

# Reforming an Insider-Outsider Labor Market: The Spanish Experience\*

Samuel Bentolila  
CEMFI

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\* Joint work with Juan J. Dolado (U. Carlos III) and Juan F. Jimeno (Bank of Spain)



## Goal

Discuss the political economy of the 2010-2011 Spanish labor market reforms

Namely, explain why a reform that seemed so hard to achieve before the Great Recession was undertaken during it

## Bottomline

It was a crisis-induced reform, triggered by international financial markets

The nature of the trigger determined the limited nature of the reform, begetting the need for further reforms (soon)



# Plan

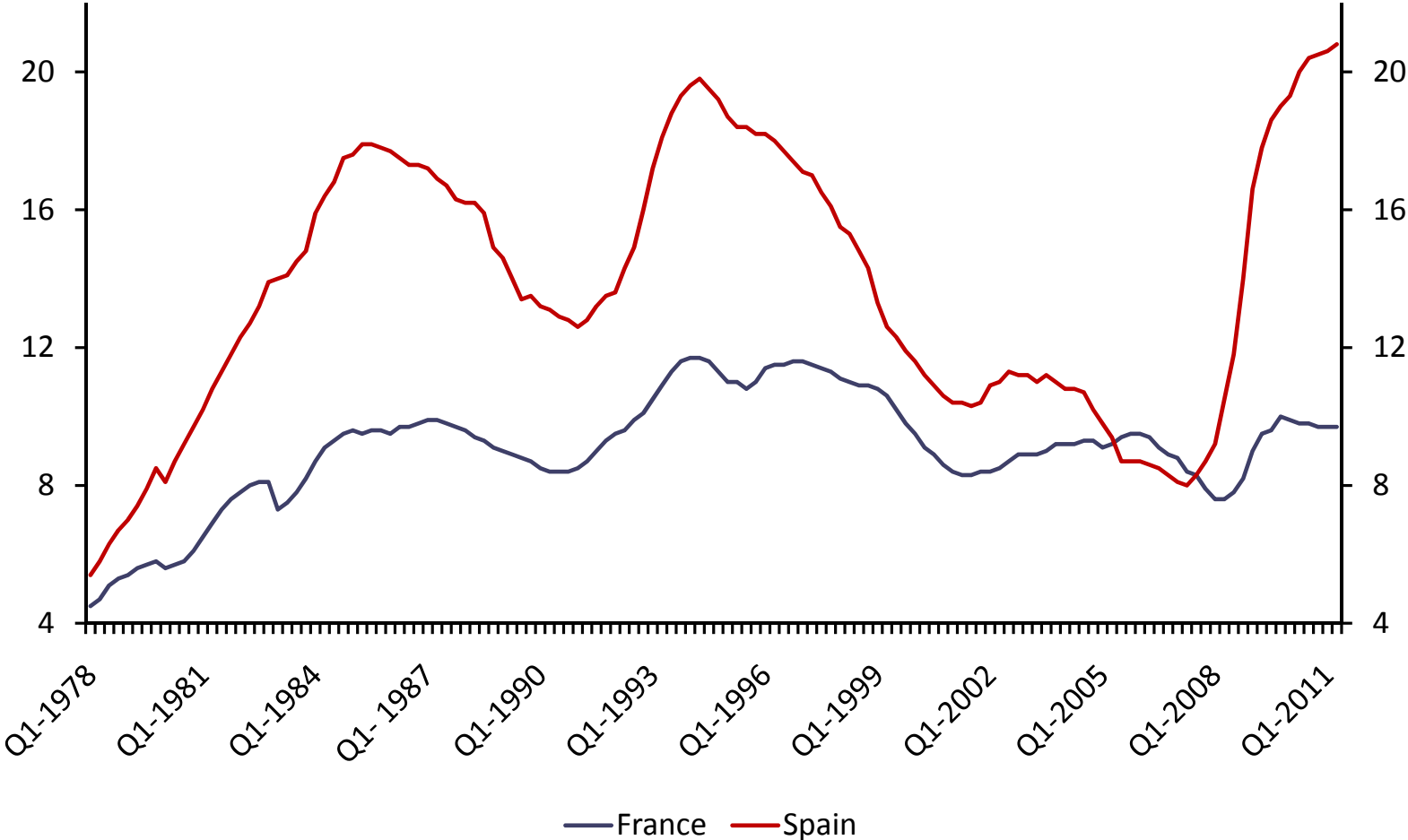
1. The need for reform (in the paper, really)
2. Political economy of reform
3. Crisis-induced reform
4. Now what?



