

A Proposal to Restart the Spanish Labor Market

The current economic crisis did not start in the labor market. However, Spain is suffering a much higher job destruction rate than most developed countries. With an unemployment rate around 15%, and which could reach 20% in the next few months, it is urgent to tackle the causes that generate such an intense job destruction. Neither fiscal stimulus packages nor employment-promoting measures –for instance the already-approved job creation subsidies– will be effective if the main problems that induce such an inefficient performance of our labor market are not solved.

Those problems explain the huge gap between our unemployment rate and the euro area average (8%), and without fixing them it will not be possible to create enough jobs in high-productivity industries once the international economic conditions return to normalcy. Creating a “new productive model” that places the Spanish economy on a path of high and sustained growth of per capita income requires, above all, a science and technology system that is more favorable to innovation and an education system that produces more highly-qualified workers, thus reducing the current alarming schooling failure rates. However, for the new model to develop strongly we also need a set of labor institutions that ease relocation of workers from obsolete to emerging industries. Here we dwell on our labor institutions, which should be redesigned regardless of the current crisis, since forces like technological progress, globalization, and population aging have rendered them obsolete.

It is desirable to act simultaneously on four fronts. Firstly, it is necessary to reduce the high employment volatility generated by a dual labor market, in which for two decades around 30% of employees have been on fixed-term contracts. In economic booms this model generates strong job creation, albeit concentrated in low-productivity industries, whereas in recessions it exacerbates job destruction. This is so because the existing regulation induces firms to respond to economic fluctuations through labor turnover, rather than looking for alternatives such as changes in workplace organization. This aspect is reinforced by a second problem: a collective bargaining system that is too rigid, too centralized in some cases, and insufficiently coordinated in others. Thirdly, unemployment protection schemes do not achieve sufficient coverage, while at the same time they discourage job search in some cases, thereby unnecessarily lengthening unemployment spells. Lastly, Spain suffers from woeful active labor market policies trying to help the unemployed to find jobs.

The international experience shows that it is possible to improve upon this situation significantly. To do so, a global approach to labor regulation is needed, bearing in mind the collateral undesired effects that one institution may have on the goals intended by other institutions. Following this approach, we think that the following measures are needed:

► **To end labor market duality**, a simplification of the current menu of labor contracts with widely different severance payments is needed. Except for interim contracts, meant for replacement of workers on temporary leave, all other fixed-term contract types should be scrapped. At the same time, a *single* permanent labor contract, with severance pay that increases with seniority, should be introduced for all *new hires*.

This would unify the grounds for dismissal, maintaining judicial protection for discriminatory dismissals.

In this way all workers would enjoy a permanent contract from the start of their labor relationships, while employers would not face the huge gap between the low severance pay for fixed-term contracts (8 days of wages per year of service and sometimes simply nil) and the high protection level afforded by the current permanent contracts. This differential is the key factor inducing excessive turnover. Therefore, this contract would also help reduce the serious inequality of opportunity suffered by certain groups, such as youth, women, and immigrants, who are the most affected by the excessive labor turnover. This measure might also induce a part-time employment takeoff, which has been discouraged in our country by the excessive use of fixed-term contracts.

When choosing the severance pay schedule it is important to avoid an increase in average labor costs vis-à-vis the status quo. For instance, they could start at a level slightly above the current severance pay for fixed-term contracts and increase progressively up to a value close to the European average, but always below the current, most frequent severance pay for unfair dismissals (45 days per year of service). The latter, as indicated by the standard rankings produced by international organizations, is among the highest in the world.

► **To improve protection of the unemployed**, expenditures on benefits should keep on growing while the crisis persists and it will probably be advisable to increase benefit duration. This measure should however be temporary and undone as soon as conditions improve. With a medium-term approach, raising protection without discouraging job search is better achieved by raising benefits in the first months of unemployment spells than increasing benefit duration. Ceilings on benefits should also be revised upwards, since they are relatively low, making it difficult for workers to meet their expenditure commitments and also implying a scarcely declining benefit profile, which reduces incentives for job search. Regarding the social security contributions that fund benefits, it might be beneficial –following the so-called “Austrian model”– to accumulate part of them in a fund that is made accessible to the worker upon becoming unemployed to finance his or her training, or else it could be accrued in a retirement pension fund. Lastly, human resource management could be rewarded by reducing social security contributions for firms with low dismissal rates and/or penalizing those with the high rates.

► **In order to modernize collective bargaining**, the social partners signed an Inter-Confederation Agreement in 1997, in which they acknowledged the presence of excessive centralization and lack of coordination in the current system. However, twelve years down the line, no progress has been made. Therefore, the structure of collective bargains still makes it difficult for firms to adjust work conditions to production needs over time and it hinders productivity growth. It will not be possible to solve the flaws in the current collective bargaining system without changes in the regulation that supports this lack of progress. In this sense, a measure to consider would be to allow firm-level agreements reached by workers and employers to prevail upon higher-level agreements. With the current regulation, agreements like those recently reached by certain large firms so as to maintain employment are only possible under very stringent conditions.

► **To increase the efficiency of labor market policy**, it should be reoriented towards certain groups and managed in an improved way. Active labor market policy should be concentrated on low-skill workers, who are the ones who suffer the longest unemployment spells, so that long-term unemployment is avoided. And it should be managed jointly with unemployment protection. Both the provision and funding of jobfinding and training activities should take into account the individual circumstances of each unemployed worker and generate opportunities and incentives to raise the exit rate from unemployment. In this sense, a rigorous evaluation of this type of activities, which is hardly ever undertaken, should become routine. This evaluation should help improve policy design and inform the allocation of funds towards those programs, agencies, and public employees who show the best results. The supply of these programs should be expanded, allowing appropriately licensed labor intermediation companies and private agencies to cooperate with public agencies in their provision and management, thus offering workers a wider choice.

In sum, we believe that following these recommendations it is possible to craft a set of measures that will foster job creation and therefore help end the crisis. This program could receive wide social support, since it would raise general welfare and reduce inequality. The design of the specific measures would require a detailed study, which could be based on a wealth of existing economic research carried out in Spain and in other countries. The undersigned believe that an initiative of this type should be urgently launched, under the leadership of the government, with the support of the opposition and the participation of the social partners.

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