused on hiring incentives, the country spends considerably less than other others in terms of service delivery, i.e. PES. Spain spent close to 18 per cent of its total ALMP budget on PES in 2008, compared with an average of 30 per cent across the European Union (Figure 5.11).

The PES in Spain is run by two main entities: National Public Employment Services and Regional Public Employment Services. In terms of the delivery of ALMPs, the National Public Employment Services plays a rather limited role. Its main task is to coordinate and manage nationwide administration of unemployment benefits and subsidies; it also keeps track of administrative databases collected by the local and regional offices. The delivery of ALMPs is fully decentralized, run by 17 regional authorities which have the jurisdiction to design and implement their own policies. However, the National Council, which became fully operational in 2008, is responsible for coordinating nationwide labour market intermediation services. This is facilitated by a computer system to ensure coherence across different regions, and the Council includes representatives from trade unions and employers' organizations.

Currently, in Spain the proportion of all hires that are made with the assistance of employment services is low.<sup>74</sup> Part of the problem lies in the fact that the caseload (the number of unemployed persons registered with PES) has grown considerably – and certainly faster than the recruitment of PES staff – as labour market conditions have deteriorated. As a result, the client-to-staff ratio of nearly 450 in Spain is one of the highest among select EU countries with available information – 15 times higher than the ratio in Germany and the United Kingdom (see Figure 5.12). Germany has managed to keep the ratio low, due in part to the lower numbers of unemployed, along with a significant increase in the resources available for PES and legally mandated ratios for certain vulnerable groups (see Box 5.1).

<sup>74</sup> Suarez-Cano, 2011.

Figure 5.11 Spending on PES as a share of the total spending on ALMPs, 2008



Source: IILS based on the OECD and Spanish Government.

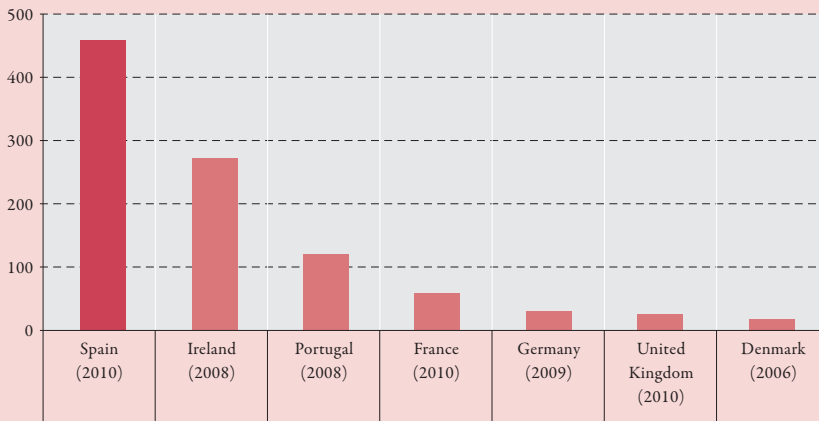
### Box 5.1 Reinforced Public Employment Services: The case of Germany

In an attempt to improve the ratio of unemployed persons to caseworkers, the first two stimulus packages announced measures to recruit on a short-term basis 1,000 and 4,000 additional staff. The efforts to recruit additional staff are an attempt to improve the effectiveness of service delivery to unemployed persons. A new law states that the ratio of staff to clients among longer-term unemployed should be reduced to 1:75 (for persons under 25) and 1:150 (for persons 25 and over). Currently, the ratio is 1: 85 for youth and 1:158 for adults.

Meanwhile, the PES in Germany allocated €1.12 billion in 2009 for training purposes – of which €200 million was targeted to re-employ temporary workers (in the same firm) and another €770 million for the extension of a re-education programme for older and low-skilled workers. Moreover, the federal Government, through loan provisions and grants, has ensured that the PES can run a deficit during times of crisis. This means the PES can function as an automatic stabilizer, i.e. there is no disruption in benefits and programmes or increases in contribution rates during downturns.

Source: ILO, 2011.