The need for reform

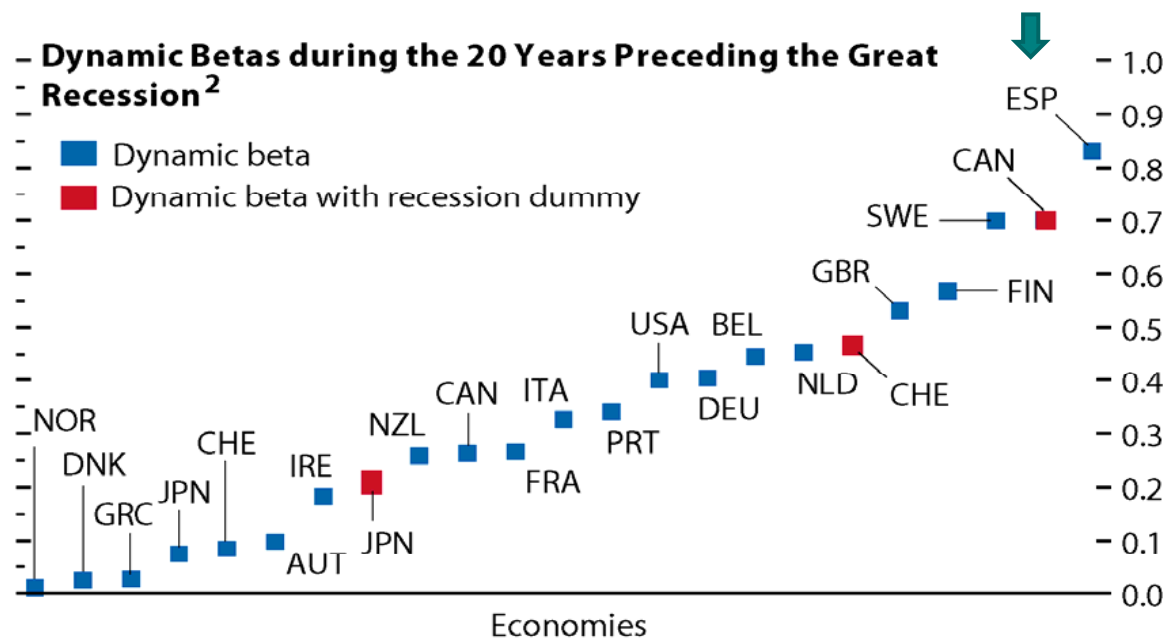
# Unemployment as a structural problem

OECD-Harmonized unemployment rate (%)



1. The need for reform

## Volatility: The highest long-run response of unemployment to output in the OECD



Source: IMF staff calculations.

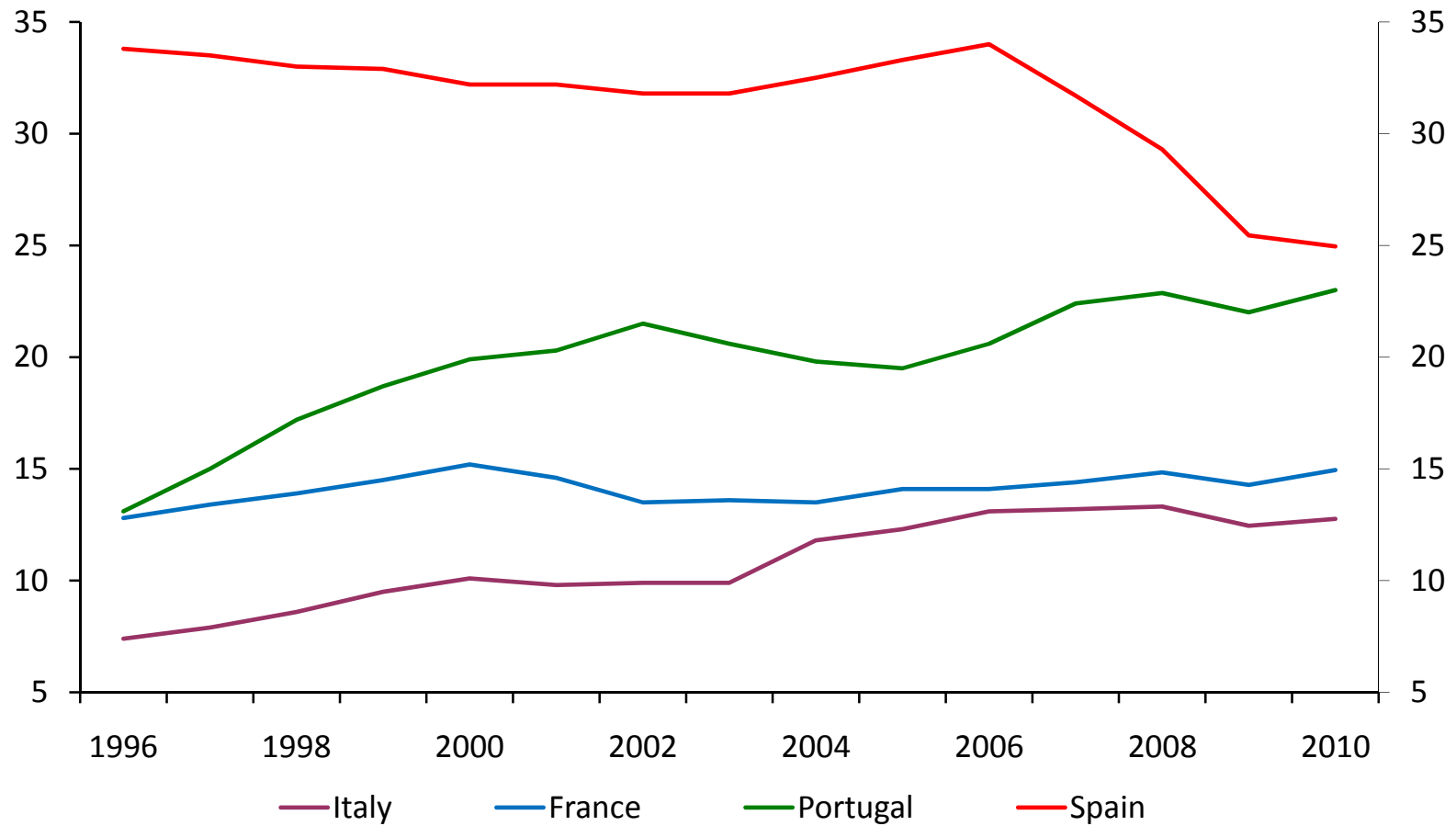
IMF *World Economic Outlook*, April 2010.

