

THE 2012 LABOUR MARKET REFORM IN SPAIN: A PRELIMINARY ASSESSMENT

EXECUTIVE SUMMARY

December 2013



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The global financial and economic crisis hit the Spanish labour market particularly hard. The harmonised unemployment rate in Spain reached 26.7% in October 2013, the second highest in the OECD area (only exceeded by Greece) and more than three times the OECD average (7.9%). Since the start of the crisis, the number of unemployed has increased by more than 4 million persons in Spain. Even more worryingly, long-term unemployment – defined as those unemployed for 12 months or more – as a share of all unemployment has risen from 19.1% in the fourth quarter of 2007 to 50.4% in the third quarter of 2013. Despite this massive increase in unemployment, the wage component of unit labour costs in the business sector was slow to adjust. It did not decline in the first four years of the crisis, and its level at the end of 2011 was above that at the onset of the crisis.

This report provides an initial evaluation of the impact of the comprehensive reform of the Spanish labour market undertaken in 2012. This assessment is complementary to the evaluation performed by the *Ministerio de Empleo y Seguridad Social* (2013). Nonetheless, the findings presented here should be considered as preliminary, given the short amount of time that has elapsed since the reform was introduced and the complexity of assessing the impact of such an extensive reform.

The reform has promoted the internal flexibility of firms...

One of the key elements of the reform is the greater priority given to collective bargaining agreements at the firm level over those at the sectoral or regional level and the greater possibility given to firms to opt-out from a collective agreement and adopt internal flexibility measures to limit job destruction. In addition, the extension of collective bargaining agreements after their end date if no new agreement is reached is now limited to a maximum period of one year. Dismissal regulations have also been modified, redefining the conditions for fair dismissal, reducing monetary compensations in the case of unfair dismissal and eliminating the requirement of administrative authorisation in the case of collective redundancies. Moreover, a new permanent contract for full-time employees in small firms has been introduced with an extended trial period of one year.

...and reduced dismissal costs for permanent workers

The labour market reform has improved the *de jure* flexibility of the collective bargaining system in a way rarely found before the crisis both in Spain and in other countries of the Euro area. OECD indicators on employment protection legislation (EPL) indicate that the reform has significantly reduced the rigidity of the Spanish legislation on dismissals (Figure A). Nevertheless, severance pay for permanent workers in Spain remains among the highest in OECD countries, despite the significant reduction in compensation for unfair dismissal brought about by the reform (Figure B).

The reform has contributed to significant wage moderation...

The changes of internal-flexibility and collective-bargaining regulations have contributed to the significant wage moderation observed in Spain over the past year (Figure C), even if part of this moderation is the result of protracted adverse cyclical conditions and public-sector wage cuts. While this wage moderation is affecting workers' living standards, there is already evidence that it has started yielding its dividends in terms of employment performance and has contributed to save jobs. Moreover, once growth is restored, the greater scope for firm-level collective bargaining could allow a better reflection of productivity gains into wages. Overall, the Spanish economy appears to have made substantial progress in achieving wage moderation, even if continuous monitoring of the effects of the reform in this area is advisable, and the government must be ready to implement further action if performance worsens. In addition, trends in income inequality should be monitored in order to guarantee that cost and benefits of the reform are equally shared.

...and increased hiring on permanent contracts...

The reform has contributed to promote hiring, in particular on permanent contracts. The empirical analysis in the report suggests that the reform could be considered responsible for about 25 000 new permanent contracts each month, with the effect concentrated in small and medium firms (those below 100 employees – Figure D). The reform has also contributed to containing the duration of the unemployment spells, in particular due to faster transitions into permanent contracts for those workers entering unemployment after a temporary job. The analysis also shows some signs that separations decreased after the reform, especially for temporary contracts, possibly resulting from the greater use of internal flexibility measures as an alternative to contract termination. All these findings point to a positive effect of the reform in dampening the widespread segmentation of the Spanish labour market, although the impact is so far small and it will take time before the duality of the labour market is considerably reduced.

