

## THE 2012 LABOUR REFORM: AN INITIAL ANALYSIS OF SOME OF ITS EFFECTS ON THE LABOUR MARKET

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### Introduction

In February 2012 a reform of the Spanish labour market was approved, which modified some of the most important aspects of the institutional framework, affecting key elements, such as the degree of centralisation of the collective bargaining system and dismissal costs and procedures.<sup>1</sup> Although some of these changes are structural and will require a long period to produce their full effect, it is already worth attempting to identify labour market developments that may be related to this labour reform.<sup>2</sup>

This article analyses recent developments in the main labour market variables (employment, unemployment and wages) to isolate the possible impact of the reform from other factors that may have driven these developments, including notably the adverse cyclical and employment situation in which it is being applied. The results are subject to a high degree of uncertainty, as a consequence of the brevity of the period elapsed since the reform was approved. Continued monitoring will be needed to confirm the evidence found and to detect any new patterns of behaviour.

The rest of the article is organised as follows. The next section briefly describes the content of the 2012 reform, while the third section analyses recent wage developments and the changes detected in collective bargaining. The fourth section analyses developments in employment and unemployment, along with job creation and destruction flows. The fifth section summarises the main conclusions.

### A brief description of the content of the 2012 labour reform

Royal Decree-Law 3/2012, approved in February 2012, included a broad set of changes to labour market institutions.<sup>3</sup> With regard to collective bargaining, and in order to increase the degree of decentralisation in the system, it was established that firm-level agreements should prevail in a broad set of areas (basic wage, supplements, overtime remuneration, and the distribution of working hours), with contradictory clauses in industry-level agreements being ineffective. Also, in order to increase firms' internal flexibility, the possibilities were widened for opting out from the terms and conditions contained in the agreement in force, as well as for unilateral changes to working conditions that exceed the minimum levels established in the collective agreement. Finally, to encourage faster renegotiation, the reform established a maximum limit of one year<sup>4</sup> for the effectiveness of an agreement after its termination.

In the area of dismissal costs and procedures, a number of measures were taken. On one hand, the economic grounds for dismissal were redefined, establishing objective circumstances that justify termination of contract. In particular, it was determined that termination is justified if the firm reports losses (or expects to) or suffers three consecutive quarters of

1 For a description of the institutional framework existing in the Spanish labour market before the crisis, see Estrada, Izquierdo and Lacuesta (2009).

2 The Ministry of Employment and Social Security has recently published an analysis of the impact of the labour reform, which is available at [http://www.empleo.gob.es/es/destacados/HOME/impacto\\_reforma\\_laboral/index.htm](http://www.empleo.gob.es/es/destacados/HOME/impacto_reforma_laboral/index.htm).

3 Eventually approved as Law 3/2012 in July.

4 From 8 July 2012, the date of publication of Law 3/2012 in the BOE. This period can, however, be extended by agreement between the parties.

year-on-year declines in sales or revenues. On the other hand, the amount of compensation payable in the event of unjustified dismissal was reduced; for objective and disciplinary dismissals it was set at 33 days per year of service, subject to a maximum of 24 months' pay (as against 45 days and a maximum of 42 months' pay previously). As for dismissal procedures, the need for administrative authorisation for collective dismissals was eliminated, as was the obligation on the part of the firm to pay wages for the period between the time of notification of dismissal and final judicial resolution.

In relation to hiring possibilities, a new type of permanent contract, called an "entrepreneurs' contract", was introduced for firms with fewer than 50 employees, with a probation period that has been extended to one year and various fiscal incentives. In addition, some of the terms and conditions of the training and apprenticeship contract and those relating to part-time hiring were made more flexible.

Finally, although this was not a legislative change, it is worth remembering the Agreement for Employment and Collective Bargaining (AENC-2012) signed by the social agents at the beginning of 2012. This agreement included recommendations for wage increases of 0.5% in 2012, 0.6% in 2013 and between 0.6% and 1.5% in 2014.

