

Dualism in Spain: *El Contrato Único*

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Roadmap

1. Spain's idiosyncratic response to the Great Recession
2. Labour market problems and potential solutions
3. The single contract proposal

1. Spain is different

Similar GDP bust across developed countries, but **largest unemployment rise in Spain**

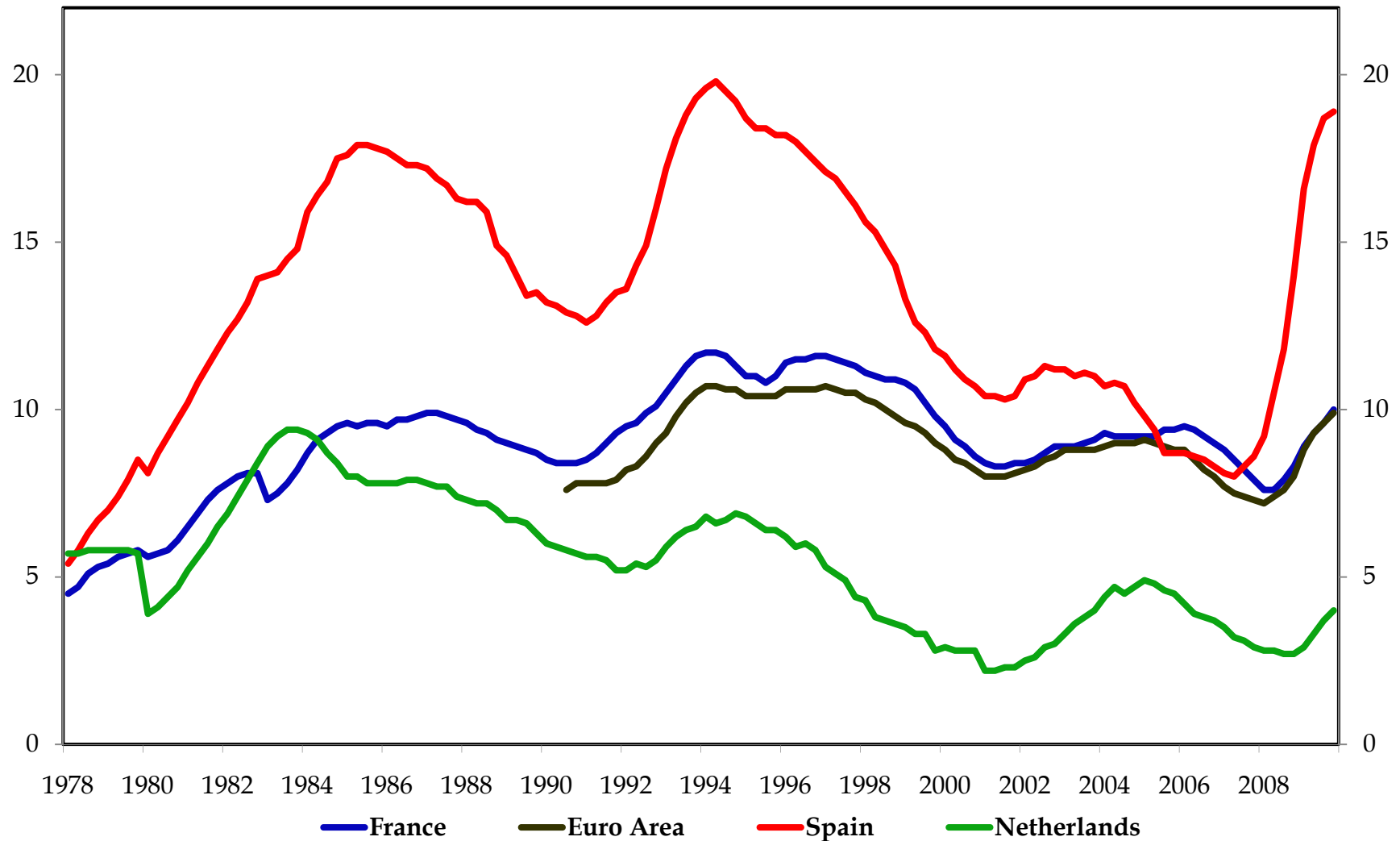
GDP (growth rate, %)	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010 (f)</u>
Spain	3.7	1.2	-3.6	-0.3
Euro area	2.6	1.2	-3.9	1.4
US	2.0	1.1	-2.5	3.0

Spain (growth rate, %)				
Employment	3.1	-0.5	-6.8	-2.5
Labour Force	2.8	3.5	0.8	-1.2

Unemployment rate				
Spain	8.3	11.3	18.0	19.3
Euro area	7.5	9.5	10.0	10.2
US	4.9	5.8	9.7	10.0

The wild ride...

