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The Spanish labour market: recent developments and the challenges ahead

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Ladies and gentlemen, good morning.

I would like to thank CUNEF, its Rector and the Instituto Español de Banca y Finanzas for this opportunity to, first, celebrate the 50th anniversary of my alma mater and, second, to participate in the beginnings of this new banking and finance research institute, under the auspices of CUNEF. The debate to follow with the institute's Director, Manuel Balmaseda, will provide an opportunity to delve deeper into issues related to the financial sector, financial stability and monetary policy. In this opening address, however, I would like to discuss the key developments in the Spanish labour market over the last four years and draw some economic policy conclusions.

During this period, the global economy has been hit by an unprecedented sequence of shocks, including the pandemic and the energy crisis triggered by the war in Ukraine, which have severely affected the labour market. The way this market functions has also shaped the final impact that such shocks have had on output, aggregate demand, employment and, ultimately, the income of households and firms.

All this has taken place against the backdrop of certain structural trends, such as population ageing and technological change, that are having a significant bearing on the labour market.

Spain's traditionally dysfunctional labour market (evidenced by a persistently very high unemployment rate) has given rise to numerous labour reforms, the most recent coming in 2021, which have also done much to shape labour market developments over the last four years.

With this in mind, allow me to highlight a number of stylised facts regarding recent developments in the Spanish labour market and draw a comparison with its European counterpart.

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The **first aspect** to point out in relation to the Spanish labour market – and a trait shared by most advanced economies – is **the resilience that employment has shown** despite the various shocks to economic activity.

For instance, at end-2023 the employment level (measured as the number of persons in work) was 4.4% higher than at end-2019, in line with the pattern for the euro area as a whole.[1] Meanwhile, at end-2023 Spain's real GDP exceeded its end-2019 level by 2.9%, again in keeping with developments in the wider euro area (3%).

These positive developments were initially underpinned by a moderate adverse employment response during the pandemic. Indeed, the slump in economic activity in 2020 yielded far more muted declines in employment rates than might have been expected given the traditional relationship between activity and employment.

This owed to the singularity of that crisis – caused by a temporary factor that was exogenous to economic developments – and the economic policy response.

[1] On the information available to 2023 Q3, euro area employment had grown by 4.7% compared with end-2019.

In many countries, central to this policy response were job retention schemes to provide an alternative to layoffs, which greatly reduced the need for such dismissals and eased the subsequent return to work.[2]

Labour markets have continued to perform well since, all while global economic activity has been weighed down by, among other factors, the economic fallout of the war in Ukraine since early 2022 and the subsequent monetary policy tightening to restore price stability.

For instance, employment continued to grow at a considerable pace in 2023, against a backdrop of economic downturn. In Spain, at end-2023 employment grew by 3.6% year-on-year, far outstripping the 2% growth in GDP. Similarly, euro area activity grew by just 0.1% year-on-year at end-2023, whereas employment was up by 1.2%.

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A **second defining characteristic** of the last four years is **the number of hours actually worked growing far less robustly than the number of persons employed.**

In Spain, at end-2023 the number of total hours worked stood 2.1% higher than at end-2019, which compares with the 4.4% growth in total persons employed that I mentioned earlier.

In other words, the average number of working hours has fallen, in Spain's case by 2.2% in the four years to end-2023.

The decline has been broad-based across sectors, albeit more pronounced in construction and certain services sectors, such as professional, scientific and technical activities and information and communication.

This same pattern has emerged across the rest of the euro area. On data up to 2023 Q3, average working hours declined by 1.3% in the euro area overall, with sharper falls recorded in Germany (1.6%), the Netherlands (2.8%) and Austria (5.1%). By and large, the drop has been even across sectors of activity.

This downward trend appears to have been shaped by a number of different factors, such as a higher share of total employment being accounted for by public employment (where average working hours are shorter) and an increase in sick leave.

On that last point, according to data from the Spanish Labour Force Survey, in 2023 4.1% of the employed reported absence from work during the reference week due to illness, accident or temporary incapacity, up from 2.4% in 2019.