### Changes in labour costs

The various modifications to the regulation of collective bargaining, the purpose of which, as mentioned above, was to make it more decentralised, to increase firms' internal flexibility and to accelerate the renewal of agreements, should enable employment conditions (wage and non-wage conditions) to be better adapted to the specific situation of firms and facilitate a more balanced adjustment between wages, employment and working hours.<sup>5</sup> The changes introduced into dismissal costs, which also have an influence on the wage bargaining process, can be expected to have operated in the same direction. Specifically, in accordance with the situation of the labour market since the start of the crisis, this set of changes should have led to wage moderation, which should, moreover, have been assisted by the AENC, signed in early 2012.

The left-hand panel of Chart 1 shows the recent developments in compensation per employee in the market economy,<sup>6</sup> according to QNA information, and in labour costs estimated by the quarterly labour costs survey (ETCL). In recent quarters there has been an intensification of the wage moderation process, with a year-on-year decline in compensation per employee at the beginning of this year, according to the QNA. The information supplied by the ETCL shows somewhat sharper wage moderation since 2012 Q2.<sup>7</sup> Given the recent inflation developments, both indicators reflect falls in wages in real terms in recent quarters.

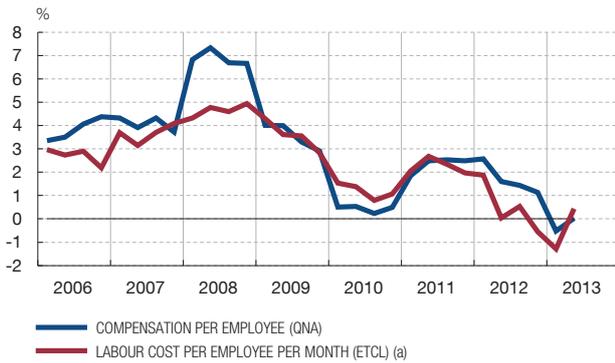
That said, in a situation of sharply deteriorating activity and employment, it is difficult to determine which part of this labour cost behaviour stems from the cyclical situation and which part may be attributed to the effects of the reform. To try to distinguish between the impacts of these two factors, a wage equation has been estimated in which wage

5 For an analysis of the impact of the level of decentralisation in collective bargaining on the functioning of the labour market, see Jimeno and Thomas (2011).

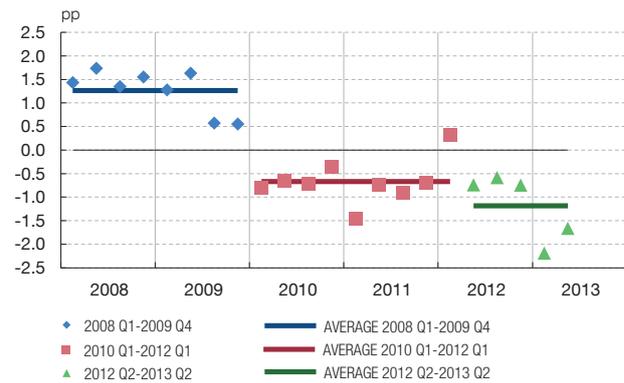
6 It is important to isolate the effects of the labour reform on the wage formation process in the private sector of the economy from the direct effect on the average compensation of the whole economy arising from the cut in public-sector wages. For this reason, the analysis is focused on the market economy.

7 In this case, the evolution of labour costs in the non-agricultural market economy has been calculated by aggregating the sectoral ETCL information in accordance with the weights available in the Harmonised Labour Cost Index (ICLA).

COMPENSATION PER EMPLOYEE IN MARKET ECONOMY  
Year-on-year rate of change of seasonally adjusted series



RESIDUALS OF THE WAGE EQUATION



SOURCES: Instituto Nacional de Estadística and Banco de España.

a Gross data.

increases are related to their traditional determinants: unemployment, inflation and productivity.<sup>8</sup> Negative values for the residuals of this equation would indicate that the slowdown observed in compensation per employee had gone beyond what could be attributed to changes in its determinants.<sup>9</sup> Thus, the evolution of these residuals in the period before and after the reform can be interpreted as an approximation of the possible effect of the legislative changes on the wage formation process. As seen in the right-hand panel of Chart 1, from 2010 the residuals have negative values, following the high positive values observed in the first phase of the crisis, and in absolute terms their value has increased in the most recent period, especially in the first two quarters of 2013. A similar analysis based on ETCL data points to a somewhat more intense process of wage moderation, which started in 2012 Q2. These results, however, must be interpreted with due caution owing to the small number of observations available following the reform, and developments in the coming quarters need to be monitored.