Harmonized unemployment rate



...and its composition

	<u>2007</u>	<u>2009</u>
<u>Unemployment rate</u>	8.3	18.0
Natives	6.4	16.0
Immigrants	12.2	28.4
Male	6.4	17.7
Female	10.9	18.4
Youth (< 25 y.o.)	18.2	37.9
Long-term unemployed (% U)	23.7	28.3
<u>Job destruction flows</u> (*)	1,469	
Construction	854	
Manufacturing	470	
Temporary	1,324	

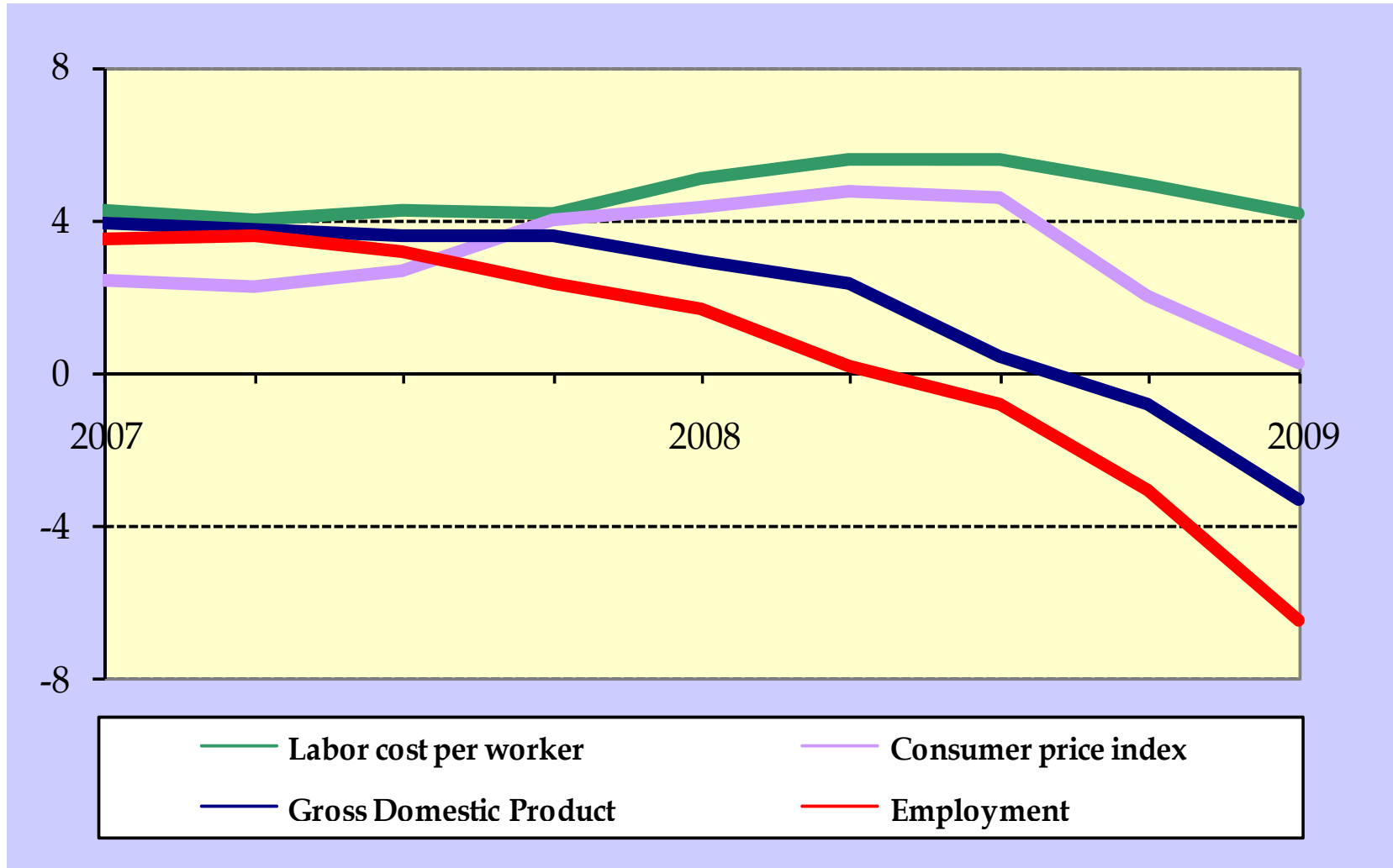
(*) Absolute changes in 2007-2009 in thousands.

2. Urgent need of labor market reforms

- In recessions with different origins [oil shocks (1975, 1979), EMS collapse (1990s), financial shock and bursting of housing bubble (2007)] the Spanish economy always reacts by **massively destroying employment**
- Reducing the weight of the residential construction sector and restoring credit flows to firms and consumers will not be enough to solve a structural problem: **high structural unemployment rate** (vs. other bubble economies IRL: 12.8 %, UK: 7.8%, DK: 4.3%)