Figure 5.12 Average number of unemployed clients per PES staff



Source: World Association of Public Employment Services (WAPES).

There is a benefit to decentralized employment services as local offices tend to have more knowledge regarding the needs of local employers. However, in a decentralized system of this nature it is important to ensure that labour market information regarding the availability of job opportunities in other parts of the country are disseminated adequately so as to enhance labour mobility. Already, as Chapter 1 has outlined, there is a significant variation in the labour market performance by region. In this respect, while the use of private employment agencies is welcome, better public–private partnerships are needed. Ensuring better collaboration will help with the diffusion of labour market information and mitigate the effects of any adverse selection bias against unemployed workers within either the public or private placement services.

The Government has taken important strides in the past few years to address a number of challenges facing the delivery of labour market policies. Indeed, as part of Plan E launched in 2008, funding was allocated to hire 1,500 additional employment counsellors in PES. There were also improvements in the web-based intermediation, namely in terms of local and nationwide job listings.

#### Box 5.2 Improving PES performance and accountability: Some country examples

In order to improve the effectiveness of labour market policy delivery, a number of countries have ensured that public employment services are subject to performance evaluations and monitoring, either through performance rating or having measurable targets (for e.g., number of registered unemployed). In other cases, by integrating benefit and support systems – often by decentralizing delivery – PES accountability and effectiveness improves. For example:

- Since 1998, New Zealand has an integrated system of benefit administration and employment services, with performance targets for placements into stable work (that is, lasting more than 3 months). Following the reform, the programme proved to be effective as placements increased and unemployment rate declined.<sup>75</sup>
- Meanwhile, Switzerland keeps track of the effectiveness of public employment offices with the use of a rating system, first introduced in 2000. This system of rating improved the performance of the public employment services as evidenced by reduction in registered unemployment rate.
- Similarly, the United Kingdom also employs detailed evaluation of the performance of PES by tracking the numbers of registered unemployed, given the delivery of different activation measures. For example, quantitative targets – in terms of number of registered unemployed – are the commonly used barometer to measure the performance of PES. Additionally, in 2002, the United Kingdom introduced Jobcentre Plus which integrates employment services and benefit delivery.

<sup>75</sup> OECD, 2005.

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In addition, as part of the 2010 labour market reform in Spain, regulation of private labour market intermediation was relaxed, mainly in terms of the restrictions on the sectors in which private employment agencies can operate. Prior to the reform, these agencies were not allowed to provide intermediary services to workers and employers in sectors such as building and public administration. In 1994, private employment agencies became legal in Spain, and since that time they have been working with public employment offices to provide delivery of intermediary services. A pending issue is the monitoring and reward of the placement performance of each public (and private) employment office. The experiences of other countries, such as New Zealand and the United Kingdom are interesting cases in point where measures of this nature have helped improve overall outcomes (Box 5.2).

The Economic and Social Agreement adopted in February 2011 also included measures to further strengthen the delivery of PES. Among the measures were: (i) provision of new resources (both people and technology); (ii) improvements to nationwide coordination of PES; (iii) improvements to planning, management and evaluation of employment services.

## **E POLICY CONSIDERATIONS**

### **1 MAINTAIN EFFORTS TO PROVIDE INCOME SUPPORT, BUT WITH IMPROVED ACTIVATION**

The system of unemployment benefits and subsidies in Spain has provided much needed protection in terms of supporting incomes during times of crisis. Given that labour demand remains weak, it will be important to maintain this level of support as the economy and the workforce undergo transformation. However, looking ahead, the benefits system needs to be better linked to activation policies, given the adequate benefit replacement rates and coverage periods. There is a need to improve the functioning of PES in order to ensure mutual obligations; i.e. in exchange for benefits, unemployed workers agree to look for a job and/or participate in labour market programmes such as training. Recent reforms of unemployment subsidies were a step in the right direction, but intervention of this nature is needed early on during a spell of unemployment. Success in this regard, however, is a function of ensuring that there is the right set of employment-oriented policies, adequate resources are provided to PES and rewards for placement performance are improved.