When wage developments are analysed in greater detail, it is important to consider the results of collective bargaining. The upper panel of Table 1 shows wage increases according to the agreement data for the period 2009-2013. The average wage increase is broken down into the initially agreed rate and the revision made as a consequence of possible activation of indexation clauses. It can be seen that the average wage increase, when the impact of the clauses has been included, exceeds two percentage points between 2009 and 2011, a slightly higher rate than that recorded by the CPI over this period as a whole, despite the intensity of the job destruction taking place during these years and the collective bargaining agreement in effect, which was signed in 2010 and tried to promote wage moderation.

8 Specifically, past inflation, the unemployment rate and productivity. The regression is estimated from 1981 to 2012 Q1 for the market economy as a whole, in such a way that the changes in wage determination following this quarter do not affect the estimation. Inflation is measured by the 12-month increase in the CPI in December of the previous year, since this is the reference used most in the wage formation process, and productivity is the year-on-year increase in this variable in the market economy. The estimated coefficients are those expected and are significant.

9 This analysis does not take into account the increase in non-wage costs for firms arising from the 5% increase in the maximum contribution bases at the beginning of 2013.

## WAGE RISE ACCORDING TO COLLECTIVE BARGAINING AGREEMENTS

TABLE 1

	2009	2010	2011	2012	2013
Total collective bargaining agreements					
CPI (Dec)	0.8	3.0	2.4	2.9	–
Wage rise without clause (a)	2.3	1.5	2.0	1.1	0.6
Clause (a)	0.0	0.7	0.3	0.2	–
Wage rise with clause (a)	2.2	2.2	2.3	1.3	–
% of workers with clause (b)	59.1	47.1	45.3	41.6	42.6
Newly signed agreements (a) (b)					
Wage rise without clause	1.7	1.2	1.3	0.7	0.4
Clause	0.0	0.4	0.2	0.2	–
Wage rise with clause	1.7	1.6	1.5	0.9	–
Firm-level agreements (a)					
Workers affected (as % of total)	9.6	8.6	8.7	9.5	4.9
Average size (no. of workers)	258	243	267	301	230

SOURCE: Ministerio de Empleo y Seguridad Social.

a With information until August 2013.

b Data of 2011 and 2012 with information until January 2013.

From 2012, however, a clear reduction is seen in the average increase in wage rates, which stood at 1.3% in 2012, more than one percentage point below the inflation rate in December of the previous year, which is often taken as a reference in collective bargaining. According to the data available for 2013,<sup>10</sup> average wage rates in the first eight months of the year grew at a rate of 0.6%, despite the rise in inflation at the end of 2012 as a consequence of the rises in administered prices and indirect taxes. Newly signed agreements (middle panel of Table 1), a more up-to-date indicator of the possible effects of the reform on collective bargaining results, reflected even more moderate wage increases, of 0.4%.

In the area of wage indexation, the effects have to date been weaker. The percentage of workers covered by indexation clauses has declined significantly in recent years, but remains above 40%. However, it should be noted that the effective impact of indexation clauses was smaller in 2012, this being related to the fact that a high percentage of the agreements signed would have included a more flexible definition, in line with the recommendations of the AENC. This greater flexibility has reduced the percentage of clauses eventually activated and their aggregate impact on wage developments. It remains to be confirmed whether this effect is permanent in nature or has been driven by temporary factors such as the adverse cyclical situation.

The same is true of the progress made in relation to the degree of decentralisation in the wage determination system. The information available shows a slight rise in the coverage of firm-level agreements in 2012, which was marginally above its 2009 level (see bottom panel of Table 1). In addition, the average size of firms that have their own agreement has barely changed and remains large, so that the greater possibilities for decentralisation do not seem to have been sufficiently exploited by smaller firms, which did not usually negotiate firm-level collective agreements before the reform. However, it should not be concluded

<sup>10</sup> When interpreting these data, it should be taken into account that the agreement data for 2013 incorporate an important technical change in their compilation, which leads to a significant decline in their representativeness.