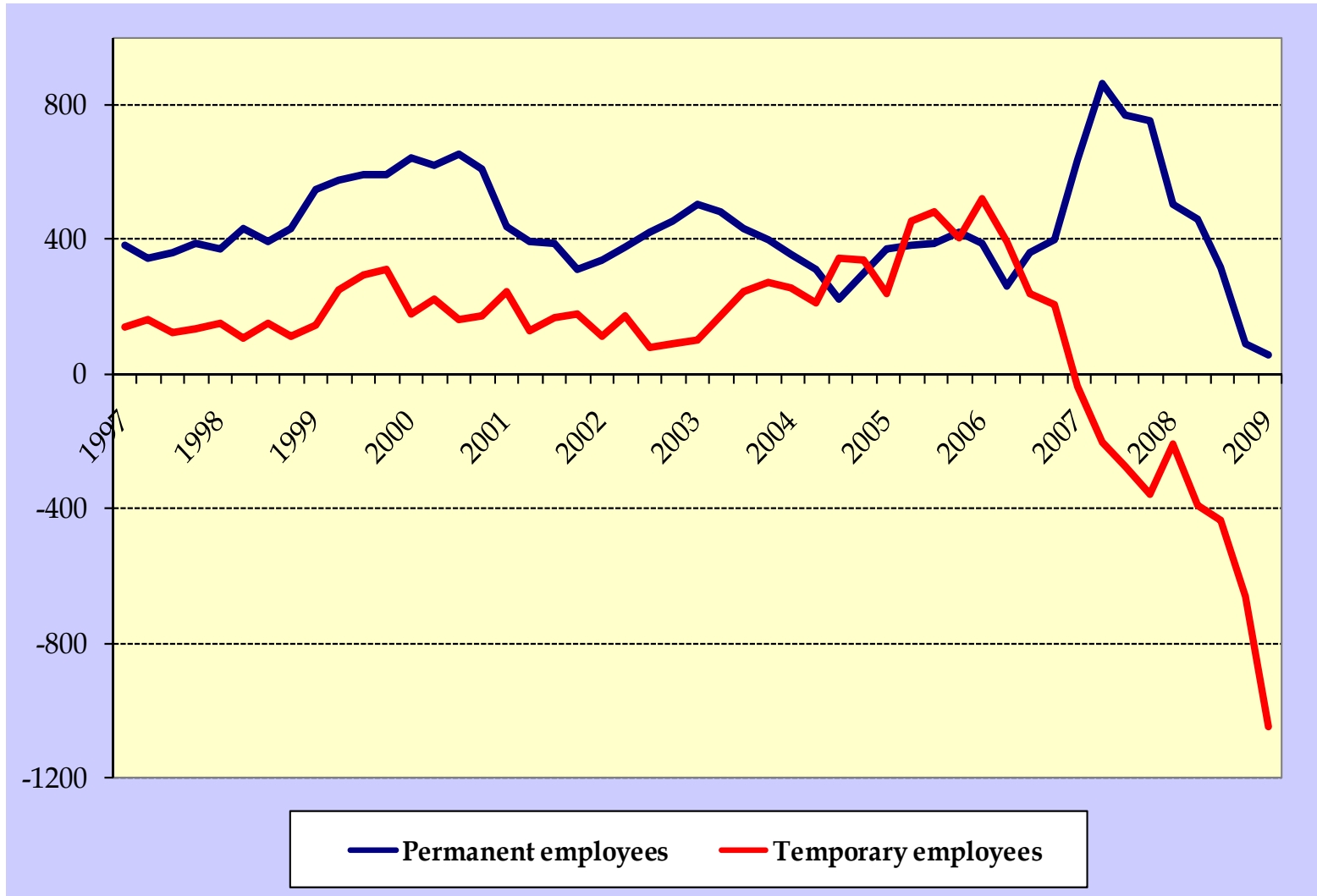
Labor market adjustment via quantities...

(Percentage change)