Similarly, in France the number of workers on sick leave in 2023 H1 was 26% higher than in 2019, in Italy 5% more workers were on sick leave in 2023 Q3 than four years earlier, and in Germany an estimated five additional working hours, in average terms, were lost per worker in 2023 Q3.

[2] See OECD (2021) for an analysis of these effects on the advanced economies overall and Izquierdo, Puente and Regil (2022) for the case of Spain.

Needless to say, were this growth in sick leave to continue, and were it associated with a persistent deterioration in the overall health of the population, the economic impact could ultimately prove significant, both in terms of higher health spending and the adverse effects on labour supply.[3]

In any event, structurally speaking, average working hours in most advanced economies have historically trended downward as a result of technological progress and other factors, such as the growing importance of services sectors, greater female participation in the labour market and a higher part-time employment rate.[4]

We should be mindful of these trends in the context of the recent debate in Spain over shortening the statutory working week. The decline in average working hours has been highly uneven across sectors and firms, thus accommodating firm-specific characteristics and the impact on productivity and labour costs, along with workers' preferences. All of this has come amid a boom in remote working, which has helped to improve workers' work-life balance.[5] Indeed, in Spain 13.9% of the employed worked from home in 2022, either occasionally or regularly, up from around 8% prior to the pandemic.[6]

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The **third aspect to highlight** is that the relatively favourable employment developments are translating into **a very weak performance from apparent labour productivity.**

In the case of Spain, at end-2023 productivity per employee was 1.4% down on the level recorded at end-2019, having declined by 1.5% last year. Hourly productivity recorded cumulative growth of 0.8% over the last four years, with a particularly poor performance in 2023, which ended with a year-on-year decline of 0.8%.

Productivity likewise dropped in the euro area: at end-2023, productivity per worker stood 0.7% below its end-2019 level, while productivity per hour was down 0.8% (based on data up to the third quarter). That fall deepened last year, with productivity down by 1.3% year-on-year in 2023 Q3 both in per worker and per hour terms.[7] The pattern has been broad-based across countries, with year-on-year productivity declines of 0.7% in Germany, 1% in France and 1.7% in Italy.

This is testimony to the fact that the slowdown in activity in 2023 is not, for the time being, translating into lower employment in the main euro area economies. According to European business surveys, this employment resilience could largely owe to firms looking to retain their workers (known as labour hoarding) on the understanding that the adverse shocks are likely to be temporary and, as we will shall see, that there is a labour shortage.

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[3] Hurtado and Izquierdo (2023).

[4] Cuadrado (2022).

[5] Harrington and Kahn (2023) find, for example, that an increase of 10% in remote working narrows the employment gap between mothers and other women by 1%.

[6] In the euro area overall, 24.4% of persons employed worked from home in 2022, compared with 14.9% in 2019.

[7] For 2023 Q4, the productivity per person data reveal a year-on-year decrease of 1.1%.

If confirmed, the projected recovery in activity over the coming quarters would be less labour-intensive and thus compatible with an improvement in labour productivity. Indeed, this is the assumption implicit in the Eurosystem's macroeconomic projections,[8] under which a recovery in real wages would be consistent with cooling inflation, thanks to expectations of favourable productivity developments and an easing of profit margins.

In any event, Spain's poor productivity dynamics are highly structural in nature. In fact, this explains Spain's failure to converge with the rest of the European Union (EU) in per capita income terms over recent decades, or indeed during the last four years. Consequently, the economic policy priorities should include ambitious reforms to improve the country's productivity dynamics, as detailed in the Banco de España's *Annual Report 2022*.[9]

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Fourth, **the resilience of employment in recent years has been relatively heterogeneous across economic sectors.**

For instance, since end-2019 employment has grown relatively faster in the public sector than in the private sector, with the former accounting for 16.9% of total employment at end-2023, up 0.6 percentage points (pp) on end-2019. This increase is higher in Spain than in the euro area.[10]

Employment growth was higher in services (except for trade and hospitality, which were initially hit hard by the pandemic restrictions) than in industry, where employment has held steady compared with end-2019, and agriculture, which has seen a fall in employment over the last four years. In the services sector, the sound performance of professional, scientific and technical activities and information and communication stands out.[11]

These changes in the sectoral composition of employment appear to be associated with two fundamental processes.