	Opt-outs 2010	Opt-outs 2011	Opt-outs 2012	Substantial changes 2012
As a percentage of employees				
Total	6.8	5.2	5.7	12.1
1-10 employees	4.3	4.3	0.9	4.7
11-50 employees	6.4	4.4	2.6	8.8
51-250 employees	8.4	6.1	5.8	14.1
Over 250 employees	10.5	7.3	12.7	20.2

SOURCE: Ministerio de Empleo y Seguridad Social.

a Authors' calculations based on microdata from the ECL.

from this result that the greater possibilities for decentralisation are having no effect on collective bargaining. The mere fact that, following the reform, it is possible to negotiate firm level agreements may be affecting the results of wage bargaining at the sectoral level. Indeed, the latest data available show that sector-level wage rates are tending to converge with the lower rates agreed in firm-level agreements, which was not usually the case previously.

Finally, the limitation to one year of the period during which an agreement may remain in effect after its termination has significantly speeded up the rate of renegotiation of collective agreements in 2013. The greater progress made in bargaining has resulted in a rise in the number of workers affected by newly signed agreements during the first eight months of the year to 1.3 million, which was significantly higher than the average number in the same period of previous years (around 800,000). Given the delay with which new agreements are usually registered, a significant rise in bargaining can be expected in the coming months, which should help identify more precisely the magnitude of the changes occurring in the collective bargaining system.

As for the analysis of the greater possibilities for internal flexibility fostered by the recent legal changes, Table 2 shows, in accordance with the information provided by the special module included in the labour situation survey (ECL),<sup>11</sup> the percentage of employment accounted for by firms that have opted out from the terms and conditions of the agreement between 2010 and 2012. Since 2010, opt-outs from the terms of the agreement have barely changed, remaining within a range of around 5%-6% of employees. By contrast, it seems that the possibilities for making substantial changes to employment conditions are being heavily used by firms. The data available (see final column of Table 2) indicate that a significant proportion of firms, accounting for 12.1% of total employment, have had recourse to this tool for internal flexibility in 2012. In any event, this instrument has been used mainly by large firms, while among small firms the rate of use is very low.

Looking ahead, it would be worth carrying out an in-depth analysis of the reasons underlying the differences in behaviour according to the size of the firm, since the use of these

<sup>11</sup> We are grateful to the Ministerio de Empleo y Seguridad Social for giving us access to this database, which is based on a questionnaire completed by firms on a quarterly basis. Since February 2012 an official register has been available of opt-outs from collective agreements, although this information does not allow the figure for opt-outs to be compared with that observed previously.

## The evolution of employment and unemployment

possibilities can be crucial to limiting employment losses. ECL data have been used to analyse the differences in the behaviour of employment at firms that declared they had opted out in 2010 and 2011. The results obtained indicate that the firms that used this option in either of these years had a better record in terms of level of employment in 2012 than those that did not (around 4.4% higher),<sup>12</sup> which shows the role that internal flexibility measures can play in promoting employment.

One difficulty for assessing the possible impact of the reform on employment, apart from the limited time that has elapsed since it was introduced, is that stemming from the adverse cyclical situation in the period analysed, which is marked by a second recession that began in mid-2011 and continued throughout the period analysed following the reform. The fall in employment intensified in this period, reaching its highest rate in the initial months of 2012 and slowing thereafter. In turn, the rate of unemployment increased continuously to peak at 27.2% in 2013 Q1. In Q2, the slowing of the fall in employment, along with the acceleration in the decline in the labour force, permitted a reduction in the rate of unemployment, which stood at 26.3%. It should be noted, however, that part of the deterioration of the labour market situation during this period has been caused by the fall in public-sector employment in the context of the ongoing budgetary consolidation plans. If this effect is stripped out, the behaviour of market economy employment does not exhibit great differences between 2011 and 2012, with average quarterly declines of slightly above 1% in both years.