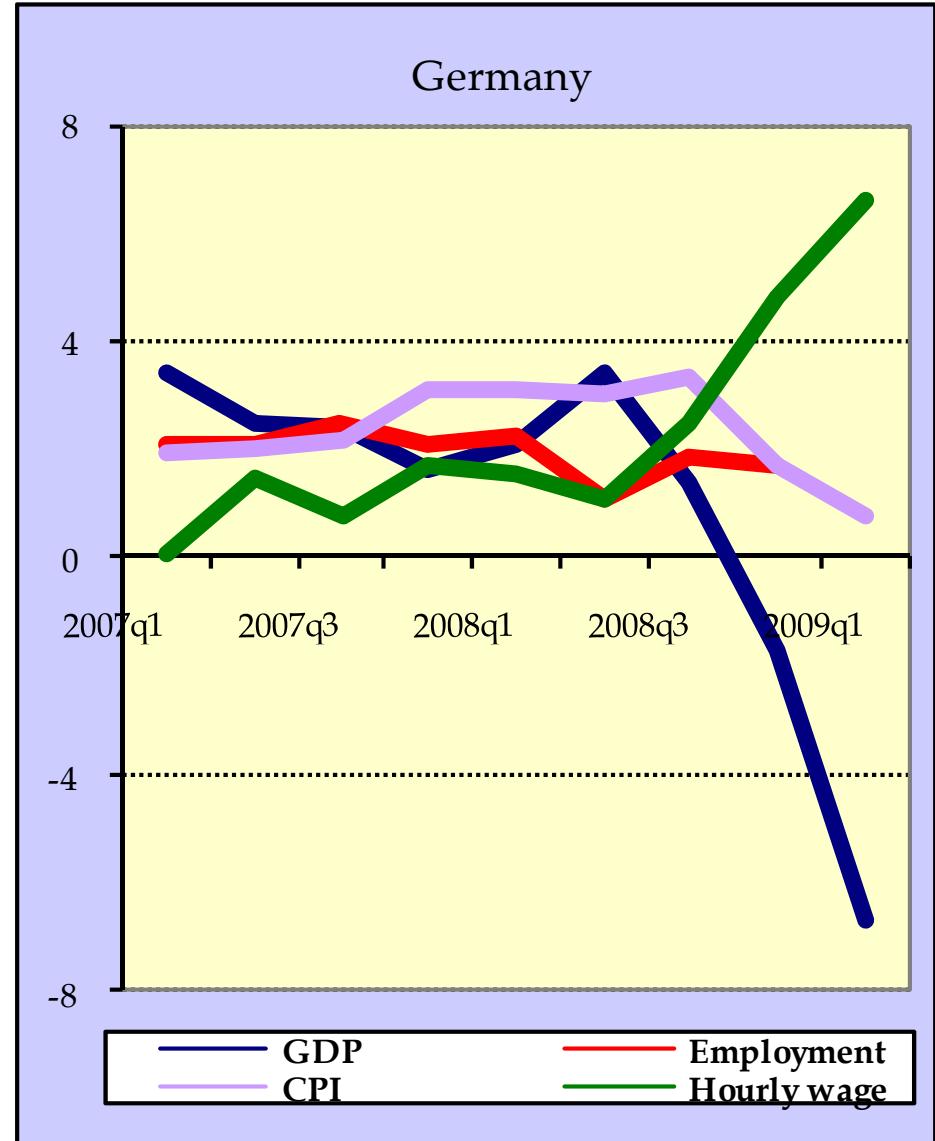
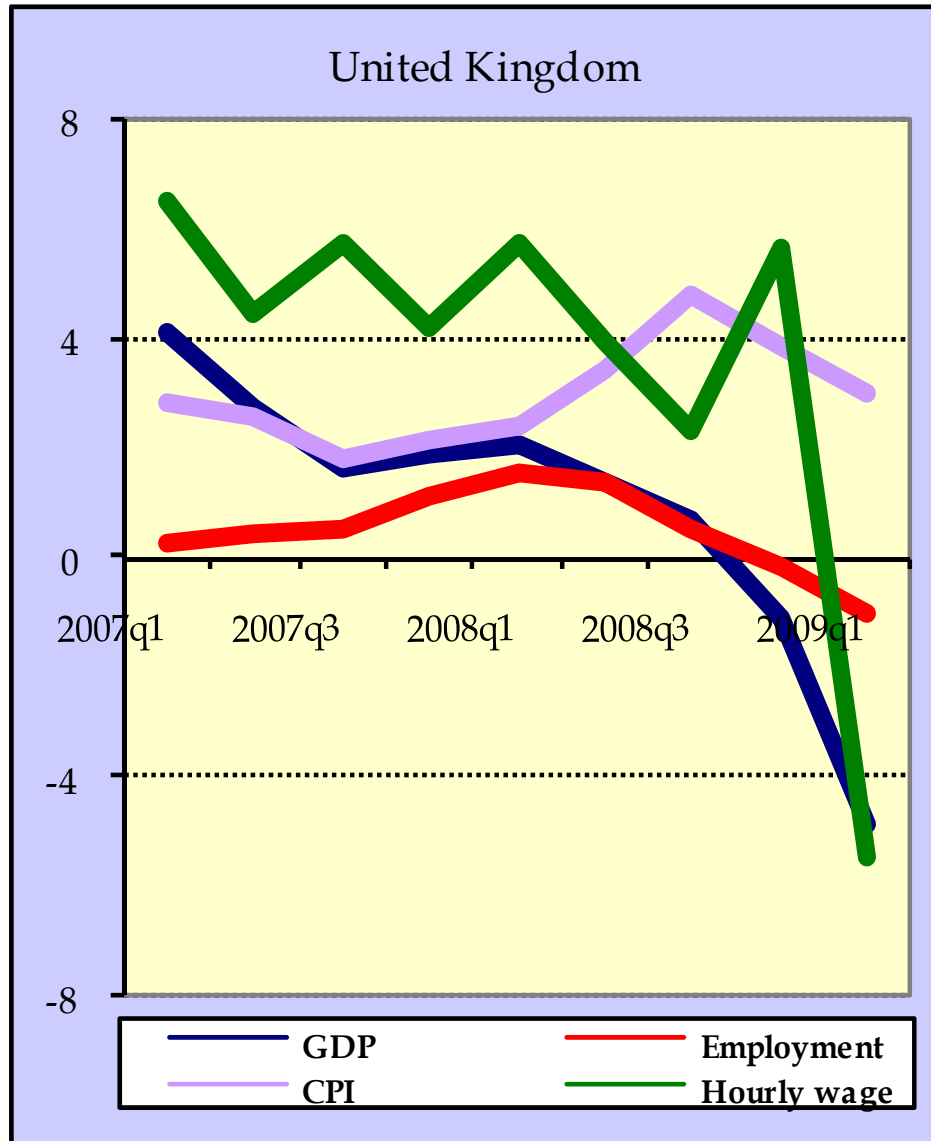


... overwhelmingly borne by temporary employees

(Change in emplotment in thousands)



...instead of adjusting wages (UK) or working hours (GE)



Little response of real wages (2009)

- Average increase in wage bargains: 2.6%
Average CPI increase: -0.3%
Real wage increase: 2.9%
Employment change: -6.8%
- Construction:
Real wage increase: 3.9%
Employment change: -23.0%
- A story: Interaction of employment protection legislation and collective bargaining institutions
 - Insiders insulated from unemployment by two-tier labor market (Bentolila-Dolado, 1994)
 - Resistance to labor market reforms (Saint-Paul, 1996)

Diagnosis: Spanish labor market institutions are
far from working properly
... however

there is **great resistance to labor market reform:**

Excess of vague proposals
("structural reforms",
"new industry specialization")

Deficit of specific proposals

A Proposal to Restart the Spanish Labour Market

21 April 2009

(Signed by 100 academic economists)

www.crisis09.es

Proposals for labor market reform based on:

1. Rigorous theoretical analysis
2. Large international empirical evidence
3. Improving efficiency without lowering social protection

Four proposals

- A. Employment protection (severance pay)
- B. Passive labor market policies (unemployment benefits)
- C. Active labor market policies (placement, training)
- D. Collective bargaining

Today I will focus on the first proposal

3. The single contract proposal

Employment Protection Legislation (EPL)

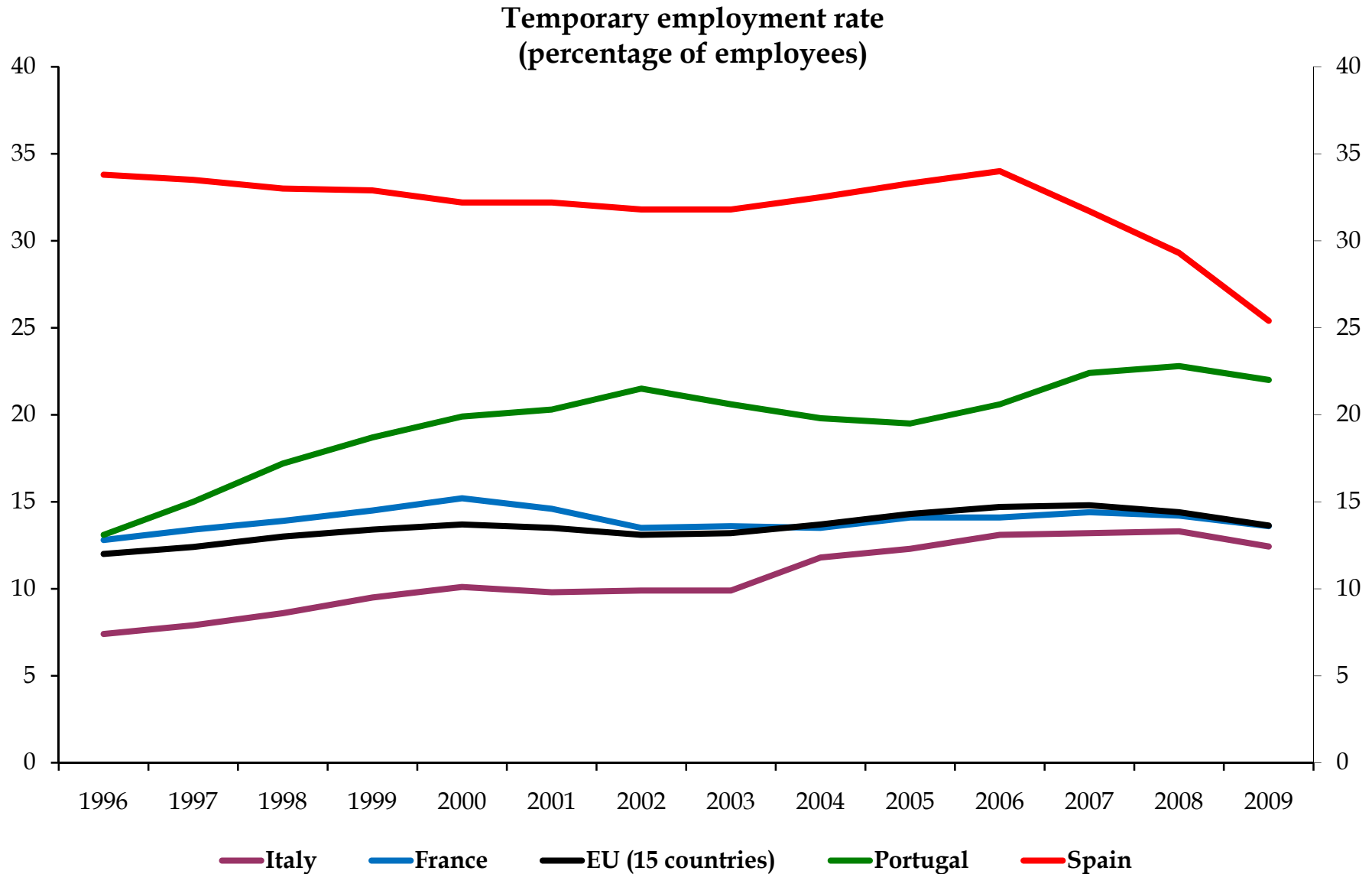
(Index 0-100, 181 countries. Source: *Doing Business 2009*, World Bank)

Indicator	Spain	OECD
Hiring restrictions	78	26
Working time rigidity	60	42
Firing restrictions	30	26
EPL rigidity	58	31
Severance pay (weekly wages, 10-year tenure)	56	26

Labor market effects of firing costs

- Employment and unemployment (Bentolila-Bertola, 1990; Bertola, 1994; Bassanini-Duval, 2006):
 - Ambiguous effect on aggregate unemployment rate (except for detrimental effects on investment)
 - ↑ Employment rate of prime age workers and ↓ female and youth employment rates
- ↓ Employment volatility and mobility of workers
- ↑ Turnover rate of temporary workers → ↑ Unemployment (dismissal costs gap) (Blanchard-Landier, 2002; Cahuc-Postel Vinay, 2002, Bentolila *et al.*, 2009)
- ↓ **Productivity growth** (Hopenhayn-Rogerson, 1993; Mortensen-Pissarides, 1994; Bassanini-Nunziata-Venn, 2008; Dolado-Stucchi, 2009)