...even if, prior to the August 2013 legal change, it also led to a decline in collective dismissals

By contrast, the reform decreased collective dismissals more than any visible effect on individual dismissals, probably due to the increased procedural uncertainty that followed the elimination of the requirement for administrative authorisation – and the consequent increase in judicial uncertainty – as well as the extension of the circumstances in which companies making these dismissals have to pay a tax and carry out a special training and relocation plan. These factors are also probably one of the main drivers behind the lack of effect of the reform on hiring on permanent contracts by large employers. In that respect, the Government quickly reacted by addressing some of the key elements of procedural uncertainty through a new legislative changes in August 2013. It is too early to say, however, whether these changes will suffice to significantly reduce judicial uncertainty concerning collective dismissals in the future.

The reform has the potential to boost productivity growth and competitiveness...

Reforms of dismissal regulations, by enhancing labour reallocation, have the potential to boost productivity growth in the long-run. Drawing from a simulation exercise based on the experience of OECD countries over a long period of time, the report suggests that the reform could potentially boost labour productivity growth in the long run by about a ¼ of a percentage point annually in the business sector (excluding agriculture, mining, fuel and professional services).

...but should be accompanied by further effort to promote greater competition in product markets and efficient activation policies

The full impact of the reform on job creation will depend however on complementary reforms in other areas. In particular, reforms in product and service markets will not only increase competition and boost

productivity, but also improve labour market performance. The effectiveness of active labour market policies is also very important in order to successfully place unemployed workers into jobs. The changes introduced recently in this area go in the right direction, but a careful evaluation of these recent reforms is necessary to ensure that the Spanish income support system to the unemployed and employment services are able to effectively and quickly encourage and help the unemployed to find work.

While a good step, further actions could be envisaged

Overall, the 2012 labour market reform appears to have brought more dynamism into the Spanish labour market and is a step towards the reduction of its widespread segmentation and the increase of the competitiveness of the Spanish economy in the medium term. Nevertheless, additional adjustments could be envisaged in order to ensure that the objectives of the labour market reform are fully attained.

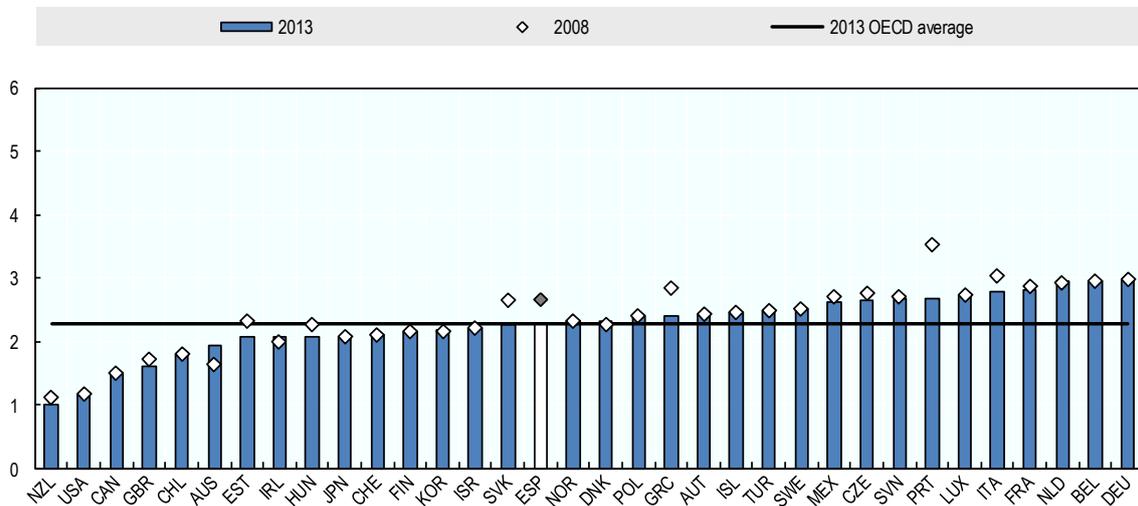
In particular, the government could consider treating unlawful collective dismissals as any other type of unfair dismissal (as in most other OECD countries), limiting the possibility of ordering reinstatement to cases of discrimination and prohibited grounds. In addition, some of the specific, additional costs of collective dismissals for employers introduced by the reform could be rolled back.

