OECD Economics Department Working Papers No. 1040

Improving Employment Prospects for Young Workers in Spain

Anita Wölfl

https://dx.doi.org/10.1787/5k487n7hg08s-en

OECD

Unclassified **ECO/WKP(2013)32**

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development **27-Mar-2013**

English - Or. English

ECONOMICS DEPARTMENT

ECO/WKP(2013)32
Unclassified

IMPROVING EMPLOYMENT PROSPECTS FOR YOUNG WORKERS IN SPAIN

ECONOMICS DEPARTMENT WORKING PAPERS No. 1040

By Anita Wölfl

All OECD Economics Department Working Papers are available through OECD's Internet website at www.oecd.org/eco/Workingpapers

JT03337152

Complete document available on OLIS in its original format
This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

English - Or. English

Abstract/Résumé

Improving employment prospects for young workers in Spain

The unemployment rate among young people has reached painfully high levels, in particular among those young people with low levels of education. There are two crucial policy priorities to improve employment prospects for youth in Spain. First, in the very short term, there is need for quick action to target well-designed active labour market programmes to the most disadvantaged youth and provide more job-search assistance and guidance for all youth experiencing difficulties in finding a job in the current labour market. Second, the current crisis is an opportunity to tackle some of the structural weaknesses in the Spanish youth labour market. This implies in particular reforms to prevent youth from dropping out of education at a very early stage and to improve the school to work transition of young people. Key issues are to better match skills acquired in education to those asked for by businesses, as well as to establish an effective system of vocational education, and to reduce remaining demand side barriers, notably labour market duality and a rigid collective bargaining system, which both have prevented an efficient allocation of labour resources in the past and a flexible adjustment during the crisis. This Working Paper relates to the 2012 *OECD Economic Survey of Spain* (www.oecd.org/eco/surveys/spain).

JEL classification: I20, I21, I22, I23, J20, J24, J52, J65, J68.

Keywords: Spain, labour market, youth unemployment, skills, educational system, vocational education, dual labour market, employment protection legislation, wage bargaining.

Améliorer les perspectives d'emploi des jeunes actifs en Espagne

Le taux de chômage des jeunes atteint des niveaux douloureusement élevés, notamment chez les jeunes peu qualifiés. Deux actions prioritaires sont essentielles pour améliorer les perspectives d'emploi des jeunes en Espagne. En premier lieu, et à très court terme, il faut prendre des mesures actives du marché du travail spécialement conçues pour les jeunes qui ont le plus de difficultés et offrir à tous les jeunes qui ont du mal à trouver un travail une aide plus efficace à la recherche d'emploi. Deuxièmement, la crise actuelle peut être l'occasion de corriger certaines des faiblesses structurelles du marché du travail des jeunes en Espagne. En particulier, il est essentiel d'engager des réformes visant à empêcher les jeunes de quitter l'école trop tôt et facilitant le passage à la vie active. Plusieurs difficultés doivent être surmontées : faire mieux correspondre les compétences acquises à l'école et celles demandées par les entreprises, établir un système d'enseignement professionnel efficace et réduire les obstacles qui subsistent du côté de la demande, notamment le dualisme du marché du travail et la rigidité du système de négociation collective, qui ont empêché une répartition efficace des ressources de main-d'œuvre par le passé et un ajustement souple face à la crise. Ce Document de travail se rapporte à *l'Étude économique de l'OCDE de l'Espagne*, 2012 (www.oecd.org/eco/etudes/espagne).

Classification JEL : I20, I21, I22, I23, J20, J24, J52, J65, J68.

Mots-clés : Espagne, marché du travail, taux de chômage des jeunes, compétences, système scolaire, formation professionnelle, dualisme, législation de la protection de l'emploi, négociation salariale.

© OECD (2013)

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgment of OECD as source and copyright owner is given. All requests for commercial use and translation rights should be submitted to *rights@oecd.org*.

TABLE OF CONTENTS

Improving employment prospects for young workers in Spain 5

Labour market challenges 5
In the short term, ensure that youth-at-risk remain connected to the labour market 8
There is need for better targeted active labour market policies 8
The mutual obligation system of unemployment insurance has to be reinforced 10
Reducing the early drop-out rate from education 11
Facilitating the transition from school to work through improved vocational education 13
Weaknesses of the system in place 14
Towards an effective combined (dual) system of vocational education 16
Ensuring that students leave education with skills asked for in the labour market 18
Educational qualification do not match skills requested by firms 18
On top of demand side barriers, inefficiencies in the education system need to be addressed 19
Helping the young to move from temporary to stable employment 20
Temporary contracts do not fulfil their role as a stepping stone to more regular jobs 20
The 2012 reform is a big step forward 21
Improving firms' incentives for youth employment through more flexible collective bargaining 22
The collective bargaining system has had adverse effects on employment of young people 22
The 2012 reform should help 23

Bibliography 26

Boxes

1. Active labour market policies in the 2012 labour market reform 9
2. What makes firms invest in apprenticeship training? 15
3. 2012 reforms related to vocational education 16
4. The 2012 reform of employment protection legislation 21
5. The 2012 reform of collective bargaining 24
6. Recommendations on improving employment prospects for young workers 25

Tables

1. Time needed to find a job since leaving school is long, 15-34 years old, 2009 8

Figures

1. Youth employment and unemployment has been poor 5
2. The increase in youth unemployment during the recent crisis has been particularly strong 6
3. A large share of youth who are not in employment and not in education or training (NEET) 6
4. Unemployment is particularly high among low skilled youth 7
5. Participation in activation is poor – even during the crisis 9
6. Graduation from upper secondary and tertiary education is weak 12
7. Combined school and work-based programmes of vocational education are rare 14
8. Tertiary education graduates are employed in lower qualification jobs 18
9. Young people are locked-in in temporary contracts 20
10. The use of part-time work is not very frequent 23

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

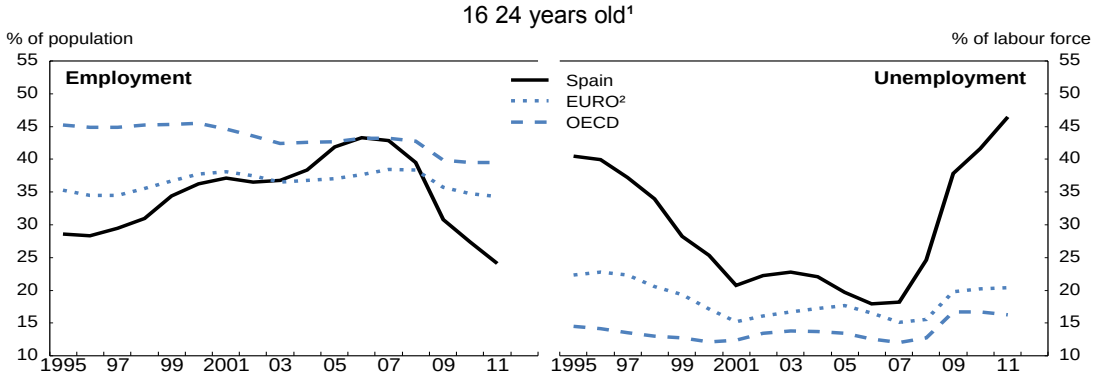
IMPROVING EMPLOYMENT PROSPECTS FOR YOUNG WORKERS IN SPAIN

By Anita Wölfl[1]

Labour market challenges

In Spain, youth employment rates rose from 1995 to 2007, reaching comparable levels to other OECD countries and higher than the average Euro area country in 2007 (Figure 1, Panel A). Additional empirical evidence suggests that on average between 2000 and 2007, employment rates for 15-24 years old have been similar to countries with comparable labour market institutions such as France, but have been significantly lower than in other European countries, notably the Netherlands, with more liberal labour markets (Dolado *et al.*, 2012). Since 2007, the employment rate has fallen drastically (Figure 1, Panel A), losing the gains made during the boom period, and even beyond. While the youth unemployment rate among the 15-to-24-year-olds fell significantly between 1995 and 2007, it bottomed out at close to 20% even in the expansion period, and has doubled since 2007, reaching 45% in 2011 (Figure 1, Panel B). At the end of 2011, almost 70% of the 15 to 19 year olds in the labour force were without a job (INE, 2012).

Figure 1. Youth employment and unemployment performance has been poor



1. Age 15-24 for Euro area and OECD.
2. Euro area 12 member countries prior to enlargement in 2007.

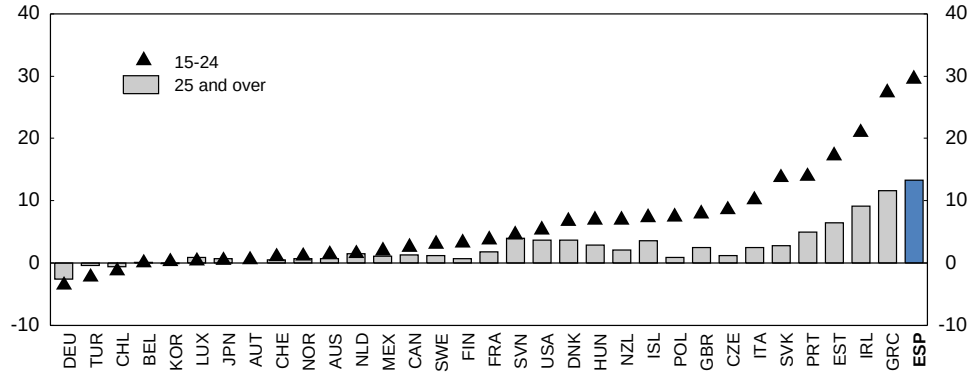
Source: OECD (2012), Labour Force Statistics (database), November.

1. This paper was originally produced for the 2012 OECD Economic Survey of Spain published on 14 December 2012 under the authority of the Economics and Development Review Committee (EDRC). At time of drafting, Anita Wölfl was economist in the Economics Department of the OECD. She would like to thank in particular Andrés Fuentes from the Economics Department for useful comments on earlier drafts. The paper has also benefitted from valuable comments by Pierre Beynet, Andrew Dean, and Bob Ford from the Economics Department, Glenda Quintini and Danielle Venn from the Directorate for Employment, Labour and Social Affairs, and Malgorzata Kuczera, Béatriz Pont and Paulo Santiago from the Directorate for Education and Skills. She would like to thank also Sylvie Foucher-Hantala and Maartje Michelson for valuable statistical and editorial assistance.

While youth unemployment is in all countries typically more sensitive to the cycle than that of prime age workers, this is particularly true in Spain. Empirical evidence suggests that in Spain, a 1 percentage point deviation of GDP growth from its potential would raise unemployment of youth by 2.3 percentage points, almost one percentage point more than youth unemployment in the OECD on average (OECD, 2010a). During the recent crisis, unemployment of young people in Spain rose by 30 percentage points, as compared to 12 percentage points for adult workers, the highest increase among OECD countries (Figure 2). To a large extent this relates to the high prevalence of young people on temporary contracts; in the past and in particular during the recent crisis, positive and negative employment growth has been mainly driven by creation and cuts of temporary jobs (OECD, 2010b).