Dual labor market: Leader in temporary work



Huge labor market turnover

- Transitions: 2008:IV (LFS): **4.45 m.** workers changed labor status
 ΔE (net) = UE+IE-EU-EI = 1.363-1.861 = **-0.5 m.**

EMP. → UNEMP.: 1.026.000 (Temp.: 81%)

UNEMP. → EMP.: 708.000 (Temp.: 87%)

EMP. → NON-AC.: 835.000

NON-AC. → EMP.: 655.000

(SP: 3.9% PWA/month approx. , vs. US: 5.4%, FR: 1.8% PWA/month)

- No. of contracts: (2007): 18.6 m. → 0.80 contracts/employee
(2008): 16.6 m. → 0.76 contracts/employee
(2009): 14.1 m. → 0.76 contracts/employee
- Low conversion rate (temp.-perm.): 5.1%; < 8% since 1994
(despite generous job subsidies: García Pérez-Rebollo, 2009)
- Very short-term temp. contracts : 2.7 m. < 7 days and 5 m. < 30 days (2008)

Other effects of temporary contracts

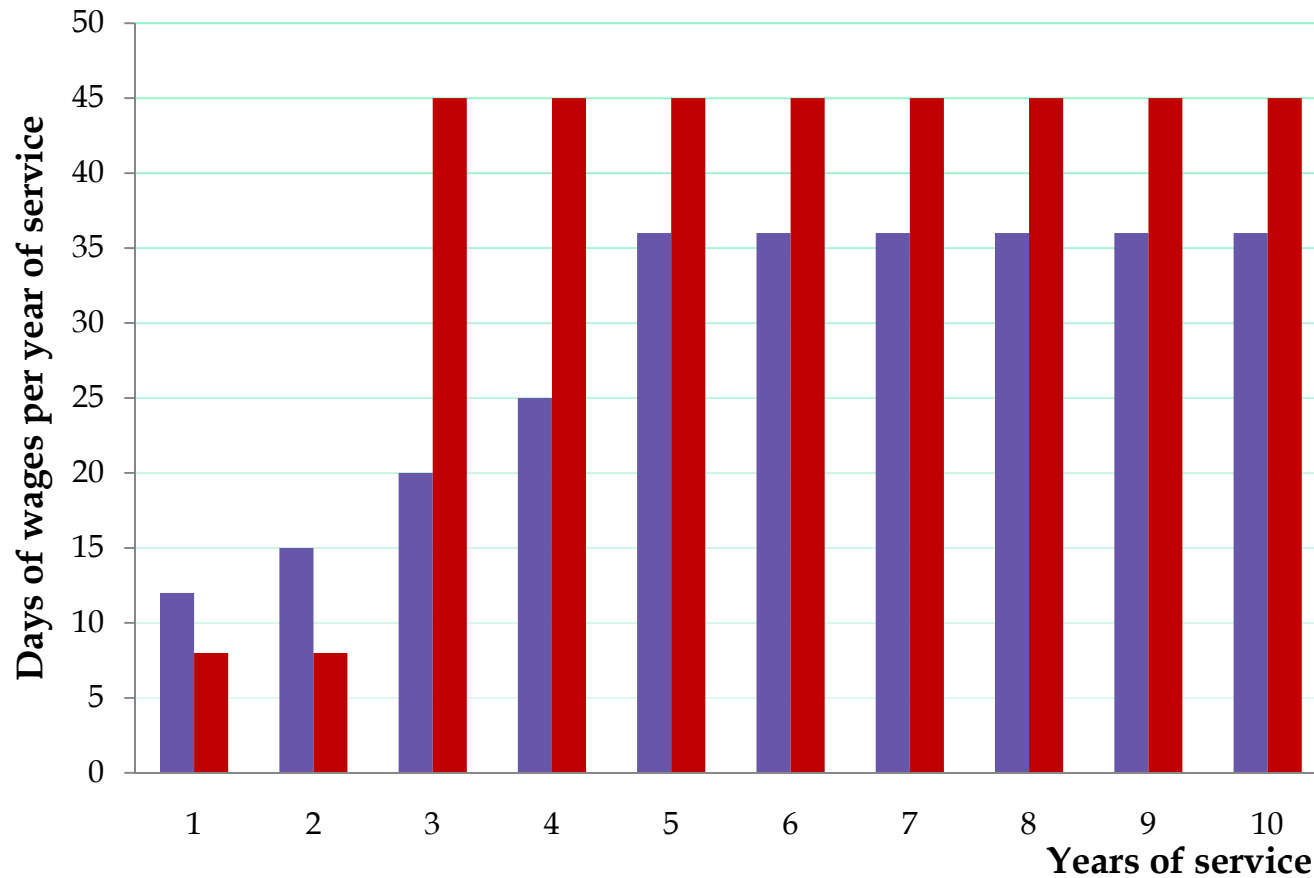
- Uneven incidence on the labour force (2008 average = 28%):
 - 30% Females vs. 26% Males
 - 47% Youth (< 29 y.o.)
 - 52% Immigrants
 - ... but also on prime-age workers (30-50 y.o.): 25%
- Reduce **productivity**: ↓ training and effort → ↑ absenteeism and over-education + generates technology adoption based on low-skill labor (Dolado-Stucchi, 2008, Dolado-Jansen-Jimeno, 2009; Bentolila-Dolado-Jimeno, 2009)
- Other effects (Dolado-García Serrano-Jimeno, 2002):
 - ↓ **Youth unemployment rate** (+)
 - ↓ **Long-term unemployment** (+)
 - ↑ **Wage inequality** (-)

Why so much turnover?