### **2 REORIENT ACTIVE LABOUR MARKET POLICIES TOWARDS TRAINING AND EMPLOYABILITY MEASURES**

If Spain is to succeed in facilitating a structural transformation, a larger share of its active labour market programmes should be dedicated to training and upskilling. Currently, only 23 per cent of ALMP spending is on training, compared with say nearly 28 per cent in the EU-15 and more than 35 per cent in Germany. Yet, employment outcomes of these programmes in Spain are relatively good. In the first instance, current resources allocated to hiring incentives could be used to augment training measures and skills upgrading. Second, the suite of training programmes needs to be tailored to match the needs of both employers and participants. With respect to

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the latter, programmes need to tackle underlying employability challenges and skills deficiencies of participants with a view to improving outcomes over the medium term. However, training programmes must be relevant to employers and match, to the extent possible, the skills in demand. This will be key to ensuring that emerging sectors have the right human capital to seize new opportunities. In this respect, efforts to leverage better private–public partnerships could help to improve the overall effectiveness of training delivery.

### **3 IMPROVE TARGETING OF HIRING INCENTIVES**

Past efforts to encourage the use of open-ended contracts via broad hiring subsidies have proven ineffective in addressing labour market duality, often with large deadweight losses. There has been a recent welcome shift in improving the targeting of hiring subsidies, i.e. more focused on disadvantaged groups, such as youth and women. Yet, the existing subsidies remain too broad in nature. Subsidies are most effective and efficient when aimed at addressing a particular disadvantage, e.g. low-skilled youth, rather than an entire group per se. Improving the targeting of existing incentives in this way should improve outcomes in the future.

### **4 ENHANCE THE EFFECTIVENESS OF PES**

Training provisions and other labour market programmes have a greater likelihood of success if administered via well-resourced PES. Labour market intermediation needs to be part of an overarching strategy to reintegrate jobseekers. First, additional resources are urgently needed to hire qualified staff who can provide personalized attention to the growing stock of unemployed. Second, and while improving client-to-staff ratios will help to improve labour market information, efforts are needed to improve dissemination of information about vacancies in different regions of Spain. Third, over the medium term, the Government could consider improving the integration of benefit support (national) and labour market programme



delivery (regional). Finally, this could be complemented by enhancing the delivery of labour market programmes and benefit support through the introduction of a system of monitoring and evaluation of PES outcomes and to reward good performance accordingly. This is particularly important as Spain is promoting complementarities with private employment services. As a first step, the National Council, which is given the task of coordinating activation policies across regions, can play a key role in devoting greater efforts to policy coherence.

## 5 FOCUS ON YOUTH

There are three sets of challenges facing youth in Spain: first, the urgent need to keep the young unemployed connected to the labour market and transition them into employment; second, the need to reduce the high school drop-out rates, which currently are double the EU-27 average; and third, the need to improve the quality of education offered to young people, which according to international comparisons is below the OECD average. There are several policy options available to address these challenges, in particular:

- To help the young unemployed, the Government could consider: (i) providing incentives for youth to engage and register with PES; (ii) mandating a lower PES client-to-staff ratio and more frequent interviews for disadvantaged youth (e.g. long-term unemployed), as is the case in Germany; (iii) ensuring preferential access to training for low-skilled youth, and reinforcing existing programmes such as *Escuelas Taller and Casas de Oficios*; and (iv) reorienting existing hiring incentives to target disadvantaged youth.
- Efforts are urgently need to reduce high-school drop-out rates by encouraging young people to stay on in school. This could be achieved by making certain forms of income support conditional on school attendance, as was done in, for example, Australia and Denmark. Another possibility would be to make the preparation of education and training plans compulsory for youth. In Denmark, 15–17 year olds are required to make

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such plans in collaboration with their parents, school and guidance centre, and the plan needs to cover such areas as further education, training, employment, internship and volunteer work.