where: Dynamic Beta =  $(\beta_0 + \beta_1) / (1 - \gamma_1)$ , from  $\Delta u_t = \alpha + \beta_0 \Delta y_t + \beta_1 \Delta y_{t-1} + \gamma_1 \Delta u_{t-1} + \varepsilon_t$

1. The need for reform

## Two-tier labor market...

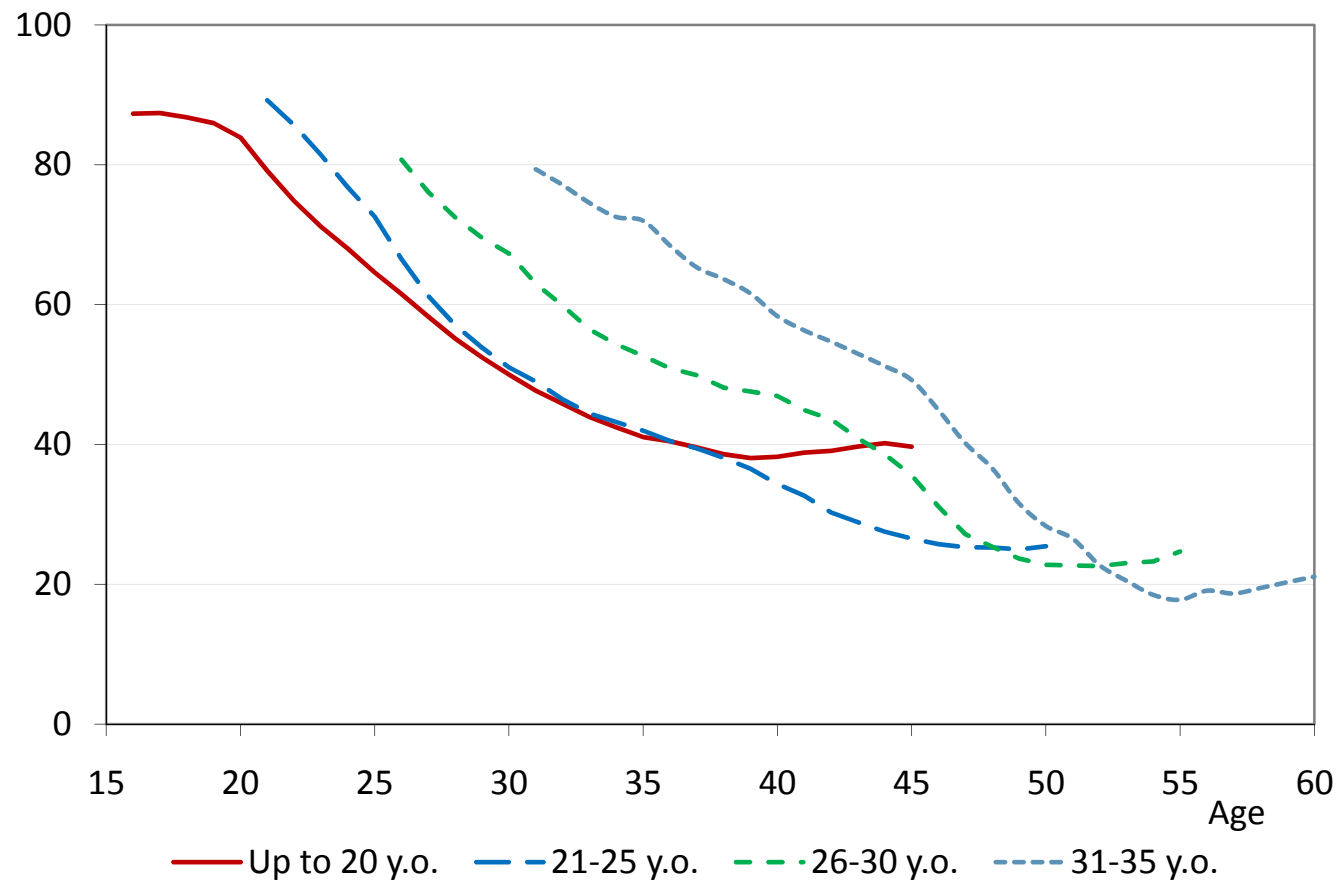
Temporary jobs as a share of employees (%)