Figure 2. The increase in youth unemployment during the recent crisis has been particularly strong

Percentage points difference from 2007-Q4 to 2011-Q4 [1]

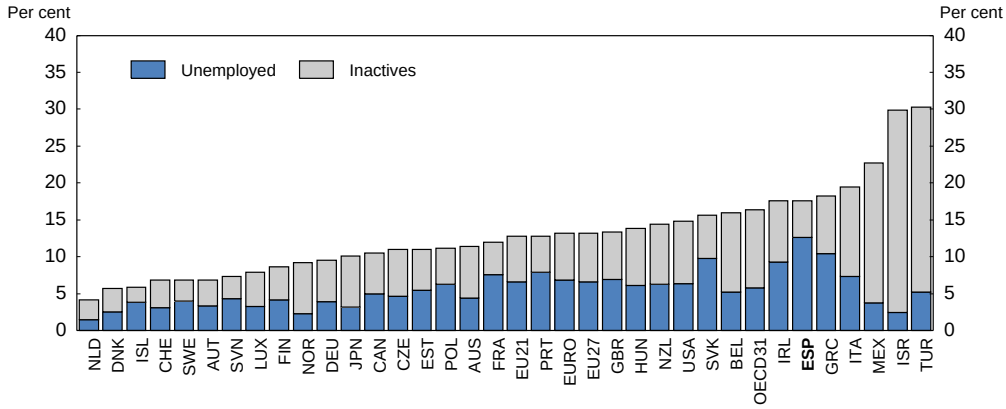


1. Data non seasonally adjusted for Chile, Iceland, Mexico, and Switzerland.
2. *Source*: OECD based on Eurostat, Short-Term Indicators and various national sources.

Spain has one of the highest shares of the youth population who are neither in employment nor in education or training (NEET). There is a risk that these young people become excluded from the labour market. In the first quarter of 2011, about 20% of 15-24 years old youth have neither been in employment nor in education or training (Figure 3). This number is especially high and has more than doubled since 2007 for those young people who are between 20 and 24 years old (Dolado *et al.*, 2012). In contrast to most other OECD countries, the largest share of youth neither in employment nor in education or training are unemployed and not inactive. This can be explained by a high incidence of young people moving from one short-term temporary contract to another, frequently interspersed with unemployment spells.

Figure 3. A large share of youth are not in employment and not in education or training (NEET),

NEET rate, by status, as percentage of population aged 15/16-24, 2011 Q1



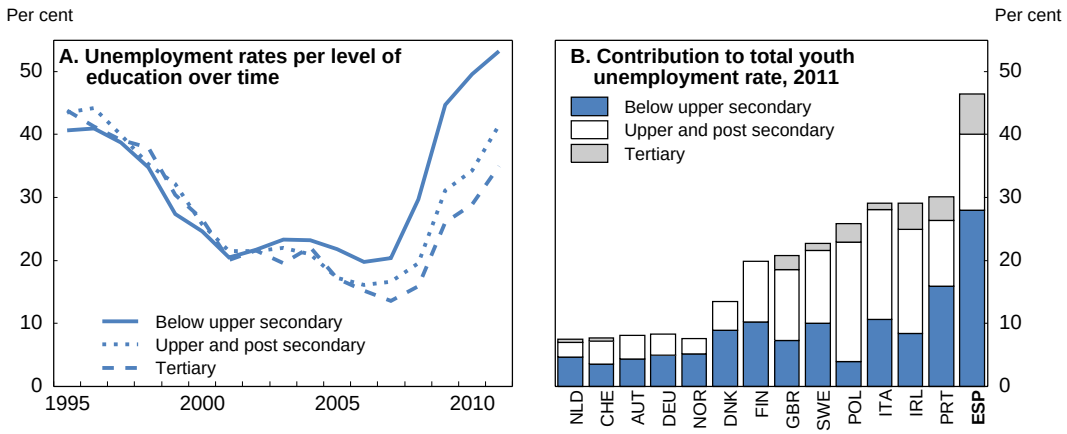
Source: OECD estimates based on national labour force surveys.

There are two crucial policy priorities to improve employment prospects for youth in Spain. *First*, in the very short term, new entrants into unemployment and those who already encountered difficulties in finding a job need to remain connected to the labour market. This implies quick action to provide job-search assistance and guidance for all youth experiencing difficulties in finding a job, and to target well designed active labour market programmes to the most disadvantaged youth. It also implies reinforcing the unemployment insurance system, coupled with strict enforcement of the requirements for unemployment benefit recipients to search and accept jobs, so as to avoid the high unemployment from becoming persistent.

Second, relatively high unemployment, even in the boom period, and the volatile reaction during the crisis indicate deep structural weaknesses in the youth labour market. The current crisis is an opportunity to tackle some of these weaknesses. In particular, reforms to prevent youth from dropping out of education at a very early stage are key to improving employability. Spain's skill-distribution is characterised by a very high share of youth having attained at most lower secondary education. In contrast to most other OECD countries, the unemployment rate of low-skilled workers was not much higher than that of skilled workers until 2007 (Figure 4, Panel A), reflecting abundant low-skilled jobs in the construction, hotels and restaurant, and tourism sectors in the past. However, these low-skilled youth were the first to lose their job during the crisis; unemployment of youth with at most lower secondary education almost tripled between 2007 and 2011 (Figure 4, Panel A), contributing the bulk to overall youth unemployed in 2011 (Figure 4, Panel B). Additional empirical evidence suggests that only a very small share of those unemployed continue education: in 2010, about 70% of 15-29 year old youth with at most lower secondary education have been neither in employment nor in education or training (NEET), between 20 to 30 percentage points higher than in other European countries (Dolado *et al.*, 2012).

Figure 4. Unemployment is particularly high among low skilled youth

Age group 15-24



Source: Eurostat (2012) database, August.

Addressing crucial weaknesses in the Spanish youth labour market is also necessary to improve the employment prospects of young people in the long-term (Scarpetta *et al.* 2010), notably as concerns the school to work transition. In Spain, the time required to find a first regular job of more than 3 months is significantly longer than in other European countries (Dolado *et al.*, 2012), and this has already been the case before the crisis. For instance, 2009 estimates suggest that 3 to 5 years after having left education (for the last time), almost 20% of the 15-34 years old had not found a job, compared to 5-6% in the Netherlands or the UK. And of those who had found a job 3 to 5 years after leaving education, it took them more than one year on average in Spain to find it, as compared to four months in the UK and six months in the

Netherlands (Table 1). Issues to be dealt with in order to improve employment prospects of young people in Spain are to better match skills acquired in education and those asked for by businesses, to establish an effective system of vocational education that could smooth the transition from school to work, and to reduce remaining demand side barriers, notably labour market duality and a rigid collective bargaining system, which has prevented a flexible adjustment to the crisis and an efficient allocation of labour resources.

Table 1. Time needed to find a job since leaving school is long, 15-34 years old, 2009

	Percentage of 15-34 years old who have not found a regular job				Average time needed to find a regular job, in months			
Months since leaving school	Spain	France	Netherlands	United Kingdom	Spain	France	Netherlands	United Kingdom
13-24	40.4	25.5	6.1	10.7	4.1	3.7	2.1	3.1
25-36	28.1	17.3	5.4	8.3	6.3	6.2	3.6	4.2
37-48	18.5	12.9	5.8	8.1	9.3	5.7	5.2	4.3
49-60	19.7	15.4	5.0	4.3	12.8	6.7	6.3	4.4

1. A regular job is defined as a job of more than three months' duration.
2. The average time needed to find a regular job applies to those who have found a job at the time of the interview.

Source: Dolado *et al.* (2012), based on 2009 EU Labour Force Survey ad hoc module.

In 2012, the government introduced a package of wide-ranging labour market measures to address these challenges. The measures were introduced in February and took effect immediately; after having been slightly amended, the law has been in force since July 2012. In general, these reforms are a substantial step in the right direction. While it is still too early to assess the impact of the reform, there are areas where they need to be complemented and made more effective, as described below.

In the short term, ensure that youth-at-risk remain connected to the labour market

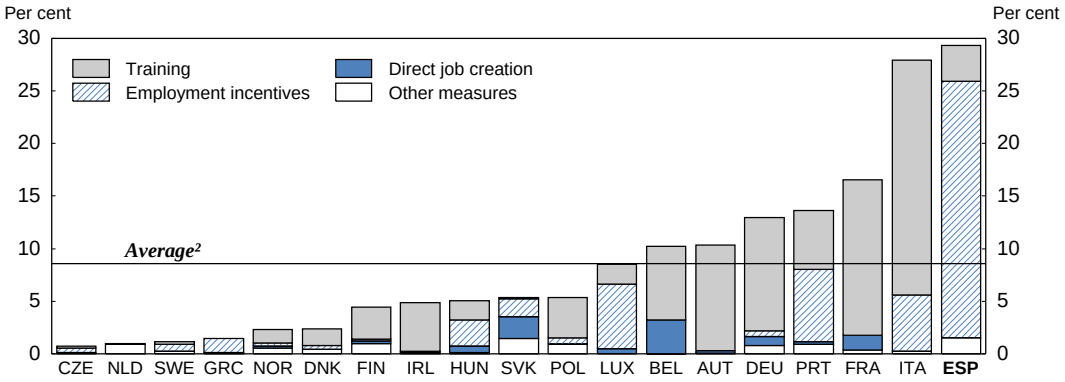
There is need for better targeted active labour market policies

In the short term, well targeted and well designed active labour market policies (ALMP) help ensure that school leavers and young unemployed do not risk being excluded from the labour market (OECD, 2010a, Scarpetta *et al.*, 2010). This is especially important for Spain given the large share of young people who are neither in employment nor in education or training (Figure 3). In this context, measures that have proven most effective are job-search assistance and guidance for all young people experiencing difficulties in finding a job, as well as obligatory training measures (OECD, 2010a; Scarpetta *et al.*, 2010).

While participation in active labour market policies (ALMP) is high in Spain as compared to other countries, ALMPs consist to a very large extent in employment incentives, mainly in the form of subsidies to firms hiring on permanent contracts (Figure 5). While a wide range of hiring subsidies were abolished in 2012, new subsidies have been introduced. These include in particular financial incentives for firms with fewer than 50 employees to hire young people below 30 years old on permanent employment contracts (Box 1).

Figure 5. Participation in activation is poor – even during the crisis [1]

Young participants aged 15-24 in active measures, as a percentage of the youth labour force, 2008



1. Data cover at least 80% of the participants in active labour market measures(categories from 2 to 7 of Eurostat and OECD nomenclature).
2. Unweighted average of countries shown.

Source: OECD (2010), Off to a Good start? Jobs for youth.