- Building a world-class education system is crucial for society. It will also support the structural transformation of Spain's economy. As firms have the ability to rapidly shift capital and production sites, an educated and skilled workforce can be the source of a country's competitive edge.

## ANNEX A

### SPECIFIC LABOUR MARKET MEASURES INTRODUCED TO MITIGATE THE EFFECTS OF THE CRISIS

Type of measure	Measures
<b>Employment support</b>	<ul style="list-style-type: none"> <li>• A 50 per cent reduction in social contributions for workers affected by temporary lay-off and working through ERE (Expediente de Regulacion de Empleo).</li> <li>• Fiscal incentives for small businesses and self-employed workers for not reducing their staff (5 percentage points reduction in taxes on profits for 3 years).</li> <li>• In the same vein, redemption leeway for new assets (effective reduction in corporate tax) when there is an explicit commitment not to reduce staff.</li> <li>• Temporary increase in subsidies for disabled workers in Sheltered Employment Centres.</li> </ul>
<b>Hiring incentives</b>	<ul style="list-style-type: none"> <li>• A 100 per cent reduction in social security contributions for firms hiring on open-ended contracts unemployed workers who have been registered with PES for 3 years.</li> <li>• A 50 per cent reduction in social security contributions for self-employed workers for the first hiring made on an open-ended contract, in particular of an unemployed worker who is registered with PES.</li> <li>• A lump-sum subsidy of €1,500 for hiring on an open-ended contract an unemployed worker with dependants.</li> <li>• A 100 per cent reduction in social security contributions for firms that hire people with disabilities on either open-ended or temporary contracts (also applies for the conversion of temporary contracts into open-ended ones).</li> <li>• Increased reduction in social security contributions for allowing workers on part-time contracts to put in 30 per cent more than the agreed working time.</li> <li>• Increased reduction in social security contributions for hiring part-time workers below one-third of full-time work.</li> </ul>
<b>Promotion of self-employment and cooperative firms</b>	<ul style="list-style-type: none"> <li>• Easier procedures and requirements to receive unemployment benefits as a lump sum to start up a business as a self-employed worker or as a member of a cooperative firm.</li> </ul>
<b>Active labour market programmes</b>	<ul style="list-style-type: none"> <li>• Extraordinary Plan for labour market intermediation, vocational training and labour market integration: the plan, launched in 2008, has been extended by two additional years. The plan included: the hiring of 1,500 employment counsellors by PES in 2008, which has been extended to 2009; subsidies for job-seeking and labour mobility; and individualized attention for beneficiaries of the transitory programme for unemployment protection and social integration.</li> <li>• Enactment and extension of the transitory programme for unemployment protection and social integration, including activation measures for beneficiaries.</li> <li>• Increase in the staff of public employment offices to improve bureaucratic procedures related to benefits and the use of new technologies.</li> </ul>
<b>Unemployment protection (income maintenance)</b>	<ul style="list-style-type: none"> <li>• Removal of the minimum waiting period for receipt of unemployment benefits.</li> <li>• Transitory programme for unemployment protection and social integration.</li> <li>• Approval of an extraordinary budget to pay unemployment benefits and subsidies.</li> </ul>
<b>Economic and Social Agreement, 2011</b>	<p><i>Structural changes in ALMPs:</i></p> <ul style="list-style-type: none"> <li>• Development of a personalized service for the unemployed, in order to provide individual strategies for finding employment (time horizon: 2013).</li> <li>• Strengthening PES, by: (i) providing new resources (people and new technologies) in order to converge to the PES standards in other EU countries; (ii) improving coordination of the National Employment System; and (iii) improving planning, management and evaluation of employment policies (no time horizon and no budget allocation specified as of March 2011).</li> </ul> <p><i>Emergency (short-term) Plan:</i></p> <ul style="list-style-type: none"> <li>• Programme for improving transitions toward stable employment (time horizon: 12 months): firms which hire young unemployed (up to 30 years old) and long-term unemployed on part-time contracts (either temporary or open-ended) will receive a 100 per cent discount on social security contributions (75 per cent for firms with more than 250 workers).</li> <li>• Professional retraining for those who have exhausted unemployment benefits and subsidies (time horizon: 6 months): combines a subsidy and active measures; the subsidy is 75 per cent of Indicador Público de Renta de Efectos Múltiples (IPREM) (€400) and is means-tested at the household level.</li> <li>• Range of actions for labour market orientation and training including: (i) for low-skilled unemployed people who are young or are long-term unemployed (aged 45 years or over) or were formerly in the construction sector (scheduled implemented: March 2011 onwards); (ii) for all unemployed, a quota of 20–40 per cent for unemployed people in training courses.</li> </ul>

