

# 1. Executive Summary

The institutional design of the Spanish labor market responds to a model that is today outworn, whose origins date back to almost the middle of the twentieth century. At that time, the Spanish economy was in the midst of a belated industrialization process that required mainly manual labor. In contrast, the services sector, which is the star performer in a modern information economy, barely hinted that it would ever gain the significance it now has.

There is no doubt that the labor market in 2009 is not exactly the same as it was 40 or 50 years ago, since there have been various specific reforms. However, its structure remains largely unchanged. Accordingly, half a century later, we find an open economy with a high degree of tertiarization and a shortfall of solutions to meet the challenges that have arisen in the last 20 years. Our young democracy, hampered by the reticence of the *status quo*, has not been able to bravely tackle the transformation required in the labor market, and has confined its actions to a series of make-shift solutions that have failed to solve the underlying problems.

At all events, there is no denying that one of the most positive characteristics in Spain's long-enduring growth phase, which has now come rudely to an end, has been the fast pace of job creation. In the period between 1995 and 2007, no fewer than eight million jobs were created, bringing the employment figures to record levels above 20 million people. This job creation capacity integrated five million immigrants and facilitated the recent incorporation of many Spanish women into the labor market. Furthermore, it pushed unemployment figures down to levels not seen for decades in Spain.

However, this excellent performance by employment rates has been neither sustainable nor sufficient to solve **various structural and circumstantial problems which have been afflicting the labor market** in Spain for a long time. Despite unemployment levels being slashed to record lows, they remain higher in Spain than in the rest of Europe. Indeed, the Spanish lows are above the highs of many of our European neighbors. Furthermore, **the surge in job creation has focused substantially on temporary employment**, to the point where almost one-third of salary-earners have been hired on temporary contracts. This gives rise to a **dual market**, which is segmented and has scant connections and rarely coinciding interests. Certain groups, like young people, have continually endured double-digit

jobless rates. In the meantime, while some regions enjoyed full employment, in other areas the unemployment rate did not, at best, dip below 12% or 13% of the active population, an evident sign of a **lack of geographical mobility** which might be added to the **insufficient functional mobility**, a perverse consequence of the numerous and partial regulations that co-exist in Spain.

Many of the problems in the labor market interact with defects in the model used by the Spanish economy to grow. One consequence of this interaction has been the **extremely slow progress –if not backward movement– in productivity** during the growth phase, which has turned into job destruction in the current recession. Indeed, growth in Spain's GDP was based on sectors that use a lot of unskilled labor, such as construction and certain services, but in which gains in productivity are scant, among other reasons because of the poor use they make of human capital, in which not enough has been invested either. In fact, Spain stands out for its **high ratios of over-qualification** among workers, especially immigrants. There is also a notable **shortage of practical and intermediate qualifications**, and this is the main reason why there is a clear duality, with an abundance of university graduates and workers with little training, and a shortage of people with sound technical training.

The presence of these problems during such an expansive phase as the one that recently ended might be explained in particular by the fact that the growth model is obsolete. It is a model with **structural deficiencies, including several faults in the institutional framework of the labor market, which lead to inefficiencies and imbalances between supply and demand**. Institutions like **collective bargaining, the regulation of contracts or the system of active employment policies** are indispensable for the good operation of this market, in other words, for the creation of stable and productive employment. However, **they require a suitable design which, as well as other objectives such as the defense of workers' rights, guarantees the necessary flexibility in a global and competitive environment the essence of which is distinctly dynamic**. In our case, we are far from such a design. A number of public and private bodies coincide in pointing to the labor market in Spain as one of the most rigid, not only among our neighbors, but in the whole world. The World Bank actually ranks Spain no less than 160<sup>th</sup> in the world in terms of labor market flexibility. For its part, the OECD identifies Spanish regulation in those markets as one of the most restrictive of all developed countries.