Box 1. Active labour market policies in the 2012 labour market reform

The 2012 labour market reform increases employment incentives and aims to improve the matching of people to jobs in the following ways:

First, it introduces new financial incentives for firms hiring young unemployed people. In particular, it introduces a new permanent contract for firms with less than 50 employees; this new contract is temporary and will be valid as long as the unemployment rate is above 15% (see also Box 2.4).

- If firms hire a long-term unemployed worker (having received unemployment benefits for at least three months) on this contract, they are entitled to a one-off tax deduction of 3 000 Euros and during 12 months, a tax deduction of 50% of the unemployment benefits which the newly hired worker would have received at the time of hiring. The newly hired worker will be entitled to receive 25% of their remaining unemployment benefit entitlement on top of their wage.
- If firms hire young unemployed workers between 16 and 30 years old on the new contract, they are entitled to rebates on employers' social security contributions during three years. The rebates would amount to 1 000 Euro/year in the first year, 1 100 Euro/year in the second year and 1 200 Euro/year in the third year.
- Hiring on the new contract is subject to a trial period of one year during which the workers are not entitled to severance payments. In the case of dismissal before three years, the firm has to repay the financial incentives received.

Second, young people below 30 can now use up to 100% of their accumulated unemployment benefits if they opt to capitalise their benefits to start up an enterprise.

Third, the system of on-the-job training and training of unemployed workers is being transformed through the introduction of a voucher (cuenta formación), recentralization of the training priorities and introducing competition in the selection of training providers.

Fourth, temporary employment and private employment agencies can now provide placement without the formal requirements that were established in the reform of 2010.

Finally, the conditionality and the obligation to take on a suitable job was increased for unemployed workers who have used up their first tier unemployment benefit. And the unemployment insurance benefit replacement ratio was reduced to 50% from the 7th month of the unemployment spell onwards. Further, the means for the public employment service to supervise recipients, update their status and take actions accordingly have been reinforced.

Subsidies to private-sector jobs may enhance effective labour supply by helping individuals to keep in contact with work, thereby maintaining their motivation and skills. The experience from previous downturns has shown that under conditions of very weak labour demand, such incentives can jump-start job creation, in particular if targeted on vulnerable groups (De Serres *et al.*, 2010; Scarpetta *et al.* 2010). However, the subsidies for hiring youth and long-term unemployed on permanent contracts should only be used as a temporary instrument during the recession; post-recession they should be phased out – as is being done for most hiring subsidies. In any case they should be targeted solely on the most disadvantaged or difficult to place youth. Empirical evidence suggests that subsidies can have large deadweight losses and substitution effects and as a result, most such schemes yield small net employment gains. For instance, evaluations of wage subsidies in Australia, Belgium, Ireland and the Netherlands have suggested combined deadweight and substitution effects amounting to around 90%, implying that for every subsidised 100 jobs only ten were net gains in terms of employment (Martin and Grubb, 2001). Hiring subsidies have also proven largely ineffective in Spain, and at the same time have been very costly for public finances (OECD, 2010b).

Fully phasing out of hiring subsidies is particularly important in the case of the new permanent contract for firms with less than 50 employees. On top of deadweight losses, this contract risks increasing excess turnover and raising unemployment. The contract foresees an extended trial period of one year, in which the worker has no right to receive severance pay on dismissal, and subsidies are paid for the first three years of the contract. Even if firms that terminate the contract before the three years would have to repay the subsidies, the contract may act as another form of temporary contract with very low firing costs as long as firms hire an employee and fire him within the trial period. The new contract will be valid as long as the unemployment rate is above 15%. This goes in the right direction, but it may take some time, even with the implementation of reform measures, before unemployment can be brought down by 10 percentage points from 25% in October 2012.

Increasing job-search assistance would help young people experiencing difficulties in finding a job. These measures have proven effective in other countries (OECD, 2010a). In a recession, the lower opportunity cost of time spent on training makes also training measures especially opportune (OECD, 2010c). Moreover, training would help the unemployed acquire a different set of skills so as to prepare them for a job outside their previous occupation. This is particularly important for Spain where the economic recovery is likely to require significant structural change. Some steps are being introduced in this direction (Box 1). This is welcome, but more is likely to be needed.

The mutual obligation system of unemployment insurance has to be reinforced

While the unemployment benefit system in Spain has played a significant role in supporting the growing number of unemployed during the crisis, rising long-term unemployment has lowered coverage of unemployment insurance benefits. Hence, active labour market policies and re-employment services to the unemployed need to be made more effective, coupled with strict enforcement of the requirements for unemployment benefit recipients to search for and accept jobs, so as to reduce unemployment and avoid it from becoming persistent (De Serres *et al.*, 2010).

The 2012 labour market reform allows for-profit temporary employment agencies to act as private placement agencies under contract to the public employment service. This is welcome, as with the surge in unemployment during the recent crisis regional public employment services may better concentrate on particular target groups and “outsource” other activities. Further initiatives will be needed, however, given the scale of the problem.

First, the division between the financing of unemployment benefits with unemployment insurance contributions at the national level, on the one hand, and the managing of the placement services at the regional level, on the other hand, may distort placement incentives for regional employment offices (OECD, 2008, 2010b). Regions do not receive the financial benefits of a reduction in unemployment. Rather, as resources are allocated across regions according to the number of unemployed, regions that succeed in placing the unemployed receive less funding. Moreover, there is a risk that ALMPs are not designed to promote employability, but to place recipients in short-term jobs that re-qualify them for unemployment benefits paid by the central government. The government may consider assigning the responsibilities for funding unemployment benefits and for managing the public employment services at the same jurisdictional level (the central government). The government has taken some steps towards monitoring and evaluation of placement services and ALMP implementation at regional level, based on quantitative output indicators (OECD, 2010b). This is welcome as such initiatives could help to improve incentives for regional employment services. Monitoring would best be combined with a stronger coordination among regional placement services so as to exchange best practices.

Second, the Spanish mutual obligation approach where, in return for benefits, recipients are required to engage in active job search activities, could be better enforced, in line with recommendations in earlier *OECD Economic Surveys* (OECD, 2008, 2010b). Some steps have been taken to make progress (Box 1), which should be complemented. In particular, entitlement to unemployment benefits should start from the initial time of registration and should no longer be paid retroactively from registration (OECD, 2008). The first intensive placement interview should be mandatory at the time of registration and the frequency of interviews between the job-seekers and the employment counsellors should be increased so as to increase the opportunities of referral to a vacancy. The requirements for unemployed to take on a "suitable" job should be reinforced early on in the unemployment spell.

In the longer term, the government may also consider reducing the duration of unemployment benefits which with a maximum of about two years is relatively long. By reducing the job-search intensity of the unemployed, a generous level or long duration of unemployment benefits can result in longer periods of unemployment. Arellano *et al.* (1998), for instance, based on longitudinal hazard estimations for a sample of Spanish men in 1987-94, show that receipt of unemployment benefits significantly reduces the probability of leaving unemployment. Furthermore, by lowering the opportunity cost of not working, they may also put upward pressure on workers' wage claims and ultimately reduce labour demand (OECD, 2006). The government reduced the replacement ratio after the 7 months of the unemployment spell from 60 to 50%. Empirical studies have found that long benefit duration is more detrimental to employment than high replacement rates (OECD, 2006). Shortening the duration of benefits may also not hit those unemployed who would need them most. People on temporary contracts have a higher probability of job loss, yet may accumulate little benefit entitlement, while people on permanent contracts would be entitled to generous unemployment benefits in case of a dismissal in addition to high severance pay (OECD, 2010b).[2]

Reducing the early drop-out rate from education

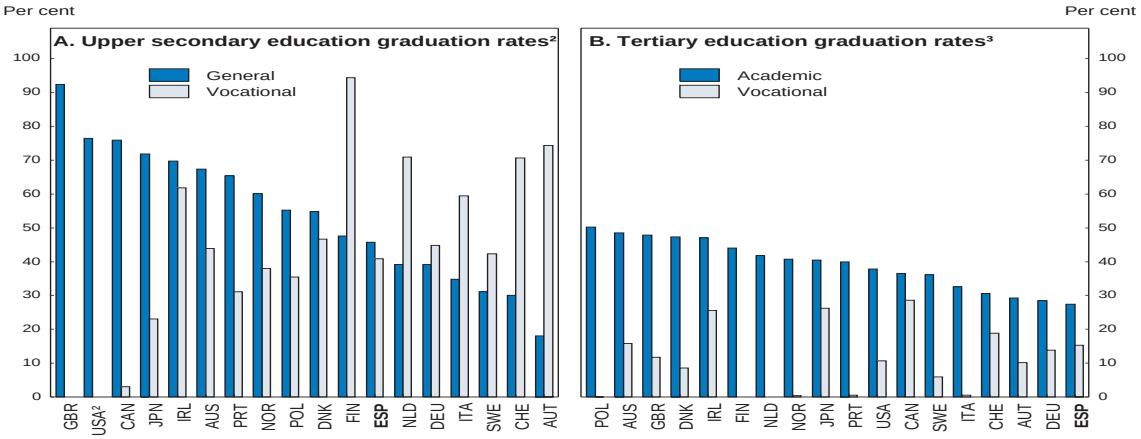
The share of low skilled among young unemployed has been particularly high in Spain in international comparison, and increased drastically since 2007. These facts point to possible weaknesses in the education system. Spain's educational distribution is characterised by a particularly high share of youth in the 15-29 year age bracket who leave school with at most lower secondary education (OECD, 2010).

2. Unemployed older than 24 years or with dependent children, whose unemployment benefits have been exhausted, have access to social assistance. The maximum amount of social assistance is about 18% of the average wage, with differences in the rate across regions. Furthermore, unemployed older than 45 years have access to unemployment assistance (OECD, 2011d).

While the share of the population who have obtained the certificate of obligatory (lower) secondary education has increased from 71% in 2007 to about 74% in 2010, this is very low in international comparison (MECD, 2012). Only 48% of young people graduate from general upper secondary education (Figure 6, Panel A) and while access to and graduation from tertiary education has increased over the past ten years (OECD, 2008), the number of graduates from tertiary education is still low in international comparison (Figure 6, Panel B). There are two main areas to address:

Figure 6. Graduation from upper secondary and tertiary education is weak

In percent of the population at the typical graduation age, 2010



1. Graduation rates measure the estimated percentage of young adults who graduate from this level of education during their lifetimes.
2. Total upper secondary education.

Source: OECD (2012), Education at a Glance.