1. The need for reform

## ... giving youth no hope of a professional career

Share of workers remaining in temporary jobs by entry cohort (1990-2009)



1. The need for reform





# Political economy of reform

## 1. Background: Main reforms

- 1975 **Franco's legacy:** High severance pay (SP) and judicial protection, no collective bargaining (CB), low unemployment insurance (UI)
- 1980 **Workers' Statute:** New institutions (SP, CB, UI)
- 1984 **Temporary labor contracts** regulation relaxed
- 1992 Reduction in generosity of **unemployment benefits**
- 1994 Restrictions on **temporary contracts**, more scope for collective bargaining
- 1997 New **permanent contract** with lower severance pay
- 2002 Firms allowed to **dismiss** at penalty severance pay without advance notice and without going to court

## 2. Political economy of reform

## 1. Background: EPL and collective bargaining

### Employment protection legislation

- Dismissal for economic reasons blocked by labor courts
- High severance pay for permanent (45 days, unfair), very low for temporary (8 days)
- Collective dismissals subject to authorization (so: unions)

### Collective bargaining

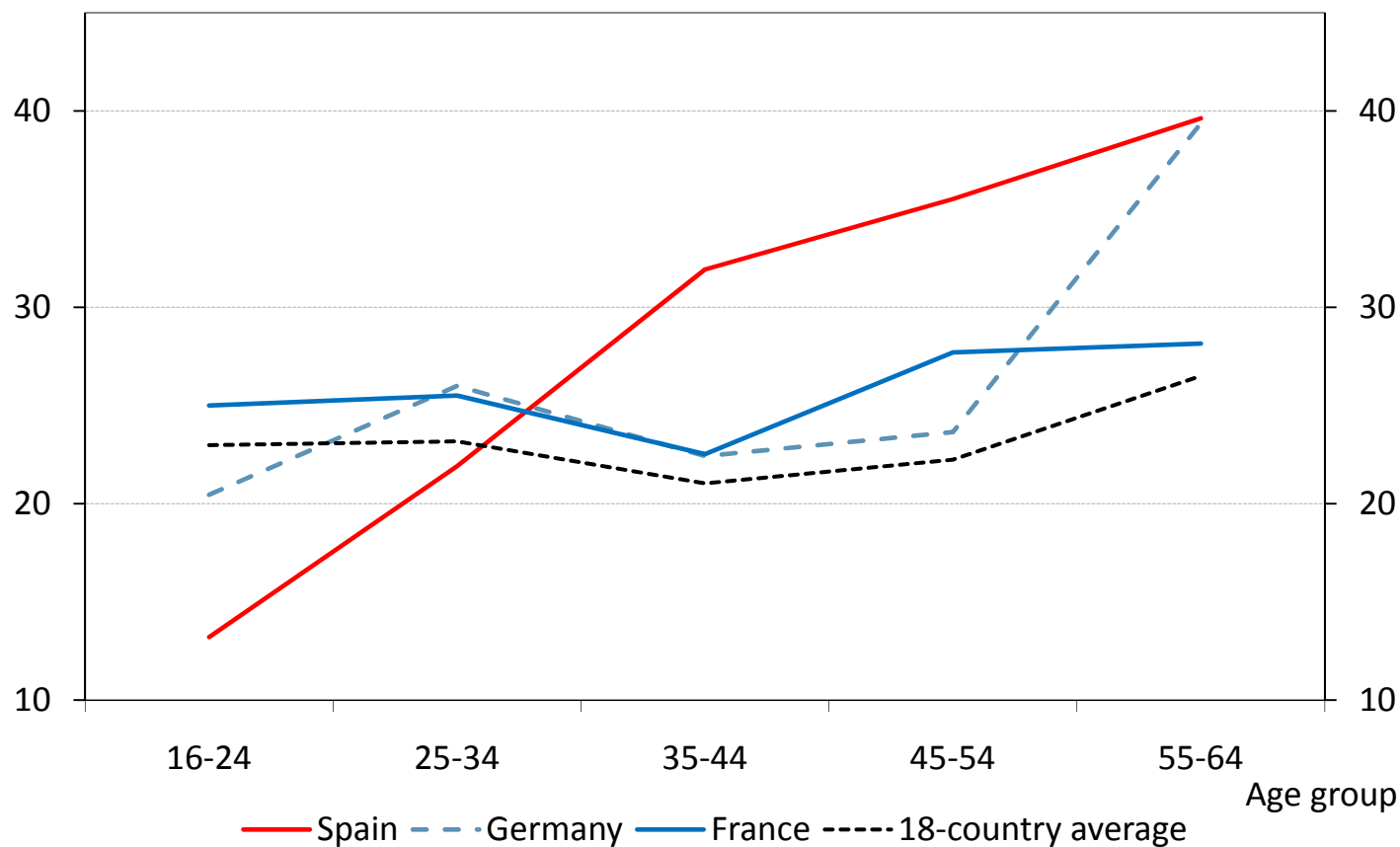
- Low affiliation (15%) & high coverage (80%), 10% enough
- Bargaining is industry-level with regional component
- Automatic extension to all workers and firms in industry
- High indexation to CPI (65%)
- Frequent social pacts