Starting from the cyclical context described, one might ask to what extent the relationship between activity and employment may have changed following the regulatory changes introduced by the reform. As above in the case of wages, a simple way of analysing possible changes in this relationship is to estimate a regression between two variables and to analyse the residuals in the period after the reform. In particular, two regressions are estimated, in which the rate of change of economic activity is related to the change in the rate of unemployment and employment growth, respectively, a relationship that is commonly known as Okun's Law.<sup>13</sup>

Chart 2 shows the residuals of these equations for the most recent period. In the case of the equation relating unemployment and activity, negative residuals are observed since 2010, which are larger in absolute terms in the latest quarters, partly reflecting the recent decline in the labour force. In the case of the equation relating employment and activity, the residuals were negative until 2012 Q1, reflecting a sharper rate of job destruction than would have been expected given the fall in activity. From that date, however, the negative residuals became smaller, turning slightly positive in the first two quarters of 2013.

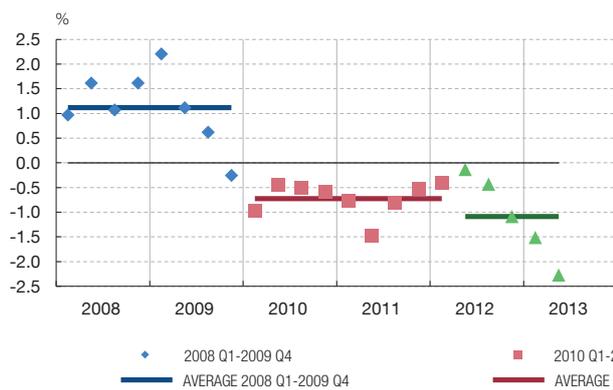
This analysis points to somewhat better than expected behaviour by employment in the private sector, at least in the most recent period,<sup>14</sup> which is in line with the slowdown ob-

12 This result is obtained from a regression using panel data, in which the effect of the opt-out is estimated after controlling for the presence of aggregate trends in the economy, so as to strip out the aggregate cyclical situation and individual firm-level trends that strip out the specific situation of firms.

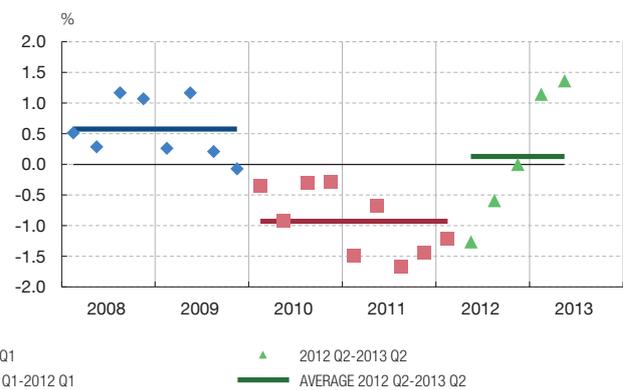
13 To ensure that the evolution of the public sector does not distort the results the estimation is carried out using the employment and GVA of the market economy. This cannot be done for the unemployment rate, which is not defined for the market economy, so the regressor in this regression is GDP.

14 When the previous regressions are estimated with parameters that change over time a recent increase in the constant of this regression is observed, while the elasticity of employment to GVA is reduced. However, it is too soon to know if these changes are statistically significant.

UNEMPLOYMENT/GDP EQUATION



MARKET ECONOMY EMPLOYMENT/GVA EQUATION



SOURCES: Instituto Nacional de Estadística and Banco de España.