**The disastrous consequences of this unsuitable design of the labor market are now taking their toll as the Spanish economy is in a recession which,**

according to the IMF, the European Commission and other bodies, threatens to prove much deeper and longer than the government's optimistic projections suggest. The situation is serious. **The decline in production is destroying jobs at a much faster rate than in other economies** in similar recession conditions. The unprecedented speed of this adjustment in employment levels suggests that there is something wrong with our labor market, making its performance notoriously worse than that of other nations, and rapidly exhausting our growth model.

*Círculo de Empresarios* has referred in the past to the structural defects of the Spanish labor market, proposing formulae for its reform, as have other bodies (such as the OECD or Bank of Spain). Now, **in view of the seriousness of the current crisis and the urgent need for a change of competitive model**, it is time to insist on this message which we have already put forward repeatedly in the last few years<sup>1</sup>. *Círculo de Empresarios* believes that it is essential to introduce **far-reaching labor reform**, that will favor the various economic agents (workers, companies and government administrations) **to re-launch job creation and resume the productivity gains that will set Spain on the road to healthy and sustained growth.**

**The benchmark** for this reform is **flexicurity**, the labor market model which combines a high level of flexibility, sound protection for the unemployed and efficient active employment policies, that truly stimulate job creation. It is a model to which the European Union has made a firm commitment and which various of its member countries have introduced, adapting it to the specific characteristics of each one. In Spain's case, it seems advisable to make the necessary regulatory changes to **improve three key institutional elements: type and characteristics of labor contracts, active employment policies and the collective bargaining system.**

As regards the first of these action lines, **the contractual framework**, the following reforms should be implemented, **not retroactively, in other words, applicable only to new contracts:**

- **Reduce the variety of contract types**, in a process of **convergence towards a single contract type**, to eliminate the substantial degree of duality between indefinite and temporary employment.

<sup>1</sup> *Círculo de Empresarios* (2005) "Spain and the New Paradigm of Competitiveness" (*España ante el nuevo paradigma de la competitividad*), *Círculo de Empresarios* (2008) "Next stop: The Information Economy" (*Próxima parada: la Economía del Conocimiento*) and *Círculo de Empresarios* (2009) "Entrepreneurial Spirit: Crucial for Tackling the Economic Crisis in Spain" (*El espíritu emprendedor: elemento esencial para afrontar la crisis económica Española*).

- **Simplify and reduce the number of labor categories** in existence, so that they reflect the skill levels recognized by the market, in order to boost workers' flexibility and multi-skilling.
- **Render modification of contractual conditions (working hours, duties, etc.) more flexible:** the existing regulations prevent these conditions from being adjusted in response to the company's needs and the employees' capacities.
- **Develop an instrument that enable us to focus on three objectives at the same time: provide coverage to workers whose labor contracts have terminated, lessen the impact of this contingency for the company, and provide incentives for workers' mobility.**
- **Foster part-time work,** easing the requirements and costs which this contractual formula presents in current regulations, in order to boost growth in the active population.

As regards **active employment policies**, reforms should include the following measures to give incentives for and facilitate the active search for work:

- **Redistribute spending on active policies,** so as to use more resources for intermediation policies and placement management, which have proved to be more effective and efficient elsewhere.
- **Introduce mechanisms for highly professionalized business management** in the public employment system.
- **Unify, through coordination,** the various components of the public employment service.
- **Boost competition in the provision of services** linked to intermediation between job supply and demand. The idea here is not to relegate the public employment service. Quite the contrary, it must be a stimulus to improve this service, not only through competition, but through cooperation and being supplemented by private employment agencies, as in neighboring countries.

Lastly, with respect to **collective bargaining**, the following would be positive measures:

- **Foster business agreements and higher level agreements:** in the current system, intermediate level agreements prevail, which do not yield either the advantages of centralization or those of decentralization in negotiations.
- **Enhance representation of worker groups** (temporary workers, unemployed) which in the current system scarcely have any weighting in collective bargaining.
- **Increase flexibility in applying opt-out clauses.**
- **Suppress automatic index-linking and implement pay review systems linked to productivity.**

All of these fronts must be tackled in a coordinated and coherent manner, in order to transform a market that is atrophied and obsolete into one capable of generating stable employment and prosperity.