Source: Table II.30 from CES (2009) and Act 35/2010.

## ANNEX B

### SHARE OF POPULATION IN SPAIN AGED 18–24, BY REGION, WHO LEAVE HIGH SCHOOL AND DO NOT CONTINUE WITH OTHER EDUCATION OR TRAINING

		1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<b>TOTAL</b>	<b>National</b>	<b>32.3</b>	<b>30.8</b>	<b>29.6</b>	<b>29.3</b>	<b>29.1</b>	<b>29.2</b>	<b>29.9</b>	<b>31.6</b>	<b>32.0</b>	<b>30.8</b>	<b>29.9</b>	<b>31.0</b>	<b>31.9</b>	<b>31.2</b>
	Andalucía	39.5	38.6	37.1	36.1	35.5	34.6	36.2	38.2	39.2	37.1	36.8	38.0	38.5	37.5
	Aragón	22.2	22.8	22.1	24.3	21.9	21.3	27.6	24.0	23.5	24.1	28.7	26.8	25.6	25.1
	Asturias (Principado de)	26.1	24.5	23.9	24.3	21.8	18.1	20.5	28.6	26.3	18.3	22.3	21.6	19.7	21.1
	Balears (Illes)	40.4	38.1	37.3	39.1	42.0	38.9	37.9	41.4	42.5	40.0	34.9	44.2	43.2	40.8
	Canarias	38.6	34.5	35.2	36.6	34.1	36.1	31.7	32.7	33.5	32.2	34.8	36.9	34.1	31.3
	Cantabria	28.8	25.8	20.8	25.3	22.8	24.4	26.0	29.1	26.3	21.8	23.7	26.8	22.8	23.9
	Castilla y León	26.1	23.4	22.1	20.2	21.6	22.1	21.1	24.4	23.3	25.1	24.2	23.2	26.0	27.0
	Castilla-La Mancha	41.6	39.0	39.4	38.3	35.8	36.3	36.6	36.2	37.0	35.0	37.9	35.1	38.1	34.4
	Cataluña	31.7	30.1	29.4	29.0	29.1	29.6	29.5	33.9	34.0	34.1	27.0	31.5	33.2	31.9
	Comunitat Valenciana	38.0	36.2	33.0	31.9	32.7	34.8	35.5	36.0	35.6	32.4	30.3	31.8	33.1	32.8
	Extremadura	45.4	40.7	39.0	41.2	41.0	38.1	39.4	36.9	39.7	36.4	35.5	34.8	33.6	34.5
	Galicia	30.2	30.5	28.2	25.6	29.2	27.1	26.8	25.0	24.3	23.6	25.6	22.1	24.1	26.0
	Madrid (Comunidad de)	23.2	21.0	22.0	22.0	19.6	20.7	23.5	22.6	25.4	26.2	25.3	24.9	26.9	26.3
	Murcia (Región de)	36.1	39.2	35.0	35.3	39.2	37.5	36.5	42.0	42.8	38.1	39.1	38.4	41.0	37.3
	Navarra (Comunidad Foral de)	20.8	18.5	16.8	19.5	16.4	16.2	22.6	20.8	21.2	17.2	12.0	16.8	19.2	19.8
	País Vasco	16.8	18.5	15.4	13.6	14.7	15.5	13.3	15.8	13.4	13.9	14.3	15.3	14.7	16.0
	Rioja (La)	29.2	30.2	26.5	30.4	26.1	27.2	28.3	34.7	35.0	29.3	26.4	30.4	37.2	32.7
	Ceuta y Melilla	46.0	40.8	30.3	38.4	37.5	29.8	33.5	40.8	41.3	43.2	45.7	54.8	42.1	36.0
<b>MEN</b>	<b>National</b>	<b>37.6</b>	<b>36.1</b>	<b>35.3</b>	<b>35.1</b>	<b>35.0</b>	<b>35.6</b>	<b>36.4</b>	<b>38.1</b>	<b>38.7</b>	<b>36.4</b>	<b>35.7</b>	<b>36.1</b>	<b>38.0</b>	<b>37.4</b>
	Andalucía	43.2	41.4	41.9	42.3	41.4	40.1	43.3	44.2	45.3	42.7	43.4	44.0	43.5	44.2