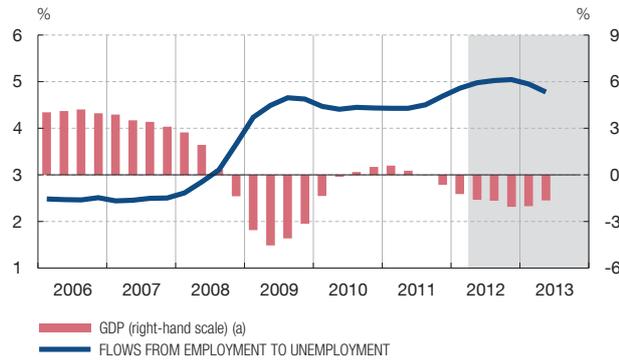
served in productivity growth and may be reflecting the effects of wage moderation on employment. As in the case of wages, it is still very premature to draw final conclusions, although it is worth stressing that other studies, which use different approximations, tend to show similar results that relate the wage moderation caused by the labour reform to improved employment behaviour.<sup>15</sup>

However, to analyse the effects of the reform on employment it is essential to examine the changes that may have occurred in the job creation and destruction processes, which may be done using the information provided by Labour Force Survey (EPA) flows data. Considering the content of the reform, one might expect the decline in dismissal costs to increase the rate of destruction of employment of workers with permanent contracts, especially if the various internal flexibility measures were not heavily used. In turn, the changes in dismissal costs and wage moderation should lead to more permanent increases in the rate of creation of permanent employment.

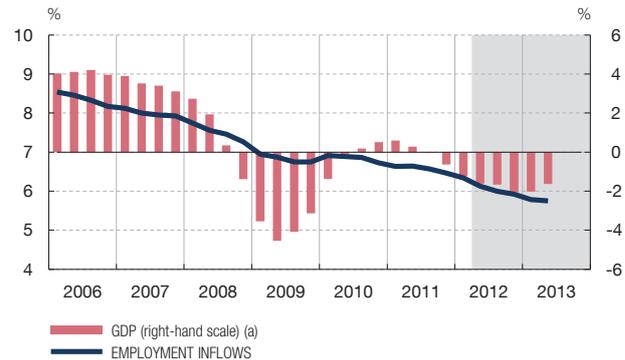
Chart 3 shows the rates of job destruction and creation, approximated by the outflow from employment to unemployment and by the inflow to employment from unemployment, respectively, along with the year-on-year growth in GVA in the market economy since 2006. As seen in this chart, in principle, neither of these two phenomena has displayed significant changes in the most recent period. The rate of destruction of employment has remained at high levels in recent quarters, although it has not accelerated further. For its part, the rate of job creation has continued to display the downward trend observed since the start of the crisis. In any case, it should be noted that this behaviour is also influenced by the sharp fall in economic activity in 2012. To control for this, a regression analysis similar to the one performed previously was carried out. The preliminary results do not show significant changes, although they suggest that the behaviour of the intensity of the job destruction has been similar to before 2012, while the fall in job creation observed since the start of the crisis has been curbed.

<sup>15</sup> Specifically, De Cea and Dolado (2013) show that growth rates of 0.3%-1.3% of GDP would suffice to increase employment in net terms, provided that the current wage moderation is maintained. BBVA (2013) estimates that the 2012 wage moderation saved the destruction of some 60,000 jobs in the short term, and had a medium-term impact of some 300,000 fewer jobs destroyed. Finally, the evaluation by the Ministry of Employment also finds that the behaviour of employment in the most recent period was even better than would be attributable to wage moderation.

AVERAGE FOUR-QUARTER RATE OF JOB DESTRUCTION AND GDP



AVERAGE FOUR-QUARTER RATE OF JOB CREATION AND GDP



SOURCES: Instituto Nacional de Estadística and Banco de España.

a Year-on-year rate of change of the seasonally adjusted series.

In terms of the composition of employment by type of contract, the downward trend in the temporary employment ratio that commenced at the start of the crisis has continued, reducing the ratio to 23% in 2013 Q2. This should basically be attributed to the impact of cyclical conditions, which again play a determining role.<sup>16</sup> In fact, as seen in Chart 4, outflows from employment have continued to be dominated by workers with temporary contracts, with a very slight increase in the probability of job loss in the case of permanent workers. For its part, the creation of permanent employment has fallen in this period, although less sharply than outflows from unemployment to temporary contracts. In relation to hiring mechanisms, it should be stressed that the new entrepreneurs' contract represents, to date, around 7% of the new permanent contracts entered into each month. Finally, with regard to part-time hiring, there was an acceleration in the upward path of the part-time employment ratio.