First, in Spain, a large number of pupils repeat grades; some fail lower secondary education. In 2009, 35% of 15 year olds had repeated a grade at least once in Spain as compared to an average of 13% in all OECD countries (OECD, 2011a; OECD, 2008). Grade repetition is ineffective in raising educational outcomes (OECD, 2012a). Still, teachers and society support this practice, and there is not much awareness of the long-term negative effects on students. In fact, the chances for those young people of finding a job at a later stage are very weak, and passing lower secondary education is the main entry into higher level education also at a later stage of life (Garcia-Perez *et al.*, 2011; OECD, 2008). Those who repeat are often from disadvantaged backgrounds and this contributes to widen inequities. Grade repetition also creates large costs for society as a whole, including the expense of providing an additional year of education for a student, and the cost to society of delaying that student's entry into the labour market by at least one year. PISA estimates suggest that the cost of using grade repetition for one age group in Spain is equivalent to at least 10% of annual national expenditure on primary and secondary school education (OECD, 2011a).[3]

One reason for the high grade repetition rate in Spain is the relatively stringent requirement to pass the certificate of compulsory (lower) secondary education (GESO). Students move to the subsequent grade if they have failed at most two subjects. In the final year, students have to pass everything eventually, although there are second-round exams for those who fail some subjects. Students can repeat a grade twice at most, and if they reach the age of 16 without having passed the GESO, their parents can decide to take them out of education (MECD, 2012). Moreover, there are few incentives for schools and teachers to reduce repetition, as individual schools are funded based on the number of students enrolled and do not

3. These estimates are based on the assumption that students who repeat grades attain, at most, lower secondary education. If they were to attain higher levels of education, the costs would be even greater.

have to internalise these costs. Alternatives such as personalised learning or targeted interventions often have direct costs for schools.

The government is planning to reform the education system so as to raise educational outcomes, and in particular reduce grade repetition and the high drop-out rate from lower secondary education. The government plans to strengthen the core subjects necessary to acquire basic skills to follow any level of upper secondary education by reducing the overall number of competencies and putting more weight in terms of hours taught on the core subjects, mathematics, language and science. Strengthening the core subjects is welcome. However, there is the risk that this measure will not reduce grade repetition unless coupled with less stringent conditions for grade advancement. The criteria for granting pupils' promotion to subsequent grades, and hence access to upper secondary education, should be focused more closely on these competencies that are instrumental for following any type of upper secondary education, as was recommended in past *OECD Economic Surveys*. This would reduce grade repetition in compulsory secondary education more effectively, and could be introduced quickly.

This could be coupled with a stronger focus on measures to prevent repetition, by addressing learning gaps during the school year, while reducing grade repetition substantially to few exceptional cases (OECD, 2012a). The government plans to address this issue to some extent through improved autonomy of the schools along with the introduction of the external and standardised tests. This would include external tests at the end of each education level (primary school, compulsory secondary school and upper secondary education) as well as a test in the 3rd year of primary school, aimed at the early detection of learning problems. Students passing this external test at the end of lower secondary school will be granted the final certification and can move to upper secondary level, provided they fail in at most two subjects.

The government also wants to allow students to follow a vocational track already in the final year of compulsory education, so as to reduce drop out from lower secondary education and make vocational education more attractive. It is planned that some core subjects would remain the same in both tracks with students sharing the courses. The two tracks would lead to different degrees which provide different access opportunities in upper secondary education. There is a risk that this may increase dependence of student performance on family background and reduce equality of opportunity. Moreover, it may also not reduce grade repetition as it would apply only to those students in the final year of lower secondary education, when grade repetition has already occurred in many cases. Maintaining education pathways open and equivalent for all pupils completing lower secondary education could help improve equal opportunities (OECD, 2012a).

Second, staying in education has not been the preferred option for many students as the skill premium of upper secondary education and tertiary education was relatively low in terms of lower gross earnings gains and weaker career prospects over an individual's working life than in other countries (OECD, 2011b). University fees were lower than on average across OECD countries in 2008-09 (latest comparable OECD data available, OECD, 2012c) although they have risen since. Access to public loans for students is limited to postgraduate courses. Furthermore, support to students enrolled in tertiary education as a share of public expenditure in tertiary education is relatively low in Spain as compared to other European countries (Eurydice, 2012). Access to higher education, especially tertiary education, has been particularly difficult for qualified students from more disadvantaged families. Conditions to grants for students from poor families have been tightened by introducing a stricter link between grants and academic results, and scholarships offered are not sufficient to cover costs of living (OECD, 2009a; Eurydice, 2012). A programme of loans with income-contingent repayments for tertiary education and improved access to grants for students from socially disadvantaged families could address this weakness (OECD, 2008).

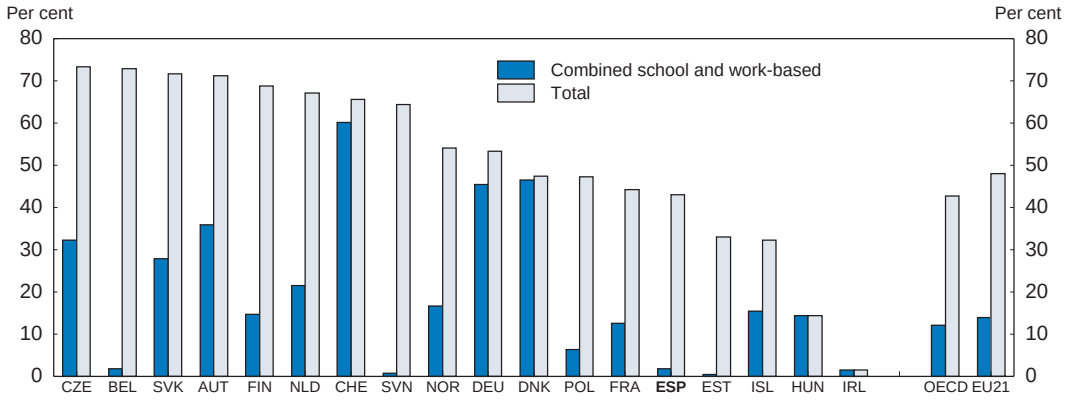
Facilitating the transition from school to work through improved vocational education

The school-to-work transition of young people is typically smoother in countries with well developed vocational education by providing work-related skills through curricula which emphasise the acquisition of

practical skills that are relevant for work (OECD, 2010d). Moreover, vocational education allows for an alternative track for youth disaffected with academic education and at high risk of dropping out. However, in Spain, graduation rates from upper secondary vocational education are very low, reflecting weak incentives for young people to follow vocational stream as compared to either staying in general education or entering the labour market immediately after lower secondary education (Figure 7). In 2009, about 45% of young people in the typical age of upper secondary education were enrolled in vocational education programmes in Spain, as compared to about 70% in Switzerland. And of those students who are enrolled in vocational upper secondary education, only very few participate in programmes in which school- and work-based training is combined, as compared to Germany or Switzerland, where combined (dual) vocational education is frequent (Figure 7).

Figure 7. Combined school and work-based programmes of vocational education are rare

Enrolment in upper secondary vocational programs in all programmes (total) and in those programmes in which school-and work-based training is combined, 2010, in percent of the typical age of population



Source: OECD (2012), Education at a Glance.

Weaknesses of the system in place

There are four main weaknesses in the Spanish vocational education system that would have to be addressed to improve its attractiveness and its efficiency. *First,* combined vocational programmes are most effective in facilitating the transition from school to work (OECD, 2010d). However, in Spain, vocational education programmes lack a proper combination between formal school and work-based education; workplace based training typically takes place for a very short period of time (up to at most 20% of total vocational programmes) and only at the very end of the two years of the programme. This prevents young people from gaining an early appreciation and understanding of the world of work.

Second, while the aim of vocational education is to prepare students for the labour market, the content of vocational education in Spain appears not to meet labour market needs. For instance, there is no requirement for vocational education teachers and trainers to have worked in their vocational field (OECD, 2012b) and courses in formal and vocational upper secondary schools are typically taught by the same teachers (MTI, 2008). Moreover, it appears that firms have had only limited influence on the curricula, further lowering the relevance of vocational programmes for firms. Employers are involved in the general curricula of vocational education system through the General Council for Vocational Education at the national level, which aims to build consensus among the national and autonomous community governments, and employers and unions, on vocational education policy. However, *de facto* at the local level, employers are engaged in the system particularly through the provision of workplace training, which has not been a very substantial part of overall vocational education (MTI, 2008; OECD, 2012b). Hence, for

the firm it may be more profitable to hire a graduate from general upper secondary education who may be assumed to be more talented and hence more productive.[4]

Box 2. What makes firms invest in apprenticeship training?

Empirical evidence suggests that a firm's willingness to train apprentices is a crucial condition for a successful vocational education system in which school-based and work-based training are combined (Wolter and Ryan, 2011). Firms do have an incentive to train young people, although the reasons and returns from apprenticeship training vary across occupations and across countries (Mohrenweiser and Zwick, 2009, Wolter and Ryan, 2011).

Investment in human capital differs from those in physical capital in that the firm does not acquire a property right over its investment in skills, so the firm and the worker have to share the costs and benefits of the investment. The question of who bears the costs of training within an apprenticeship or a dual vocational programme depends on the type of human capital acquired (Wolter and Ryan, 2011): if the skills are truly general (i.e., transferable across firms), the firm would not have an incentive to bear the costs of the training. In the absence of an enforceable contract, the firm would lose all its investment if the worker were to leave the training company. In this case, the worker who has an incentive to take up the training as the skills are transferable would bear the costs. If the training is purely firm-specific, neither the firm nor the trainee would have an incentive to finance all of the costs. Both parties would lose all their investment in the event of separation after the training. In this case, training would only take place under a sharing of the costs between the firm and the worker.

An apprenticeship system that includes both school-based and work-based training and that leads to recognized formal qualifications, ensures that firms provide training (and trainees take up the training) although the apprenticeship provides at least to some extent transferable skills (Wolter and Ryan, 2011). Apprentices are mostly young people living with their parents, and are hence willing to accept a lower wage during the training in exchange of the skill acquired. Moreover, an apprenticeship contract commits the trainee to stay until its completion, as only then he/she would obtain the recognized qualification.

Empirical evidence suggests that the incentives for firms' investment in training are reinforced through the existence of market distortions or externalities (Wolter and Ryan, 2011):

- *Information asymmetries:* these mean that the wage paid in the external market will be lower than the true productivity of the ex-trainee, giving the training firm a competitive advantage in setting the post-training wage and increasing the incentive for the trainee to stay.
- *Industry- or occupation-specific monopsonies:* even if the skills acquired through an apprenticeship are transferable, they are still specific to an occupation or industry, reducing the number of firms that compete for a particular set of skills and raising the costs of changing jobs.
- *Skill complementarity:* firms may be willing to invest in general/transferable skills, as acquiring firm-specific skills is more productive if accompanied by the acquisition of general skills.
- *Make-or-buy:* by hiring former apprentices a firm can save on adaption costs that would arise by hiring skilled workers externally (Mohrenweiser and Zwick, 2009).
- *Labour market regulation:* apprenticeships can be used as a screening device to reduce the risk of a bad match and hence to reduce possible dismissal costs. Empirical evidence suggests for instance, that firms are willing to incur net costs in the short run to avoid costs implied by strong employment protection (Muehlemann et al., 2010).