## 2. Political economy of reform



### 3. Perceptions of insecurity

Share of respondents agreeing with the statement “My job is secure”



*The largest differential in perceived insecurity between old and young*

## 4. Political support for reform

Share agreeing with “Contracts should be more flexible to incentivize job creation” (%)

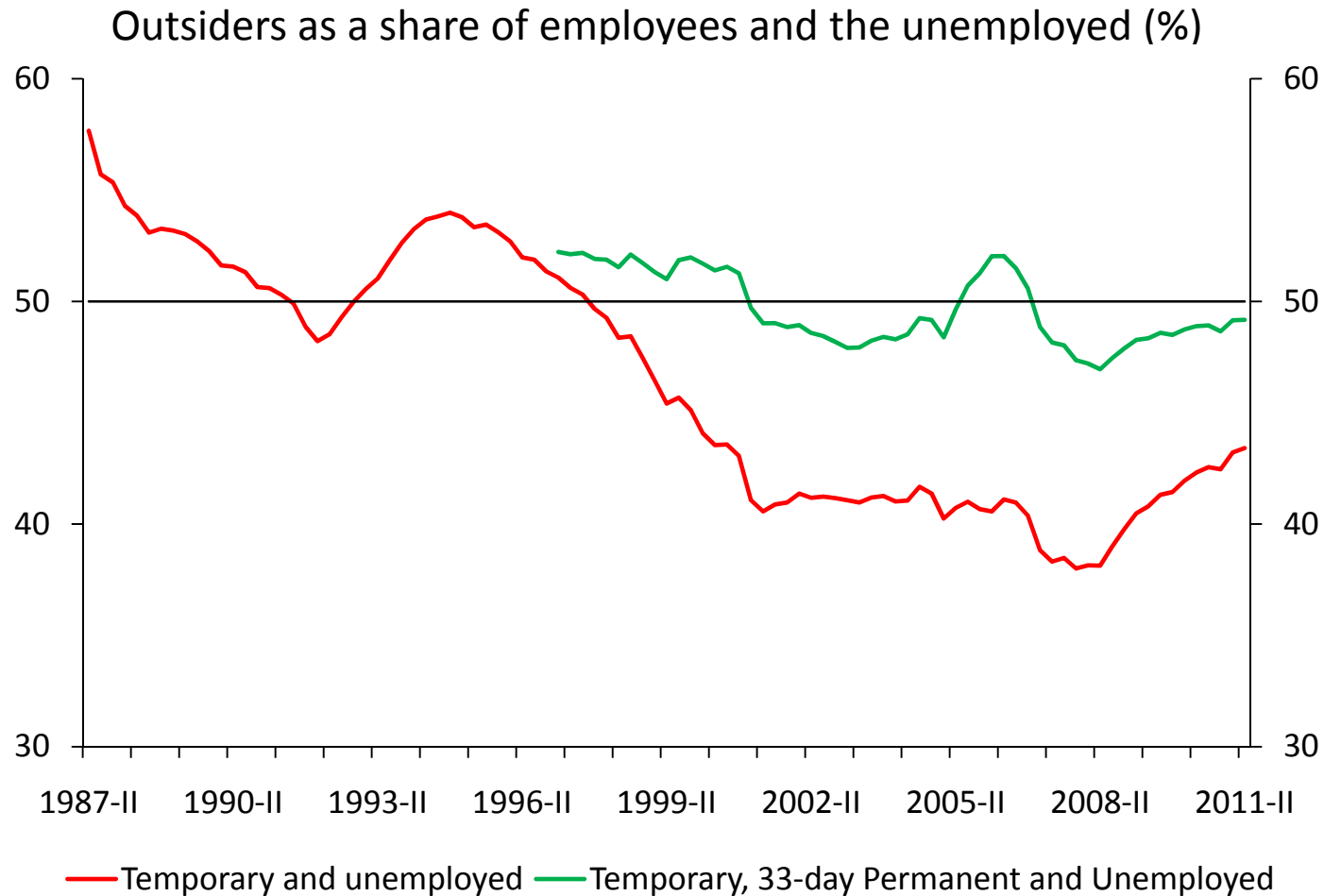
	Spain	EU-15
Population 16 years old and over	61.2	71.2
16-24 years old	64.9	71.2
45-54 years old	58.8	68.6
Lost their jobs during the crisis	70.3	73.5
Did not lose their jobs during the crisis	60.0	70.5
Self employed/Entrepreneurs	67.2	77.4
Managers	62.2	68.5
Professionals (employees)	65.3	73.6
Other skilled employees	51.0	67.3
Low-skill employees	69.3	71.2
Unemployed	69.6	72.6

Source: Eurobarometer, May-June 2009.