Dismissal cost gap: 45 (perm.) vs. 8/0 (temp.) days p.y.s.

Proposal: Single Contract with increasing severance pay

(Example: SC 12-36, max. 24 months)



Pros of single contract

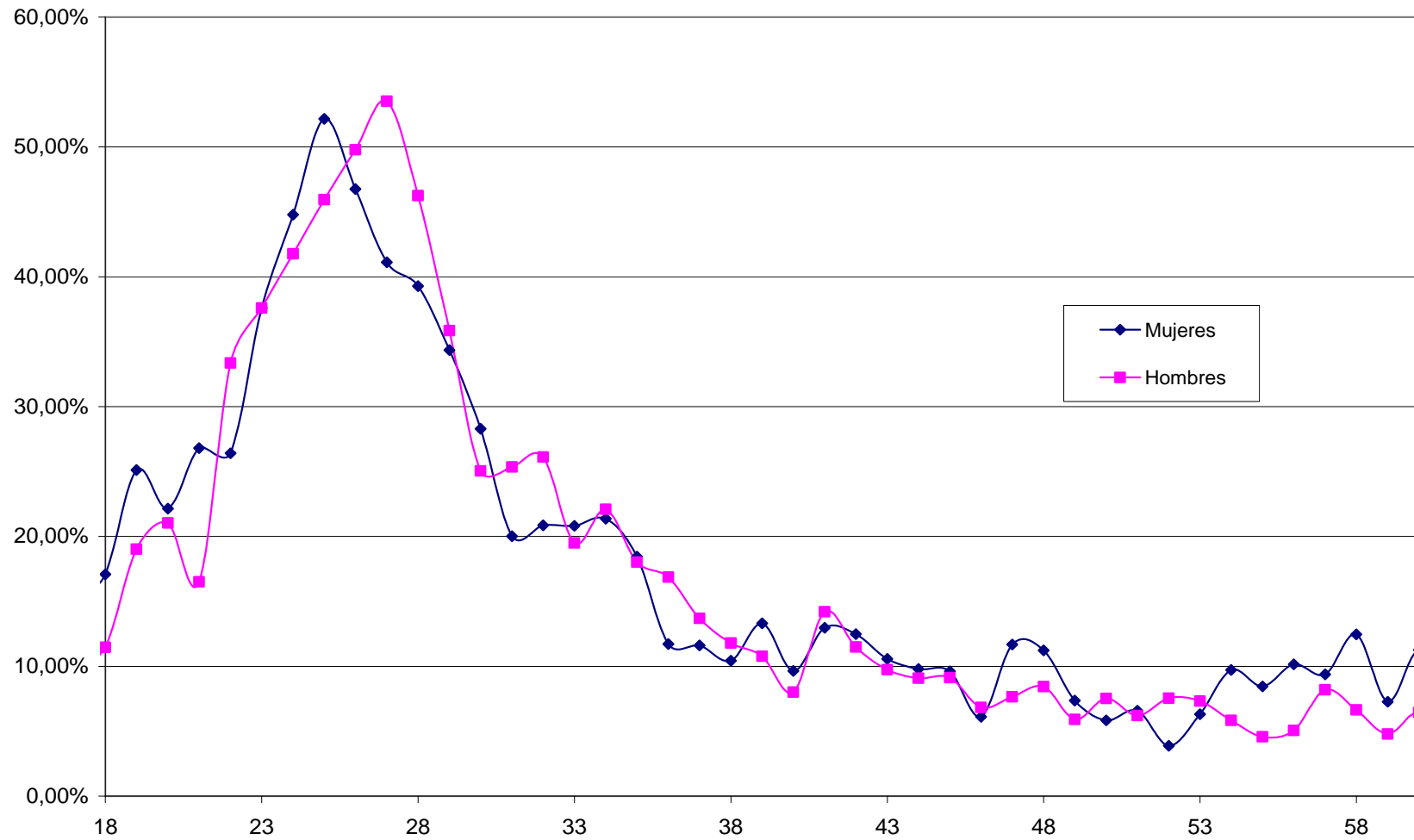
- By default, all new contracts become **open ended** (except for temporary replacement)
- Marginal cost of conversions: **gradualism** vs. big gap (“the ramp that runs through the wall”)
- **Average dismissal cost** could remain the same or increase, **job durations** increase
- Rationale for **increasing severance pay**: Compensation for loss of specific human capital investment, psychic cost of dismissals (Blanchard-Tirole, 2003)

Some simulation results

Longitudinal Sample of Working Lives (MCVL 2007)
(García-Pérez, 2010)

- Scenario based on projections of dismissal and re-employment rates (33-severance pay contract)
- Minimal increase in **average firing cost** (+0.5% in year 1, +1.5% in year 10)
- Significant **increases in job duration** (graph →)

Increase in job duration 10 years after introduction of SC (male and female)



Using France as a benchmark

Bentolila-Cahuc-Dolado-Le Barbanchon (2010)