Third, vocational education in Spain is purely publicly financed. It would be more efficient if the cost of vocational education were shared between government, employers and students according to the benefits obtained (OECD, 2010d). The positive social net returns from the investment in vocational education, due to positive effects for society as whole, justify public investment in vocational education. Moreover, to the extent that vocational education provides transferable skills, employers' incentives to share the costs are weakened, as they would lose their investment if the trainee left to another firm after the training. However, within a system in which formal school and workplace training is combined, the skills acquired at work are to some extent firm-specific, and firms can draw benefits from the training (see

4. This assumes that students self-select into general versus vocational upper secondary education based on their perceived capabilities (Wolter and Ryan, 2011).

Box 2). Both effects justify contributions by firms to the funding, for instance by paying trainees a wage at least for the period of work-based training (Box 2, Wolter and Ryan, 2011; Höckel, 2008). Trainees would accept a lower wage in exchange to the skills acquired.

Fourth, so-called training contracts (*contratos de formacíon*)[5] aim to provide work-based training. However, the incentives for firms to offer such contracts on the one hand, and for young people to take on training contracts on the other hand, have been weak. The skills acquired through training contracts were not formally recognised, making young people reluctant to take on such jobs (OECD, 2007). Moreover, training contracts were typically relatively short and with a maximum duration of two years (OECD, 2007). Empirical evidence from apprenticeships system in Germany and Switzerland suggest that firms typically draw a net return from the training only in the second half of the apprenticeship, once the trainee can work with almost full productivity. In some cases this is only once the trainee has been taken over after the apprenticeship (Wolter and Ryan, 2011; Mohrenweiser and Zwick, 2009).

Towards an effective combined (dual) system of vocational education

The government is planning to reform the current vocational education system. It is envisaged to improve the existing components, the formal vocational programmes on the one hand and the training contracts on the other hand, to move towards a system combining formal school with longer work-based training (Box 3).

Box 3. 2012 reforms related to vocational education

The government has prepared a draft Royal Decree to reform the existing system of vocational education and the training contracts (*contratos para la formación*) to better tailor vocational education to the skill needs in the labor market, and to improve access to upper secondary education, reduce early school drop–out and facilitate the school-to-work transition. The reform seeks to achieve this in two ways:

First, it has improved the design of training contracts. Training contracts will be extended to a maximum of three years (as compared to two years now). If undertaken in an accredited firm, the training provided within a training contract is certified as a part of the educational qualification. Training will occupy at least one third (as compared to 15% now) and no more than 75% of the overall duration of the training contract. Trainees will receive a wage which cannot be lower than the minimum wage, though. Companies may receive public funds to cover part of the training costs, through rebates in employer contributions to Social Security. The Public Employment Service would manage the funds.

Second, the government is working with autonomous regions that have launched a set of pilot projects for a dual vocational education programme. Training could be provided exclusively within an accredited training center (educational body), exclusively in an authorized training company, or in cooperation between the two, where the firm would provide at least one third of the training. Students would either receive a wage from the firm or a grant from the educational institution, administered by the Public Employment Service.

These measures go in the right direction. However, the government should combine formal vocational education and training contracts within one single system. Training contracts should be extended for the whole period in which formal education takes place. In this way, work-based training would be on a

5. *Contratos de formación (CF)* are contracts targeted at youth aged 16-21 with an upper secondary education degree and for individuals belonging to specific target groups for training in a firm. They last at least six months but no more than two years. Employers receive a subsidy to cover training costs and accident insurance for the students. As a counterpart, employers have the obligation of providing training of at least 15% of the time spent in the firm to be dedicated to training. At the end of the contract period, employers have to issue a certificate containing information on the duration of the contract, job content and major assignments carried out by the trainee. Trainees are paid a salary set in collective agreements within the limits established by law and which cannot be lower than the minimum wage (OECD, 2007).

continuous basis and would alternate with school based training, either some days per week or in blocks in regular intervals. As is envisaged, contracts would be signed between the trainee, the training firms and the representative for vocational education, respectively the vocational school, so as to increase commitment (see Box 2.2). By linking the content of the work-based training to the formal skills acquired at schools more closely, the combination of school-based vocational education and the training contracts would ensure that content in work-based training is in line with the requirements for a certain job and formally recognised. Finally, by combining school-based vocational education with training contracts, training firms pay a wage for work-based training and hence participate to the financing of the system, while the government can concentrate its contribution to the financing and provision of school-based training.

The government plans to provide firms offering a training contract with rebates of social security contributions (Box 2). However, there is a risk that firms abuse training contracts as a cheap way to hire trainees to do low-skilled jobs while providing only a minimum amount of training limited to what would be paid through subsidies. The incentives of the firms to offer training contracts and to participate in an apprenticeship programme would be best achieved by allowing them to pay the trainee, during the work-based training, a wage that can be lower than the minimum wage (OECD, 2007). While in aggregate the minimum wage is relatively low in Spain as compared to other countries, there are reasons to assume that it may often be high as compared to the median wage of young workers (see below).

Firms also need to be involved more widely in the curriculum of school-based training, as appears to be planned. Beyond improving the attractiveness of vocational education for firms, this would help ensure that curricula can be adapted to the rapidly changing nature of jobs, *e.g.* linked to the technical developments in information and communication. In Norway for instance, placing students in apprenticeships is achieved through Training Offices for Vocational Training at the local level, in which those firms cooperate which have common needs for trained workers or have decided to offer apprenticeships together. Municipal school authorities have a secretariat that provides support and help in establishing and running the circles. In addition, there are teachers in most schools who maintain contacts with enterprises as a regular part of their job (Kuczera *et al.*, 2008). Consideration should also be given to opening up the teaching profession in vocational schools to practitioners more widely, which could raise the awareness of general teaching staff of ongoing developments (OECD, 2008).

Maintaining quality standards, both as regards teaching at school and training at the firm is a potential challenge. Some firms, notably small firms, may find it difficult to provide a combined vocational training, for instance because they are too specialized or lack the necessary professional infrastructure or technical equipment to cover all required areas of the particular training. Countries have come up with different ways to deal with this issue. In Germany, for instance, an individual firm can provide apprenticeships in cooperation with either another company or with an official training provider or educational institution (for instance a regional training center). This allows individual firms to share administrative and organisational costs or to offer specific elements or steps of the training for a particular occupation (BfA, 2012).

Finally, quality assessment mechanisms need to be in place, both at the level of the educational bodies or training centres that provide school-based training and at the firm level. Assessment should be based on general quantitative criteria based on the success of the training in moving graduates into suitable jobs (OECD, 2008). Setting up a system of indicators and analysis relating to vocational schools could be a starting point for more widespread evaluation of apprenticeship programmes. This could include the collection of data on the flow of students through education and on the long-term labour market performance of young people with a vocational degree (OECD, 2010d).

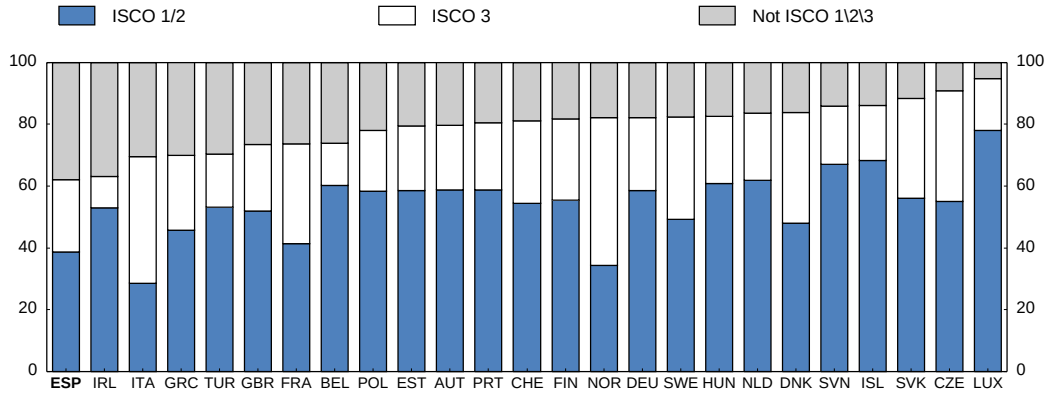
Ensuring that students leave education with skills asked for in the labour market

Educational qualification do not match skills requested by firms

In Spain, the prospects for young people to gain access to occupations that reflect the skills they have acquired in education are poor (OECD, 2008). This phenomenon is particularly prevalent for tertiary education graduates. About 40% of young people between 25 and 34 years old with a tertiary education degree are not employed in occupations that typically require this qualification, such as managers and professionals or technicians and associate professionals (Figure 8). In Spain, tertiary education graduates also need a long time to find a job, even on a temporary basis, and the average time needed to find a longer-term job of at least 3 months is 7 months in Spain as compared to 3 months in the United Kingdom and the Netherlands and 4.6 months in France (Eurydice, 2012). Moreover, a high rate of over-qualification has been observed already in the past and it has not changed much over the past decade (Eurydice, 2012). These facts point to distortions in the labour market, such as informational barriers in job search and lack of geographical or job mobility which avoid an efficient allocation of labour or skills resources to jobs (OECD, 2008; OECD, 2011c). In fact, once corrected for the incidence of temporary contracts, Spain shows a very low rate of job mobility, even within industries (OECD 2009b).

Figure 8. Tertiary education graduates are employed in lower qualification jobs

Distribution of people with tertiary education, aged 25-34, by occupational class, 2010, in percentage



1. ISCO 1/2: legislators, senior officials, managers and professionals; ISCO 3 : technicians and associate professionals.

Source: Euridyce (2012).

The high incidence of temporary employment and the lack of geographic and job mobility are to a large extent due to employment protection legislation, which has strongly favoured insiders on permanent contracts, and to a rigid collective bargaining system. Both have made it difficult or costly for firms to upgrade job content, open positions and hire workers with more appropriate skills. And employees on permanent contracts have had no incentive to move to another job, opening their position to younger people, as they risk losing their protection. As a consequence, young people move from one very short term temporary contract to the next before finding a longer term job, interspersed with frequent unemployment spells, with adverse effects for their longer term employability. The likelihood of a person being employed on a job for which she is over-qualified increases with the time spent in unemployment (OECD, 2011c). Addressing these weaknesses as described in the following sections would limit the adverse effects for the recovery and facilitate the switch to more export-led growth, beyond their positive effects on employment. Theoretical and empirical evidence suggests that the reallocation of labour resources to more productive uses is facilitated by on-the-job search and direct job-to-job transitions, rather than movements of workers through unemployment spells (Krause and Lubik, 2007).

Lack of geographical mobility is also driven by a housing market that favours home-ownership vis-à-vis the rental market. Linked to the low rate of conversion of temporary contracts into permanent ones, young workers face a high degree of uncertainty as to how long they will be able to remain in the same job or enterprise. It is also more difficult for young people to buy an apartment due to the limited availability of security they could provide so as to have access to a mortgage. Hence, young people may prefer to search and accept a job close to their families. In fact, empirical evidence suggests that in Spain, young people stay much longer with their parents than in other countries (Dolado *et al.*, 2012). Disincentives for renting should be reduced as described in OECD (2012d).