*Groups more in favor of reform are not the most influential/median voter*

2. Political economy of reform

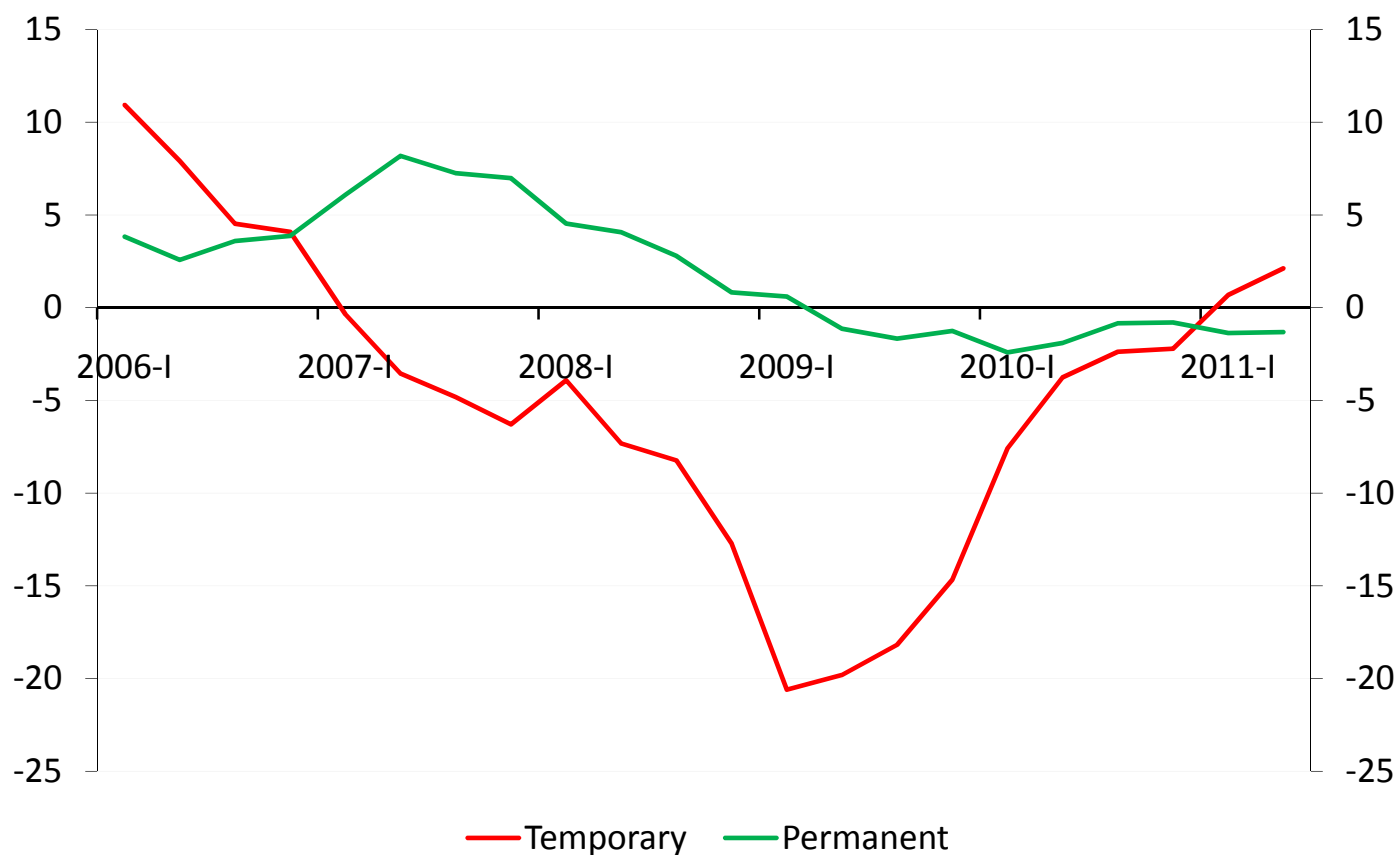
## 4. Political support for reform



*Potential support for flexibility is still below a clear majority*

## 4. Political support for reform

Exposure of insiders: Employment growth rate (% variation on a year before)