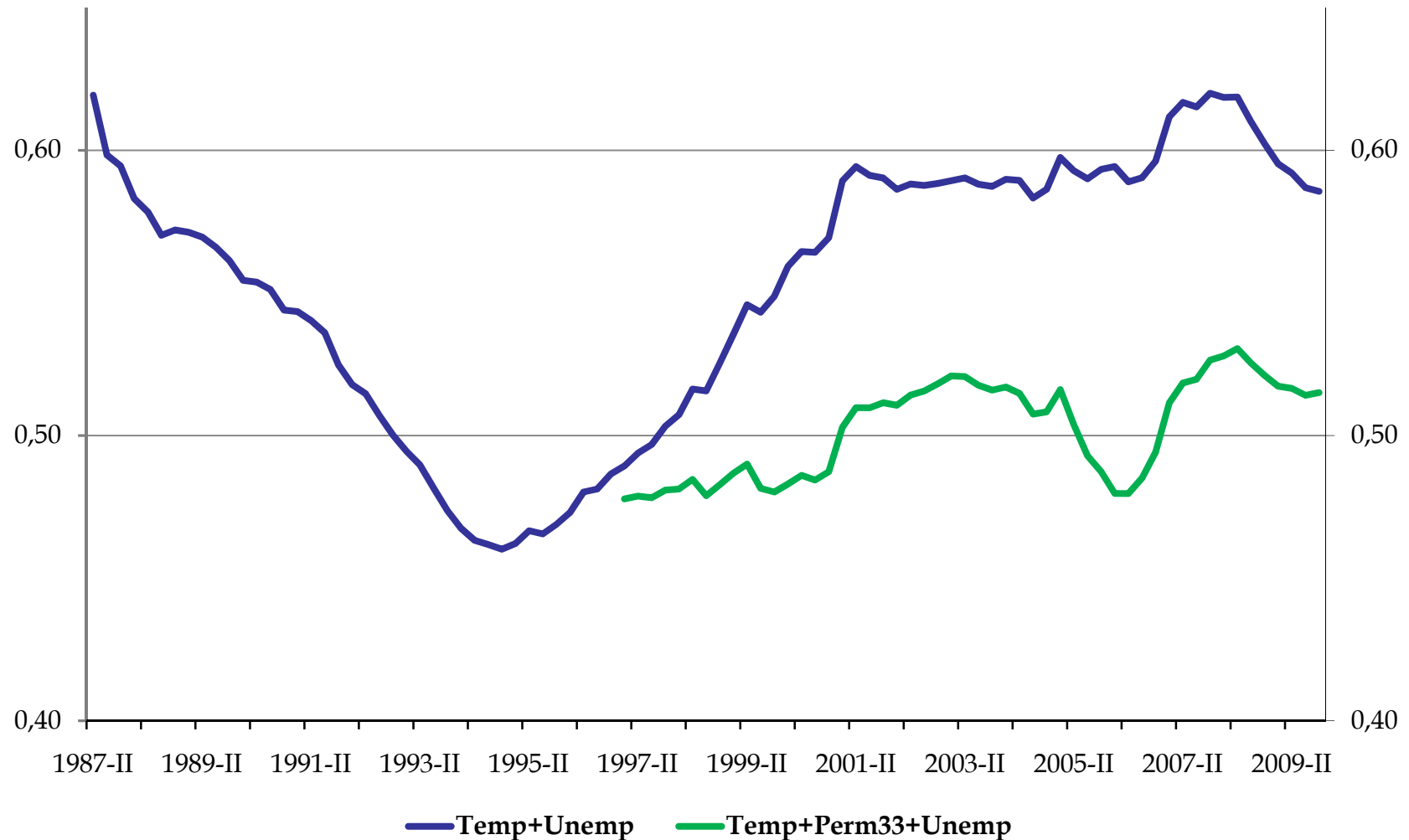
- Search and matching model w/ perm. and temp. contracts calibrated before (2006-07) and during the crisis (2008-09)
- Similar labor market institutions (EPL, Unemp. benefits, Collective bargaining) but in France unemployment rate has only risen by 2 p.p.
- Exception: Red-tape dismissal cost gap France < Spain
(1.33 quarters v. 2 quarters) (Temp. rate around 15%)
- If Spain had adopted French EPL, its unemployment rate would have risen by 4-5 percentage points less

Is the single contract politically viable?

- Temporary contracts were introduced in 1984 as a two-tier (insider-outsider) device to foster flexibility in a rigid labor market (inherited from Franco)
- Further reforms in: 1994 (restrict temp. contracts), 1997 (introduce new perm contract with lower dismissal costs, 33, but restricted), 2002 (avoid judges), 2006 (widen coverage of new contract)... 2010?
- Median (union) voter argument (graph →)
(close to 50% if perms. with lower firing costs support the reform)

Median voter and resistance to EPL reform

Indicators of political viability of labor reform
(share of employees plus unemployed)



Is the single contract legally viable?

Bentolila and Jansen (2010): Concerns about viability

- **Equality** (2 contracts with different severance pay)
 - **Spanish Constitution** allows it for employment promotion reasons
 - It already happens: 45-day and 33-day contracts
- **Judicial protection** (ILO Conv. 158, EU Charter Art. 30):
 - Still protected against: violation of **fundamental rights** (e.g. discrimination), **disciplinary** dismissal (45 days)
 - Law already allows employers to **avoid going to court** since 2002: disciplinary dismissal + recognition of unfairness
 - **Perversion** of law: Disciplinary (33%), Non-renewal of temporary (54%) → Only 13% of dismissals now protected
 - So: Single contract would **protect all workers**

Thank you
for your attention!