On top of demand side barriers, inefficiencies in the education system need to be addressed

Addressing inefficiencies in the tertiary education system would help to ensure that the skills acquired in academic or vocational education match those demanded by the labour market. In fact, empirical evidence suggests that in Spain, a large share of workers are holding jobs in areas that are unrelated to their field of study (OECD, 2011c).

The following weaknesses should be addressed in particular:

- *First*, tertiary education curricula and programmes do not respond to the needs of the labour market (OECD, 2009a). Involving labour market actors, such as businesses, professions, and labour unions, in bodies that provide advice and analysis to educational policy authorities can help, as is the case already with employers' involvement in the General Council for Vocational Education. Public authorities should seek to widen participation of labour market actors also in the governing councils of tertiary education institutions.

- *Second*, academic tracks are favoured vis-à-vis vocational tracks, reducing the responsiveness of the educational system to labour market needs. Higher vocational or specialised tertiary education are disconnected from the tertiary education system, as they are seen instead as an extension of upper secondary education schools. This reduces their attractiveness and recognition as education of equal standard to academic tertiary education (OECD, 2009a). Higher vocational education should be integrated into the tertiary education system.

- *Third*, educational efficiency is weak, as reflected in a low number of students completing their studies in a given year when compared to total enrolments, and in a long time to completion. Indeed, the long time needed for completion appears to be taken by some teachers as a reflection of the "quality" of the programme (OECD, 2009a). Authorities should help the institutions improve their understanding of the longer-term career paths of graduates, for instance through the establishment and maintenance of a data base that tracks graduates' labour market performance (OECD, 2009a). Besides involvement in the design of curricula, businesses could also be more strongly involved in identifying graduate competencies for the assessment of programmes. Institutions should also be provided with enough human resource autonomy so that they can more flexibly redeploy academic staff according to those programmes which best respond to labour market needs (OECD, 2009a).

- *Fourth*, while some regions have started to introduce formula-based funding, partly based on performance indicators, funding of tertiary education institutions is still input-based in most regions, *i.e.,* based on the number of students enrolled and the programmes provided. These are mostly decided in proposals put forward by the autonomous communities, and they do not react well to labour market demands (OECD, 2009a). Central and regional governments should move towards an output based funding of tertiary education, based on objective indicators – as was already recommended in earlier *OECD Economic Surveys* (OECD, 2008). This would also raise public spending efficiency beyond the effects on educational efficiency.

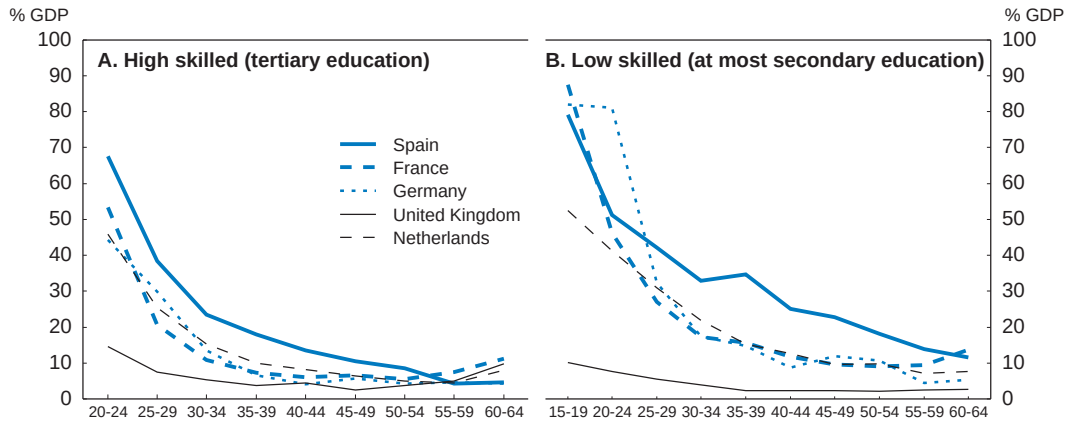
Helping the young to move from temporary to stable employment

Temporary contracts do not fulfil their role as a stepping stone to more regular jobs

Typically, employers tend to hire youth on temporary contracts whose productivity is not immediately observable. As a result, temporary employment may be a good entry path to the labour market, notably for youth who enter the labour market with adequate skills and get a chance to prove their productivity on relatively long temporary contracts (OECD, 2010a). However, Spain is unique in that temporary contracts are of very short duration and youth tend to stay on temporary contracts for a very long period of time (OECD, 2007). In Spain, almost 40% of less-educated and 20% of high-educated workers hold temporary contracts until the age of 39 (Figure 9). Moreover, positive and negative employment growth has been driven mainly by creation and cuts of temporary contracts with adverse effects in particular for young people (OECD, 2010b).

Figure 9. Young people are locked-in in temporary contracts

Temporary employment rates, by level of education, as a percentage of youth population per age group



Source: Dolado et al. (2012), based on the yearly subsamples of the European Labour Force Survey 2010.

One of the main reasons why temporary contracts do not act as a stepping stone in Spain is the large difference between dismissal costs for temporary contracts as compared to permanent ones which makes firms reluctant to transform temporary contracts into permanent ones. Even if firms are satisfied with the performance of the worker, it may still be cheaper to fire the worker and search for a new candidate, leading to excess turnover. Moreover, young people are trapped in precarious employment or unemployment, with adverse effects for their long-term employability and large costs for society as a whole. Two years after having been on a temporary contract, more than 22% of 15-29 year olds in Spain were still on temporary contracts, unemployed or inactive. In the United Kingdom, the number was less than 2% (OECD, 2010a).

Workers on temporary contracts are paid less than with permanent ones. Although, in principle, wage rates cannot be differentiated by contract type, researchers have found that in general, fixed-term workers earn somewhat less than comparable permanent employees, even if the wage differential falls when unobserved heterogeneity is accounted for. However, empirical estimates suggest that the wage penalty is higher in Spain than in other countries (Mertens *et al.* 2005). De la Rica (2004) estimates that, after controlling for heterogeneity in personal and job-related characteristics, permanent workers earn between 5 and 10% more than workers on temporary contracts. The evidence also indicates that the wage gap is associated with employers' decisions to under-classify temporary workers when assigning them to occupational categories (which determine their wage) (Bentolila *et al.*, 2008).

Moreover, temporary contracts have adverse effects for economic growth (Mora-Sanguinetti and Fuentes, 2012). According to human capital theory, agents are more likely to invest in the acquisition of skills the longer is the post-training period over which they can amortise their investment. If either the firm or the worker expects job attachment to be short-term, then work-related training will either not be provided (the firm) or will not be accepted (the worker), depending on who bears the training costs (Arulampalam and Booth, 1998). Empirical evidence for Spain suggests that workers with temporary contracts are not only less likely to be employed in training firms but, once they are in those firms, they also have a lower probability of being chosen to participate in firm-provided training activities (Albert *et al.*, 2005). Moreover, the prospect of starting on and remaining for some time on temporary contracts may reduce the effort exerted by workers on temporary contracts (Dolado and Stucchi, 2008) on top of their reduced incentives to invest in their own education (see also Mas-Ivars and Robledo-Domínguez, 2010).

The 2012 reform is a big step forward

The Spanish government has been introducing reforms of employment protection legislation since 2010, and equally in the 2012 labour market reform (Box 4).

Box 4 The 2012 reform of employment protection legislation

The 2012 labour market reforms aim to reduce further the duality in the Spanish labour market, with a reform of employment protection legislation and by fostering internal flexibility (see also Box 5):

- The law redefines the economic reasons for dismissal, further clarifying the conditions under which a dismissal for objective reasons could be justified. In this case, the employer pays 20 days' wages of severance pay per year of seniority. The law specifies that dismissal is justified for economic reasons if the company faces a persistent decline in revenues or income, i.e. over three consecutive quarters as compared to the same periods of the preceding year. As concerns other objective reasons for dismissal that would also justify justified dismissal, the firm has to show only that it has undertaken technical, organizational or other production process-related changes, but no longer has to prove that the dismissal was necessary for future profitability of the firm.
- If a dismissal is judged unjustified, the maximum severance pay is reduced to 33 days' wages per year of seniority up to a maximum of 24 months, compared with 45 days and a maximum of 42 months on the regular permanent contract before. This applies to all new contracts and for future years of service on existing contracts.
- The law eliminates the need for administrative authorization of collective dismissal, in line with current regulations in most European countries.
- While it removes the option of express dismissal, according to which firms could declare the dismissal upfront as being "unjustified" and pay 45 days' wages per year of seniority to avoid litigation, firms no longer are obliged to pay interim wages during the period the case is adjudicated.
- The law introduces a new type of permanent contract for companies with fewer than 50 employees. Hiring on this new contract is subject to an extended trial period of one year, compared with a previous maximum of six months, and various tax credits (see Box 1).
- It further restricts the use of temporary contracts, by reinstating the maximum period of extension of a temporary contract to two years. This law was temporarily suspended in August 2011.

The reform defines economic reasons in a clearer way. This has the potential to make it easier to have dismissal judged as justified, resulting in sharply lower severance payments of 20 days' wages per year of seniority Box 4. Indeed, data suggest that the number of dismissals for objective reasons has already slightly increased recently from around 7% on average in 2010 to about 14% in the first quarter of 2012 (MLSS, 2012). The possibility to shed labour in bad times should raise the incentive of firms to use permanent contracts. Moreover, firms no longer have to pay interim wages while judicial procedures are

pending and collective dismissals have been made easier by doing away with the requirement of approval by a regional or the central government. Hence, employees have less incentive to go to court a priori, to claim that the dismissal would have been unjustified. The reform has also removed the requirement that excessive unjustified absence from work could only justify dismissal of a worker if, at the same time, unjustified absence exceeded a threshold of 2.5% among the firm's employees on aggregate, which is welcome.

While the reform should facilitate restructuring and flexibility also in good times, it remains to be seen how many dismissals will be judged as justified by the courts then.[6] In any case and especially if most dismissals remain judged unjustified, severance pay for unjustified dismissal should be further reduced; even at the current 33 days' wages per year of seniority, severance pay for unjustified dismissals remains high by international comparison. In particular, they would remain high in comparison with the dismissal costs on temporary contracts. Hence, if the reform does not prove effective in reducing duality substantially, introducing a single contract with initially low but increasing severance payments would reduce the difference in dismissal costs of temporary and permanent contracts more effectively. It would also hold the promise of a smoother transition from short to long-term employment.

The reform reinstates the pre-recession limit of 24 months on the duration of fixed-term contracts. While in theory this should improve incentives to hire permanent workers or convert temporary to permanent contracts, in practice it had little effect in the past. Moreover, it can be circumvented by firms through redefining the job and by rehiring workers on another temporary contract after an unemployment spell. In the medium term, introducing experience-rating of firms' contributions to the Unemployment insurance (UI) fund, as a complement to the introduction of a single contract proposed above, could reduce this incentive and eliminate this implicit subsidisation of temporary contracts. In such a system, employers' contributions to the unemployment insurance depend on the firm's dismissal history. At present, the government pays subsidies to small firms towards the cost of justified dismissals which amount to 40% of compensation in such cases. These subsidies are not an effective substitute for further reform of employment protection and may encourage excessive worker turnover at the expense of government finances. These subsidies should be abolished.