*Limited employment losses of insiders, even several years into the recession*

2. Political economy of reform

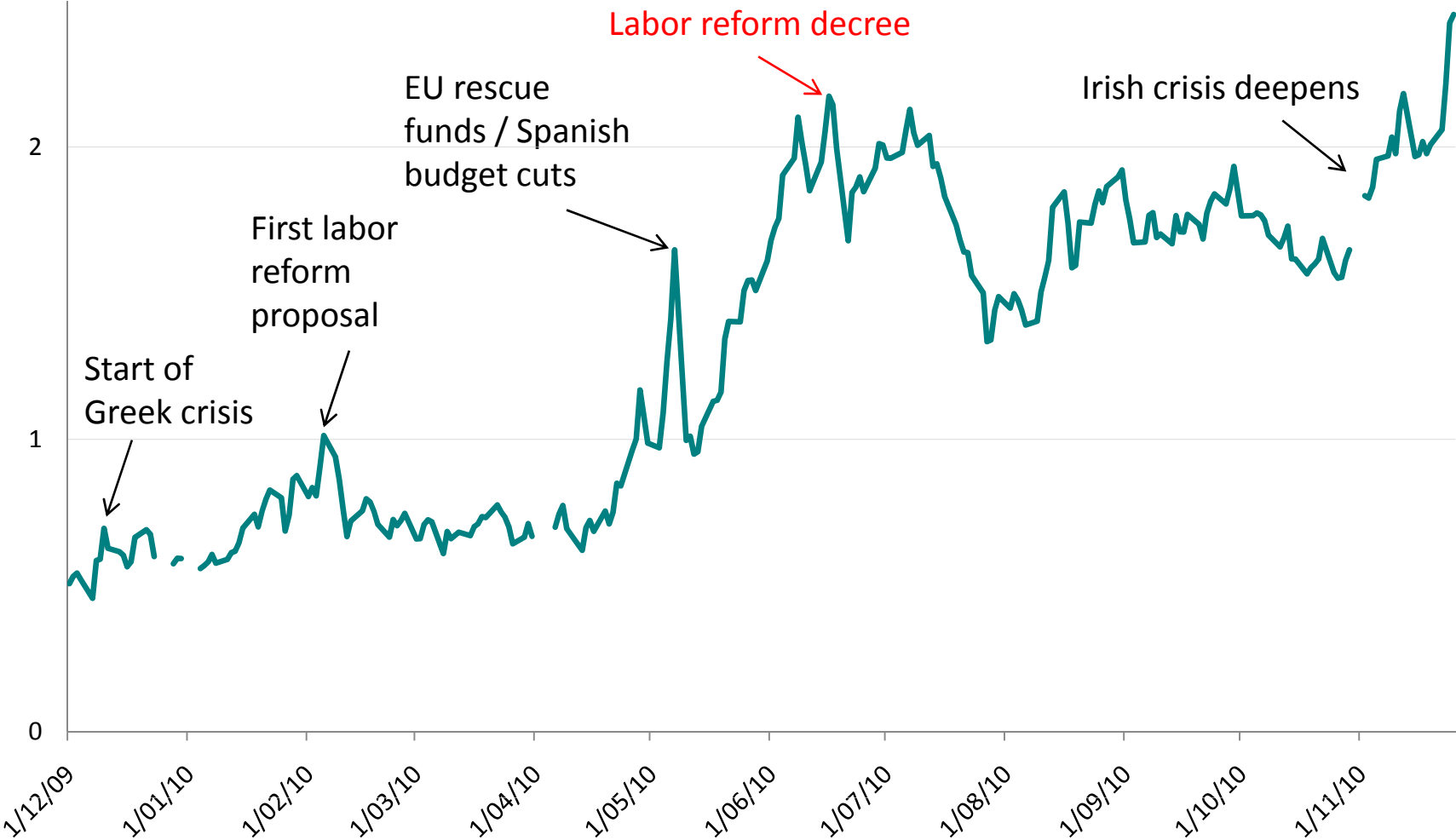




Crisis-induced reform

# 1. What triggered the 2010 reform?

Differential yield between Spanish and German 10-year bond





## 2. Content of reforms

### Employment protection (2010)

1. **Economic reasons:** Include current or expected losses.  
Advance notice shortened from 30 to 15 days
2. **New permanent contract:** Severance pay reduced to 33 days of wages per year of service, without going to court (previously 45 days through disciplinary dismissal)
3. **Temporary contracts:** Gradually increasing severance pay from 8 days of wages p.y.s. to 12 days in 2015

## 2. Content of reforms

### Collective bargaining (2010 and 2011)

1. Firms under stress can **opt out** of the industry collective-bargain wage *level* with agreement of workers, but **must go back to it in no more than 3 years**
2. **Firm-level agreements:** Priority vis-à-vis the industry-wide agreement , regarding wages and key working conditions, *unless it is undone by industry-wide agreements*
3. **Compulsory arbitration** of non-renewed coll. agreements *unless it is undone by industry-wide agreements*
4. For most working conditions, **union committee**, not worker committee, become the employer's counterpart

### 3. What type of reform?

It includes measures that labor unions dislike, but it was made more palatable by **reducing its scope**, in particular by:

- Leaving the core of the two-tier system in place
- Leaving changes in regulation of collective bargaining in the hands of industry-level bargainers (unions and employer associations) – uncertain outcome as of today

Introducing **insider-protecting measures**:

- Subsidies for reduced hours (as opposed to dismissals)
- Backtracking on limitations on chaining of temp contracts
- Increasing the chances that workers will challenge individual dismissals in court



Now what?