In relation to dismissal procedures, the information available points to an increase in the percentage of objective dismissals, which would have reduced the average cost of layoffs for economic reasons.<sup>17</sup> In relation to collective dismissal procedures, the elimination of administrative authorisation has not increased the weight of applications for labour force reduction through terminations, while the high percentages of applications for labour force reduction through working hours reductions and temporary suspension of employment recorded since 2009, when this type of procedure began to be promoted, continue to exist. However, as a result of the elimination of the need for administrative authorisation, there was a decline in the percentage of applications agreed with the workers' representatives.

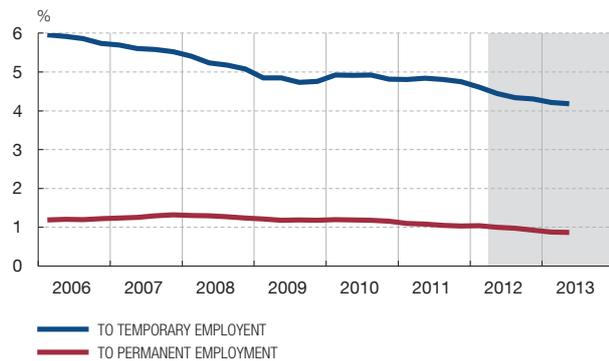
Conclusions

This article has analysed the recent evolution of the main Spanish labour market variables, and has attempted to relate this evolution to the legal changes approved in February last year. The analysis is subject to significant limitations. In particular, the shortness of

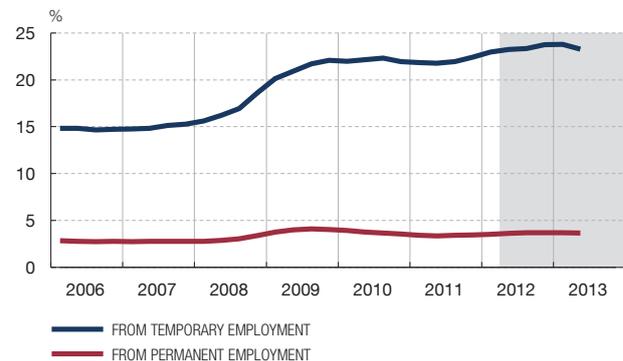
16 A similar analysis to the above-mentioned ones to eliminate the cyclical component of the recent developments in the temporary employment ratio shows no significant changes in the period after the reform that may be associated with the legal changes approved.

17 The statistics available on the cost of dismissal per worker dismissed do not allow a very firm conclusion to be drawn, since it is not possible to separate out from the evolution of the average cost of dismissal possible changes over time in the composition of the dismissed workers.

EMPLOYMENT INFLOWS (a)



EMPLOYMENT OUTFLOWS (a)



SOURCES: Instituto Nacional de Estadística and Banco de España.

a As a percentage of population of origin. Four-quarter average.

the period that has elapsed since the approval of the reform limits the data available, in a context in which distinguishing the possible impact of the reform from that of cyclical factors arising from the adverse economic situation is essential. Also, some of the changes that are structural in nature will only fully manifest their effects over the medium term, when agents have internalised the new institutional framework.

The incipient results point to a deepening of the wage moderation process following the approval of the 2012 reform, which may be starting to reflect greater sensitivity of the wage determination process to the specific situation of firms. That said, no significant increase in the degree of decentralisation of the bargaining system has yet been seen. For its part, the use of the internal flexibility mechanisms that have been introduced has been concentrated among large firms. In relation to employment, the results tend to show a certain positive impact on net employment, which may be associated with the wage moderation observed, although the evidence is less conclusive. Finally, significant progress has not been seen in terms of the composition of employment flows, which continue to be dominated by temporary workers.

Looking ahead, continuous monitoring of the labour market is needed in order to establish the degree of permanence of the patterns observed to date. In this respect, it would be desirable for some aspects of the statistical information to be adapted to the new situation created after the successive labour reforms of recent years. In particular, the information available on aspects such as the procedure for and effective cost of dismissals and the collective bargaining system needs to be expanded.

19.9.2013.

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