Improving firms' incentives for youth employment through more flexible collective bargaining

The collective bargaining system has had adverse effects on employment of young people

In Spain, firms have had limited leeway to adjust wages or working hours to economic conditions. This is due to a complex system of collective bargaining which takes place predominantly at the sectoral or regional level, and where bargaining outcomes are extended by law to all firms of the same sector or region, even if they are not represented in the agreement. Beyond the positive effects for overall employment and competitiveness as discussed above, making working conditions more flexible would be particularly helpful for hiring young people for the following reasons:

- Once firms are given more leeway in their wage setting, wages can again fulfil their role as price signal guiding workers and employers in their decision as concerns labour supply and demand, the matching of skills and jobs, or the investment in training or human capital accumulation (OECD, 2004).

- If firms cannot offer the median wage to new employees, which may be the case especially for smaller firms, they can attract young qualified people by making other working conditions more

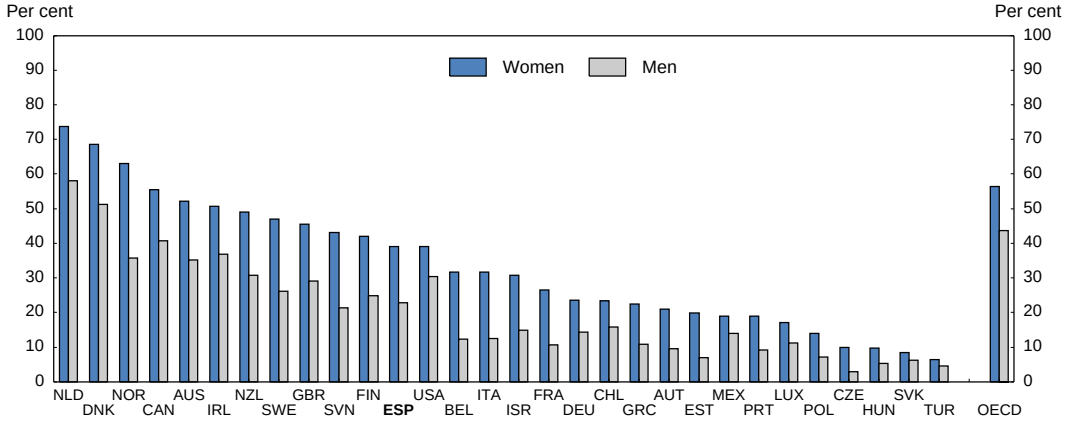
6. There are also some issues with interpretation of the new rule. For instance, a firm that had a 1% fall in revenue for three consecutive quarters would be able to dismiss workers while a firm that suffered a 30% fall in revenue for two consecutive quarters could not.

interesting. For instance, firms could more easily hire on part-time jobs, which would be attractive for those young people who want to continue with higher-level education or training. Part-time jobs would also make it easier for women with children to stay in work, which would have a double dividend as it would raise female participation in the labour force and increase potential growth. In the past, part-time work was relatively rare in Spain as compared to other countries (Figure 10), which was mainly linked to the rigid collective bargaining system where firms did not have much leeway in setting or changing working hours.

- Well functioning collective bargaining is not only an important factor for job creation in itself, but it is also a fundamental complement to other reforms, especially of employment protection described above. More flexible collective bargaining on the firm level would give firms an alternative to dismissing workers if things turn sour, hence would hire more easily on permanent contracts *a priori*. This could also make the subsidies for hiring on permanent contracts, including the new permanent contract for small enterprises, redundant (see above).

Figure 10. The use of part-time work is not very frequent

Percentage share of part-time employment in total dependent employment by sex, 15-24 year-olds, 2011



Source: OECD(2012), Labour Force Statistics database,November.

The 2012 reform should help

The government has been introducing reforms of the collective bargaining system since 2010, and also most recently in 2012 (Box 5). The 2012 labour market reform allows companies to reach firm-level collective agreements, removing the restrictions that sector-level bargaining could impose on such agreements. Firms can more easily opt-out from collective agreements, even if employers and workers fail to agree; in this case, binding arbitration procedures apply. Moreover, firms can unilaterally alter employment contracts. Finally, the reform limits to one year the maximum time period during which the conditions of a collective agreement remain in force beyond the period originally foreseen in the agreement.

These steps significantly improve flexibility of work conditions at the firm level which is welcome. Recent data show wage moderation is taking place: wage increases agreed in collective bargaining diminished in September to 1.3% and even further 0.3% in the case of new agreements Nevertheless, shortcomings remain. The limit of automatic extension provides social partners a stronger incentive to respond to changes in economic conditions, lowering to some extent the relevance of the legal extension. However, some collective wage agreements may still apply for up to 4 years as some are negotiated for 3 years and could be in force for another year following the originally foreseen end period. This could

make wages less responsive to economic conditions, although the measures described above improve flexibility and nominal year-on-year wage growth per worker fell to 0% in the second quarter 2012. For firms failing to reach a firm-level agreement, legal extension requires them to apply higher-level agreements.

Box 5. The 2012 reform of collective bargaining

One of the main building blocks of the 2012 labour market reforms concerns the collective bargaining system so as to enhance adaptability of firms to shocks. It also aims at reducing labour market duality by fostering the internal flexibility firms:

- It allows companies to reach a collective agreement with representatives of workers to establish relevant working conditions within the firm, most notably including basic salary, allowances and overtime compensation, or the distribution of working time. These firm-level agreements have priority vis-à-vis higher-level agreements.
- If there is no collective agreement on the firm-level, the new law aims to further facilitate opting out from higher level agreements. No further condition applies to opt-out as concerns working hours, wages, work location or functions, if the firm has suffered declining in revenues for two consecutive quarters as compared to the same periods of the preceding year. Opting out is also easier to justify for technical, organizational or production-related reasons. In particular, the law introduces obligatory arbitration if workers and employers do not agree on the conditions of the opt-out.
- If a firm suffers declining revenues over two consecutive quarters, it can unilaterally alter or suspend employment contracts beyond what was originally agreed between employers and workers. Changing a contract unilaterally by the employer is possible under economic, technical, organizational or production-related reasons – similar to dismissal for justified reasons (see above Box 4) and opting out. In case of disagreement with the decision of the employer, the employee may choose to charge compensation of 20 days per year worked and terminate the employment relationship or appeal before the Social Courts.
- The reform aims to encourage more flexible renegotiation of the agreements and reduce their inertia. It sets a maximum of one year (ultra-actividad) during which a former agreement is valid. If there was no new agreement within this one year, labor relations would be governed by the provisions of the agreement at higher levels. This would be a sectoral or regional agreement, or if also this is not renewed, the Workers' Statute.

High-level agreements may become more flexible to changes in economic conditions in response to the implemented reforms. Still, the outcomes of new firm-level agreements are likely to remain conditioned by legally extended sectoral agreements, as these will in most cases provide the fall-back option if a firm-level agreement is not reached. Another option to address these shortcomings could be to abolish the legal extension principle and replacing it with an opt-in system where employers decide *ex ante* whether to be represented in sectoral wage bargaining.

An opting-in system would in particular be preferable to the option under the new law for firms to unilaterally alter or even suspend employment contracts, under certain conditions, beyond what was originally agreed between employers and workers. The prospect of such *ex post* changes of working contracts may create uncertainty among workers – despite the existence of a court ruling that aims to increase legal certainty in the application of internal flexibility measures. Unnecessary uncertainty may also be introduced by new provisions which make it easier for firms to fire workers if they have been absent from the workplace, including in cases in which such absence is justified (*e.g.,* illness which is not work-related and of a duration of less than 20 days). For example, a justified absence of 9 days within a 2 month-period is a valid cause for justified dismissal. In the short-term, both types of uncertainty may harm consumer confidence, potentially resulting in a loss of activity. In the medium term, these rules may encourage inefficient human resource management within the firm, with perhaps adverse effects on productivity.

Box 6. Recommendations on improving employment prospects for young workers

Ensuring that youth-at-risk remain connected to the labour market

- Post-recession, abolish subsidies for hiring the unemployed on permanent contracts, and in any case, target them solely on the most disadvantaged or difficult to place youth.
- Provide the most disadvantaged youth access to closely monitored job-search assistance programmes and increase training measures.

Reinforcing the mutual obligation system of unemployment insurance

- Introduce comprehensive monitoring and evaluation of placement services and ALMP implementation at regional level based on quantitative output indicators.
- Start entitlement to unemployment benefits at registration and do not pay benefits retroactively from registration. Make the first intensive interview mandatory at the time of registration and increase the frequency of placement interviews. Reinforce the requirement for unemployed to take on a suitable job.
- In the longer term, the government may consider reducing the duration of unemployment benefits.

Reducing the early drop-out rate from education

- Narrow the criteria for granting pupils promotion to subsequent grades to those core competencies that are needed to follow any type of upper secondary education.
- Introduce loans with income-contingent repayments for tertiary education and by improve access to grants for students from socially disadvantaged families.

Improving upper secondary vocational education

- Combine school-based vocational education and training contracts within a single scheme, extend the period for which training contracts are signed, and provide work-based training through training contracts alternated with school-based training.
- Involve firms more strongly in the curriculum of school-based training and open up the teaching profession in vocational schools more widely to practitioners.

Ensuring that tertiary education graduates leave with skills demanded by the labour market

- Involve business actors more widely in bodies providing advice to educational policy authorities and in the governing councils of tertiary education institutions. Involve businesses also more strongly in identifying graduate competencies for the assessment of study programmes.
- Ensure that institutions have enough human resource autonomy so that they can more flexibly redeploy academic staff according to those programmes which best respond to labour market needs.
- Integrate higher vocational education into the tertiary education system.
- Central and regional governments should move towards an output based funding of tertiary education, based on objective indicators.

Helping the young to move from temporary to stable employment

- Further reduce severance pay for unjustified dismissal. If the reform does not prove effective in reducing duality substantially, a single contract with initially low but gradually increasing severance payments would help reduce the still large difference in dismissal costs between temporary and permanent contracts.
- Reduce the 1-year probationary period for small enterprises in line with other contracts.
- The subsidies to small firms towards their cost of justified dismissals should be abolished.

Improving firms' incentives for youth employment through more flexible collective bargaining

- An option to improve the flexibility to react to economic conditions is to abolish legal extension of higher level collective bargaining agreements or replace it by an opt-in system, where employers decide whether to be represented in sectoral wage bargaining.

Bibliography

Albert, C., C. Garcia-Serrano and V. Hernanz (2005), "Firm-provided training and temporary contracts", *Spanish Economic Review*, 7, 67–88 (2005).