## 1. An alternative package

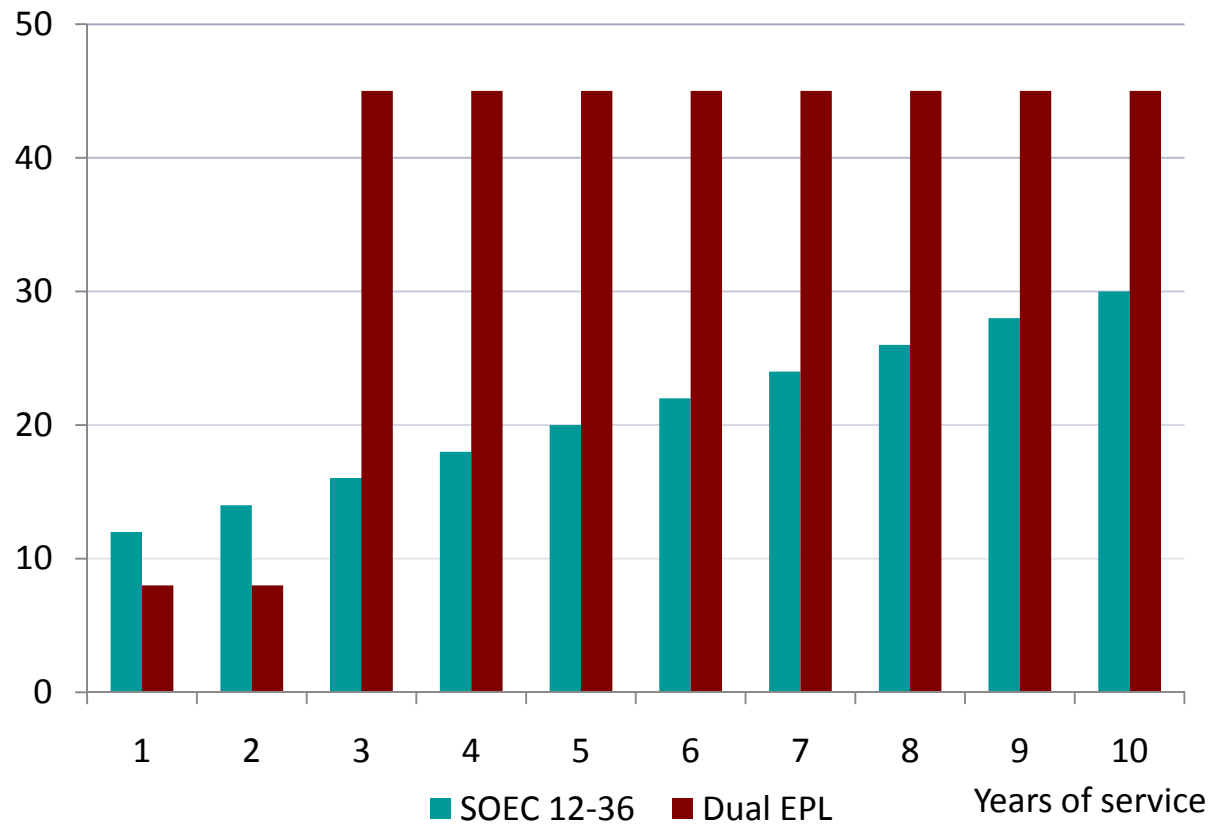
- A. Employment protection: a single, permanent labor contract with severance (p.y.o.s.) increasing with seniority
- B. Collective bargaining: decentralization, deindexation, limitations on duration, competitiveness guidelines
- C. Unemployment benefits: increase initial generosity with steeper downward slope, link to ALMP
- D. Active Labor Market Policies: focus on less skilled workers, assess rigorously their results

“A proposal to restart the Spanish labour market”, signed by 100 academic economists (April 2009); “Guidelines for a comprehensive reform of the collective bargaining system in Spain” (March 2011), signed by 13 academic economists. [www.fedea.es](http://www.fedea.es)

4. Now what?

## 2. The single open-ended labor contract (SOEC)

Marginal severance pay of dual EPL and SOEC



4. Now what?



## 2. The single open-ended labor contract (SOEC) - References

### International proposals

- France: Blanchard and Tirole (2003) and Cahuc and Kramarz (2004)
- Italy: Boeri and Garibaldi (2008) and Ichino (P.) *et al.* (2009)
- Spain: Bentolila, S., J.J. Dolado, and J. F. Jimeno (2008), “Two-Tier Employment Protection Reforms: The Spanish Experience”, CESifo DICE Report 4/2008.
- “A proposal to restart the Spanish labour market”, 100 economists (April 2009)

### Related analyses (see paper)

- Bentolila, S., P. Cahuc, J.J. Dolado, and T. Le Barbanchon (2011), “Two-Tier Labor Markets in the Great Recession: France vs. Spain”, mimeo, CEMFI.
- Costain, J., J. F. Jimeno, and C. Thomas (2010), “Employment Fluctuations in a Dual Labor Market”, Banco de España Working Paper 1013.
- García Pérez, J.I. and V. Osuna (2011), “The Effects of Introducing a Single Open-ended Contract in the Spanish Labour Market”, mimeo, U. Pablo de Olavide.
- Conde Ruiz, J. I., F. Felgueroso, and J.I. García Pérez (2011), “Reforma Laboral 2010: Una primera evaluación y propuestas de mejora”, Fedea Working Paper 01-2011.

4. Now what?

# Conclusion

The extraordinary rise in **unemployment** in Spain in the Great Recession was insufficient to trigger labor market reform

Reform only became **politically viable** when, additionally, the risk premium on Spanish debt increased sharply —and the accompanying pressure from Eurozone partner countries

**Internal political-viability constraints** still mattered, since they limited the scope of the reform and affected its contents, leaving the core of unemployment-inducing institutions largely in place —further reform is bound to come



Thank you  
for your attention!