	Aragón	25.6	28.2	26.9	28.0	25.7	27.1	31.0	32.6	31.3	30.6	36.8	31.8	31.7	29.8
	Asturias (Principado de)	31.1	30.2	28.5	29.9	28.2	24.0	26.4	31.3	31.4	25.5	30.5	26.2	26.4	24.5
	Balears (Illes)	51.8	43.8	43.3	49.5	51.7	47.9	45.5	51.6	49.8	45.8	44.7	49.1	49.2	46.0
	Canarias	45.3	41.3	42.2	43.3	40.4	43.6	39.3	42.5	39.7	36.0	40.9	44.9	43.5	39.4
	Cantabria	36.0	34.8	28.3	33.8	28.7	29.7	36.3	37.3	32.2	25.5	29.7	30.3	31.1	32.0
	Castilla y León	32.4	30.6	30.5	27.3	29.5	29.6	27.4	32.2	29.4	30.8	30.4	29.4	31.6	32.5
	Castilla-La Mancha	47.3	43.1	46.3	44.7	42.8	44.1	45.7	46.1	45.5	41.5	46.6	42.7	45.8	42.0
	Cataluña	38.1	37.5	35.0	35.7	34.7	35.1	34.6	35.1	45.5	40.5	42.4	32.3	36.0	39.7
	Comunitat Valenciana	43.6	42.4	40.7	38.0	38.9	40.8	41.6	42.2	44.2	40.1	36.8	35.2	38.2	39.1
	Extremadura	49.1	48.8	43.9	51.6	48.9	45.2	44.9	45.5	49.3	44.4	45.7	42.8	39.1	40.6
	Galicia	37.0	37.1	36.1	32.0	37.3	35.4	35.1	32.0	32.4	30.6	34.3	31.3	32.2	31.7
	Madrid (Comunidad de)	28.5	24.5	25.6	24.7	22.9	26.6	29.4	26.6	29.9	27.0	27.6	27.6	32.4	32.8
	Murcia (Región de)	39.8	40.8	40.9	41.3	46.8	46.6	44.2	46.5	50.0	43.7	41.9	43.2	49.7	41.5
	Navarra (Comunidad Foral de)	28.7	26.4	23.6	23.9	19.8	22.6	25.2	25.1	30.0	18.3	12.6	17.1	23.9	20.7
	País Vasco	20.4	22.3	19.2	17.4	19.8	21.1	18.1	20.3	18.2	17.4	20.1	20.5	18.1	20.9
	Rioja (La)	38.7	39.9	34.0	35.6	29.4	33.0	39.6	38.6	42.7	34.7	28.8	36.1	41.9	35.8
	Ceuta y Melilla	53.7	43.8	30.8	40.5	43.2	33.7	36.3	44.1	46.5	49.6	46.0	49.0	44.1	43.1
<b>WOMEN</b>	<b>National</b>	<b>27.0</b>	<b>25.7</b>	<b>24.1</b>	<b>23.4</b>	<b>23.2</b>	<b>22.7</b>	<b>23.1</b>	<b>24.8</b>	<b>25.1</b>	<b>25.0</b>	<b>23.7</b>	<b>25.6</b>	<b>25.7</b>	<b>24.7</b>
	Andalucía	35.9	35.7	32.4	29.9	29.5	28.9	28.9	31.9	32.7	31.4	30.1	31.8	33.2	30.2
	Aragón	18.6	17.6	17.7	20.8	18.0	15.3	23.8	15.1	15.3	17.1	20.2	21.6	19.1	20.3
	Asturias (Principado de)	20.8	18.8	19.4	18.7	15.5	12.2	14.6	25.7	21.2	10.8	14.0	16.5	12.8	17.4
	Balears (Illes)	30.0	32.6	31.5	28.8	32.3	29.5	29.5	30.7	34.6	33.9	24.3	39.2	37.0	35.1
	Canarias	32.0	27.8	28.3	29.9	27.9	28.7	24.2	23.0	27.1	28.1	28.8	28.7	24.5	23.2
	Cantabria	21.9	17.1	13.6	17.1	16.7	19.3	14.9	20.3	20.1	18.0	16.5	23.2	14.8	16.0