The evidence presented in the report also suggests that the trial period is too short for firms that are not eligible for the *contrato emprendedores*. The duration of maximum trial periods for other permanent contracts could be made longer, particularly in those cases in which this duration is currently much shorter than in other OECD countries.

Finally, a greater convergence of employers' costs of termination for permanent and temporary contracts would be desirable. This will be already the case by 2015 for firms with less than 25 employees – for fair terminations – due to a severance-pay subsidy in place for these firms and the schedule of increases in severance pay for fixed-term contracts approved in 2010. Nevertheless, the government could consider deepening this convergence process, notably by reducing ordinary severance costs for large employers to align them closer to the OECD and European averages.

Figures

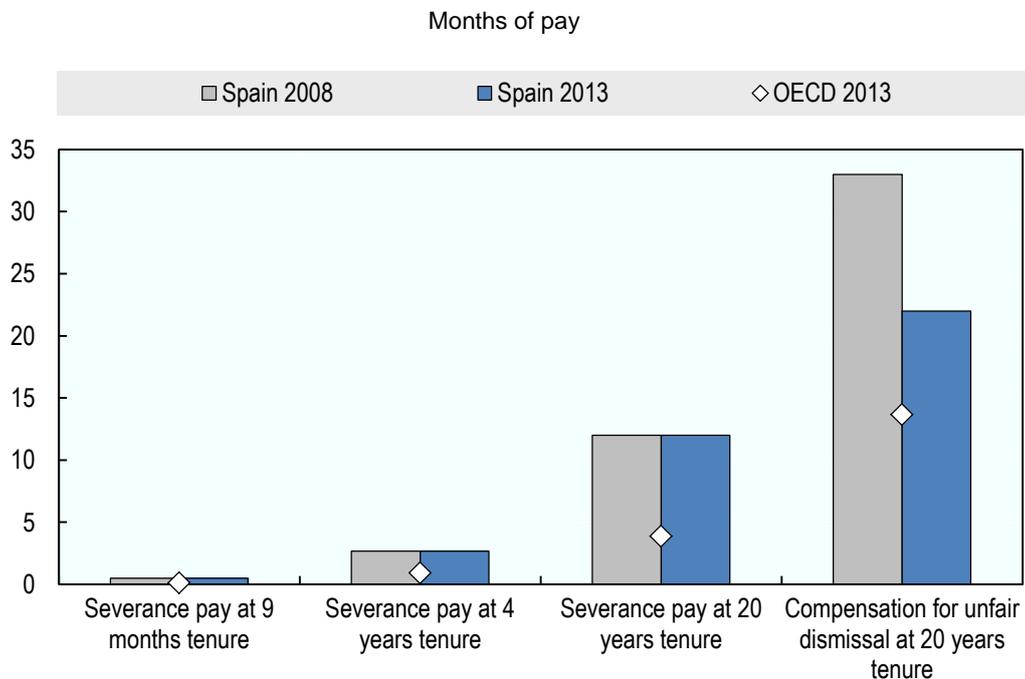
Figure A. Indicators of the stringency of employment protection legislation for permanent workers against individual and collective dismissal, 2008 and 2013



Notes: The indicators vary from 0 (least restrictive) to 6 (most restrictive).

Source: OECD Employment Protection Database, 2013 update.