Arellano, M., S. Bentolila and O. Bover (1998), "Unemployment Duration, Benefit Duration and the Business Cycle", *CEPR Discussion Paper*, No. 1840, Centre for Economic Policy Research, London.

Arulampalam W. And A. L. Booth (1998), "Training and labour market flexibility: is there a trade-off?" *British Journal of Industrial Relations* 1998; 36:521-536.

Bentolila, S., J. J. Dolado and J. F. Jimeno (2008), "Two-Tier Employment Protection Reforms: The Spanish Experience", *CESifo DICE Report*, Vol. 6, No. 4, CESifo Group, Munich.

Bundesagentur für Arbeit (BfA,2012), Ausbildung von A bis Z, Nürnberg.

De la Rica, S. (2004), "Wage Gaps between Workers with Indefinite and Fixed-Term Contracts: The Impact of Firm and Occupational Segregation", *Moneda y Crédito* 219, 43-69.

De Serres, A., F. Murtin, and C. de la Maisonneuve (2010), "Policies to Facilitate the Return to Work," *Economics Department Working Paper*, OECD.

Dolado, J.J. and R. M. Stucchi (2008), "Do Temporary Contracts Affect TFP? Evidence from Spanish Manufacturing Firms". *IZA Discussion Papers* 3832.

Dolado, J., F. Felgueroso, M. Jensen, A. Fuentes and A. Wölfl (2012),"Youth labour market performance in Spain and its determinants - a micro-level perspective", forthcoming as *OECD Economics Department Working Papers*, Paris.

Education, Audiovisual and Culture Executive Agency (Eurydice, 2012), "The European Higher Education Area in 2012": *Bologna Process Implementation Report*, Brussels.

El Pais (2012), « El PP endurece la reforma laboral al acortar la prórroga de los convenios » http://economia.elpais.com/economia/2012/05/24/actualidad/1337853481_327630.html.

Felgueroso, F., M. Hidalgo and S. Jiménez-Martin (2010), "Explaining the fall of the skill wage premium in Spain", *Fedea Working paper*, Madrid.

García-Pérez, J.I., M. Hidalgo-Hidalgo and J. A. Robles-Zurita (2011), "Does grade retention affect achievement?" Some evidence from PISA, *University Pablo de Olavide Working Paper*,Sevilla.

Höckel, K. (2008), "Costs and benefits in Vocational Education and Training", OECD Publishing**.**

Krause, M. U. and T. A. Lubik (2007), "On-the-job-search and the cyclical dynamics of the labour market", *ECB Working Paper* No. 779, July 2007, Frankfurt.

Kuczera, M., G. Brunello, S. Field, N. Hoffman (2008), "A Learning for Jobs Review of Norway", OECD Publishing Paris

Martin, J.P. and D. Grubb (2001), "What works and for whom: a Review of OECD Countries' Experiences with Active Labour Market Policies", *Swedish Economic Policy Review*, Vol. 8, No. 2.

Mas-Ivars, M. and J. C. Robledo Domínguez (2010), "Productividad. Una perspectiva internacional y sectorial, Fundación BBVA", Madrid.

Mertens, A., V. Gash and F. McGinnity (2005), "The Cost of Flexibility at the Margin". Comparing the Wage Penalty for Fixed-Term Contracts in Germany and Spain using Quantile Regression.

Ministerio de Educación, de Cultura y Deporte (MECD, 2012), www.educacion.gob.es/educacion/que-estudiar-y-donde/educacion-secundaria-obligatoria.html).

Ministerio de Empleo y Seguridad Social (MESS, 2012), *Bulletin of Labour Market Statistics*.

Ministerio de Trabajo y Immigración (MTI, 2008), "Overview of the Vocational Education and Training System – Spain".

Mohrenweiser, J. and T. Zwick (2009), "Why do firms train apprentices? The net cost puzzle reconsidered, in: Labour Economics", 16 (2009) 631-637, Elsevier.

Mora-Sanguinetti, J.S., and A. Fuentes (2012), "An analysis of productivity performance in Spain before and during the crisis: exploring the role of institutions", *OECD Economics Department Working Papers,* No. 973, OECD Publishing.

Muehlemann, S., H. Pfeifer, G. Walden, F. Wenzelmann, S.C. Wolter (2010), "The financing of apprenticeship training in the light of labour market regulations", in: *Labour Economics* 17 (2010) 799-809.

National Institute for Statistics (INE, 2012), *Labour force statistics*.

OECD (2004), "Wage-setting Institutions and Outcomes", Chapter 3 of 2004 *OECD Employment Outlook*, OECD Publishing.

OECD (2006), *OECD Employment Outlook* 2006, OECD Publishing.

OECD (2007), "Jobs for Youth", Spain, OECD Publishing.

OECD (2008), *OECD, Economic Survey of Spain*, OECD Publishing.

OECD (2009a), *OECD Reviews of Tertiary Education*, OECD Publishing.

OECD (2009b), "How do Industry, Firm and Worker Characteristics Shape Job and Worker Flows?" Chapter 2 in: 2009 *OECD Employment Outlook*, OECD Publishing.

OECD (2010a), "Off to a Good Start, Jobs for Youth", OECD Publishing.

OECD (2010b), *OECD, Economic Survey of Spain*, OECD Publishing.

OECD (2010c), *OECD Employment Outlook*, OECD Publishing.

OECD (2010d), "Learning for the Job – OECD Reviews of Vocational Education and Training," OECD Publishing.

OECD (2011a), Pisa in focus 2011/6, OECD Publishing.

OECD (2011b), *Education at a Glance*, OECD Publishing.

OECD (2011c), "Right for the Job: Over-qualified or Under-skilled?", Chapter 4 in *OECD Employment Outlook*, OECD Publishing.

OECD (2011d), *Benefits and wages – Spain 2010*, OECD Publishing.

OECD (2012a), "Equity and quality in education: supporting disadvantaged students and schools". OECD Publishing.

OECD (2012b), "OECD Reviews of Vocational Education and Training – a commentary on Spain", forthcoming,

OECD (2012c), *Education at a Glance*, OECD Publishing.

OECD (2012d), *OECD Economic Survey of Spain*, OECD Publishing.

Scarpetta, S., A. Sonnet and T. Manfredi (2010), "Rising Youth Unemployment During the Crisis: How to Prevent Negative Long-term Consequences on a Generation?", *OECD Social, Employment and Migration Working Papers*, No. 106, OECD, Paris.

Wolter, S.C., P. Ryan (2011), "Apprenticeship, in: Handbook of the Economics of Education", Vol. 3, Elsevier.

WORKING PAPERS

The full series of Economics Department Working Papers can be consulted at www.oecd.org/eco/workingpapers/

1039. *Youth labour market performance in Spain and its determinants - a micro-level perspective*
(March 2013) by Juan J. Dolado, Marcel Jansen, Florentino Felgueroso, Andrés Fuentes and Anita Wölfl

1038. *The efficiency and equity of the tax and transfer system in France*
(March 2013) by Balázs Égert
Efficacité et équité du système de prélèvements et de transferts en France
(mars 2013) par Balázs Égert

1037. *Income inequality and poverty in Colombia. Part 2. The redistributive impact of taxes and transfers*
(March 2013) by Isabelle Joumard and Juliana Londoño Vélez

1036. *Income inequality and poverty in Colombia. Part 1. The role of the labour market*
(March 2013) by Isabelle Joumard and Juliana Londoño Vélez

1035. *Policy options to durably resolve euro area imbalances*
(March 2013) by Yvan Guillemette and Dave Turner

1034. *Labour market, welfare reform and inequality in the United Kingdom*
(March 2013) by Christophe André, Clara Garcia, Giulia Giupponi and Jon Kristian Pareliussen

1033. *Work incentives and Universal Credit – reform of the benefit system in the United Kingdom*
(March 2013) by Jon Kristian Pareliussen

1032. *Strengthening social cohesion in Luxembourg: making efficiency and equity go hand in hand*
(March 2013) by Jean-Marc Fournier and Clara Garcia

1031. *The price of oil – Will it start rising again?*
(March 2013) by Jean-Marc Fournier, Isabell Koske, Isabelle Wanner and Vera Zipperer

1030. *The system of revenue sharing and fiscal transfers in China*
(February 2013) by Xiao Wang and Richard Herd

1029. *The declining competitiveness of French firms reflects a generalised supply-side problem*
(February 2013) by Hervé Boulhol and Patrizio Sicari

1028. *Do the overall level and dispersion of socio-economic background measures explain France's gap in PISA scores?*
(February 2013 by Hervé Boulhol and Patrizio Sicari

1027. *Labour market performance by age groups: a focus on France*
(February 2013) by Hervé Boulhol and Patrizio Sicari

1026. *Moving towards a single labour contract: pros, cons and mixed feelings*
(February 2013) by Nicolas Lepage-Saucier, Juliette Schleich and Etienne Wasmer

1025. *Boosting productivity in Australia*
(January 2013) by Vassiliki Koutsogeorgopoulou and Omar Barbiero

1024. *Housing, financial and capital taxation policies to ensure robust growth in Sweden*
(January 2013) by Müge Adalet McGowan

1023. *Labour market and social policies to foster more inclusive growth in Sweden*
(January 2013) by Stéphanie Jamet, Thomas Chalaux and Vincent Koen

1022. *Educational attainment and labour market outcomes in South Africa*, 1994-2010
(January 2013) by Nicola Branson and Murray Leibbrandt

1021. *Education quality and labour market outcomes in South Africa*
(January 2013) by Nicola Branson and Murray Leibbrandt

1020. *Do policies that reduce unemployment raise its volatility? Evidence from OECD countries*
(January 2013) by Alain de Serres and Fabrice Murtin

1019. *Slovakia: A catching up euro area member in and out of the crisis*
(January 2013) by Jarko Fidrmuc, Caroline Klein, Robert Price and Andreas Wörgötter

1018. *Improving the fiscal framework to enhance growth in an era of fiscal consolidation in Slovakia*
(January 2013) by Caroline Klein, Robert Price and Andreas Wörgötter

1017. *Investing efficiently in education and active labour market policies in Slovakia*
(January 2013) by Caroline Klein

1016. *The performance of road transport infrastructure and its links to policies*
(January 2013) by Henrik Braconier, Mauro Pisu and Debra Bloch

1015. *The US labour market recovery following the great recession*
(January 2013) by Wendy Dunn

1014. *Why do Russian firms use fixed-term and agency work contracts?*
(December 2012) by Larisa Smirnykh and Andreas Wörgötter

1013. *The Equity implications of fiscal consolidation*
(December 2012) by Lukasz Rawdanowicz, Eckhard Wurzel and Ane Kathrine Christensen

1012. *The Dutch labour market: preparing for the future*
(December 2012) by Mathijs Gerritsen and Jens Høj

1011. *Reforming policies for the business sector to harvest the benefits of globalisation in the Netherlands*
(December 2012) by Mathijs Gerritsen and Jens Høj

1010. *Health care reform and long-term care in the Netherlands*
(December 2012) by Erik Schut, Stéphane Sorbe and Jens Høj