	Castilla y León	20.2	16.4	13.8	13.0	13.5	14.4	14.3	16.3	16.9	18.9	17.7	16.7	20.2	21.4
	Castilla-La Mancha	36.0	34.9	32.6	31.7	28.6	28.1	26.9	25.6	27.6	27.9	28.8	27.1	29.9	26.2
	Cataluña	25.2	22.5	24.1	22.0	23.3	24.0	24.0	26.0	27.1	25.2	21.7	26.9	26.4	25.6
	Comunitat Valenciana	32.5	30.1	25.6	26.0	26.6	28.8	29.0	29.3	26.7	24.6	23.7	28.2	27.8	26.1
	Extremadura	41.8	32.6	34.4	31.0	33.2	30.7	33.5	28.3	29.8	27.9	24.7	26.3	27.9	28.1
	Galicia	23.7	24.0	20.6	19.2	21.1	18.8	18.3	17.8	15.7	16.3	16.5	12.7	15.8	20.1
	Madrid (Comunidad de)	17.9	17.6	18.5	19.3	16.2	14.8	17.3	18.5	20.6	25.5	23.0	22.1	21.4	19.6
	Murcia (Región de)	32.4	37.5	29.3	28.8	31.1	27.4	28.1	37.2	34.9	32.3	35.8	33.3	32.1	32.8
	Navarra (Comunidad Foral de)	13.1	10.7	9.5	14.8	12.7	9.5	20.0	16.2	12.3	16.1	11.2	16.5	14.4	18.8
	País Vasco	13.1	14.4	11.5	9.6	9.5	9.7	8.3	10.9	8.4	10.0	8.4	9.7	11.2	11.2
	Rioja (La)	19.1	20.7	18.7	25.4	22.6	21.2	16.0	30.5	26.4	23.6	23.9	24.2	32.3	29.3
	Ceuta y Melilla	39.1	37.9	29.9	36.4	31.3	25.3	30.3	37.2	36.1	37.4	45.3	61.0	40.2	28.5

Source: Table II.30 from CES (2009) and Act 35/2010.

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## SPAIN:

### QUALITY JOBS FOR A NEW ECONOMY

It is often argued that the cost of social equity is less economic growth, highlighting the supposed trade-off between these two goals. The crisis that erupted in 2008 – which was preceded by rising social inequalities – has shown that this is simply not the case. In fact, if properly designed, equity-enhancing policies can also promote prosperity and reduce the risk of future crises. The aim of the *Studies on Growth with Equity* is to show how such policy complementarities can be achieved.

Spain has slowly begun to emerge from a deep crisis – one that has highlighted the inefficiency of the previous growth model. The recovery process is marked by a structural transformation that will entail further reallocation of resources, notably firms and jobs. However, a successful transition to a new growth model is possible, but only if employment and economic policies are adequately aligned and counterproductive measures such as wage cuts and poorly-designed austerity measures are avoided.

ISBN 978-92-9014-988-0



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