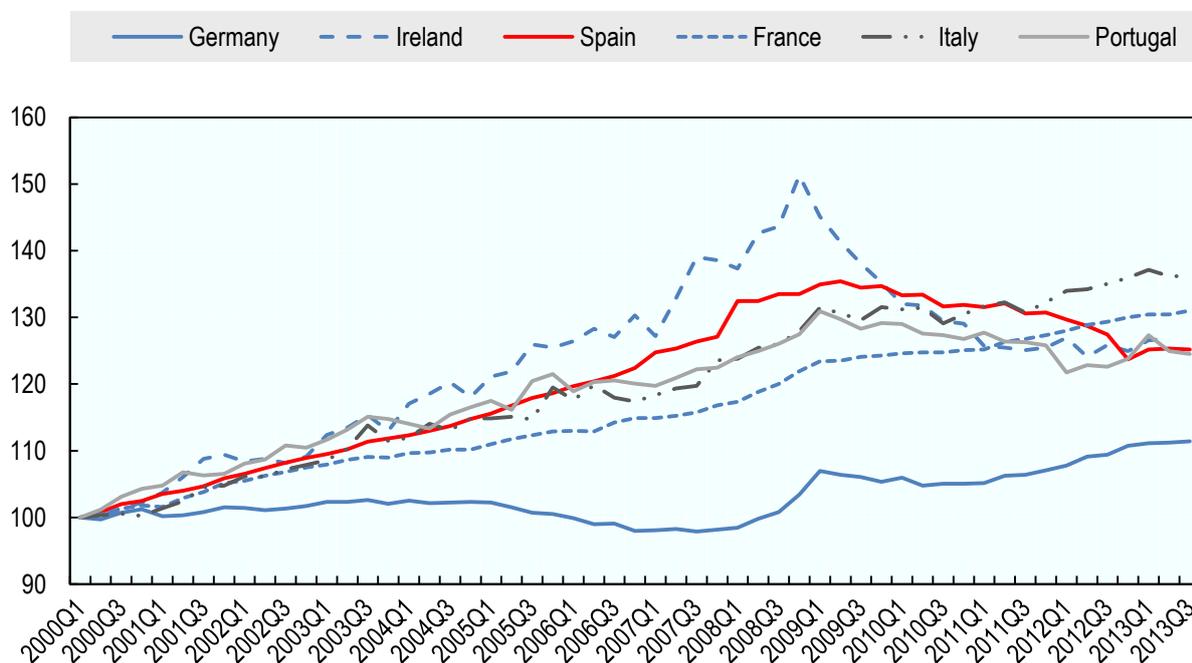
Figure B. Severance pay in Spain and in the OECD



Source: OECD Employment Protection Database, 2013 update. (see figure

Figure C. Evolution of unit labour costs in selected European countries, 2000-2013

Q4-2011 = 100

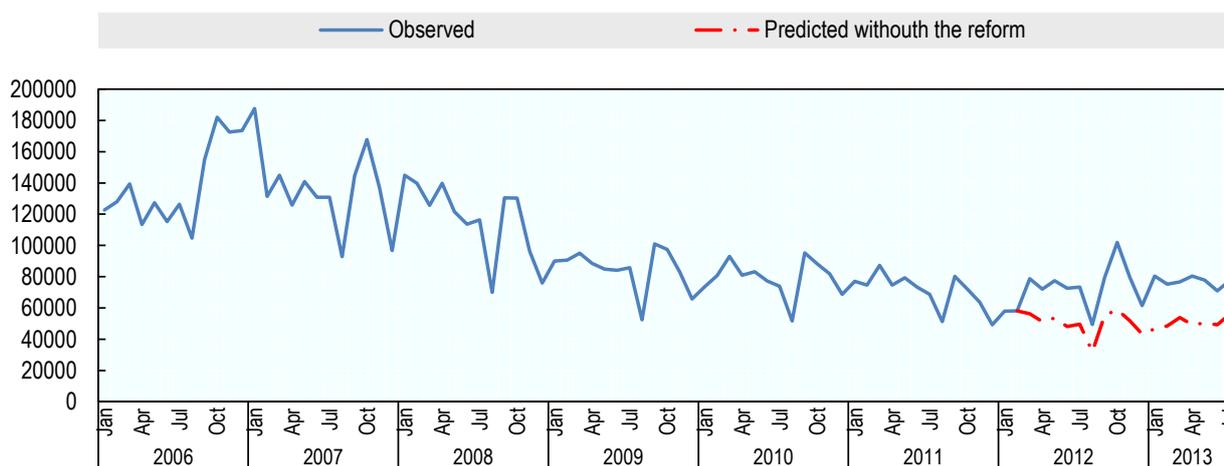


Notes: Data are seasonally adjusted and adjusted for working days.

Source: Eurostat.

Figure D. Monthly inflows into permanent contracts, including contract conversions, 2006-2013

Firms with 100 or fewer employees



Notes: The figure presents the number of new permanent contracts signed each month, as observed in raw data and as they would have been in the absence of the reform, according to baseline estimates covering the period January 2006-July 2013.

Source: Estimations on the basis of data on the *datos estadísticos de contratos* (Source: SEPE).