First, the necessary reallocation of employment that took place during the COVID-19 pandemic, arising from the uneven sectoral impact of the health measures adopted, which initially affected the most contact-intensive services to a greater extent. Also in play were the greater needs for public sector employment in human health activities that partly explain the behaviour of this variable in this period and have since taken hold.

The second process, which is poised to become more relevant in the medium term, is the impact of the technological changes prompted by digitalisation and, more recently, the development and penetration of artificial intelligence (AI) and robotics.

In this respect, some studies[12] show that such technological developments would not necessarily have an adverse effect on the jobs most exposed to them. Indeed, the relative

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[8] https://www.ecb.europa.eu/pub/projections/html/ecb.projections202312_eurosystemstaff~9a39ab5088.es.html

[9] Chapter 2 of the *Annual Report 2022*.

[10] The share of public sector employment grew sharply in 2020 to a peak of 17.7% in 2021 Q1 and has gradually declined thereafter, reflecting the recovery in private sector employment.

[11] The share of these sectors in total employment in the Spanish economy increased from 12.6% to 13% and from 2.6% to 3.1%, respectively, between end-2019 and end-2023.

[12] Albanesi, Dias da Silva, Jimeno, Lamo and Wabitsch (2023).

share of employment in jobs involving the tasks where AI has progressed the most, particularly jobs with a higher proportion of young people and workers with a high educational attainment level, has increased. This evidence is consistent with the theory that technological change is biased towards highly-skilled employment, reflecting its greater complementarity with technological capital.

Looking ahead, much uncertainty surrounds the impact of AI on the labour market. The productivity gains associated with these technologies could in principle improve total employment income, but the risks of greater inequality and the displacement of certain employment groups are also high. By country, the impact of new technologies will hinge on the development of digital infrastructure, human capital and workers' digital skills, and the flexibility of the labour market and employment policies. According to an AI Preparedness Index[13] combining these institutional factors, the Spanish economy is lagging slightly behind the most developed countries.

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Fifth, the labour force participation rate has recovered strongly in recent years, after falling during the COVID-19 pandemic.

There are two trends worth mentioning here, relating to migratory flows and population ageing.

First, after grinding to a halt during the most acute quarters of the pandemic, immigration flows explain most of the labour force developments in Spain in this period.

Indeed, the foreign population lies behind all the recent growth in the population residing in Spain. In particular, the number of foreign nationals residing in Spain has grown by close to 1.3 million in such period. The foreign population aged 15 and over has grown by 19.1% in Spain, compared with 13.5% in the euro area. This has resulted in larger total population growth in Spain than in the euro area (3.1% and 1.4%, respectively).

This higher relative population growth in Spain explains why in this period, despite cumulative real GDP growth being similar, the Spanish economy has continued to diverge from the EU in terms of per capita income.

Population growth is the main factor behind the increase observed in the labour force, which has grown 4% since end-2019, versus 2.2% in the euro area. In this respect, it is worth mentioning that the share of foreign nationals in the Spanish labour force reached 14.9% at end-2023, up 1.6 pp from end-2019.

Similarly, turning to employment, just over 40% of the almost 1.2 million increase in workers in the period is attributable to foreign nationals.

As for the second trend, the effects of gradual population ageing on the labour market are visible in the most recent period. This phenomenon could have repercussions for not only the size of the working-age population and the aggregate employment level, but also for the composition of employment by occupation and economic sector. In the near term, changes

[13] IMF (2024).

in the working-age population are shaped entirely by the low birth rates of previous decades and immigrant inflows.

Needless to say, this population ageing is driving a very marked increase in the relative share of older workers in the labour force.

Between 2019 Q4 and 2023 Q4, the proportion of older persons (aged 55-69 years) in the labour force grew by 21.1%, while that of young persons (aged 16-24) climbed by 12%, spurred by the recovery in employment. Meanwhile, the share of adults (aged 25-54) shrank by nearly 1.3%. This fall was not caused by a declining labour force participation rate, which in fact has followed a trajectory similar to that of the employment rate. Rather, it was entirely attributable to the shrinking population in this age group.

The recent increase in the participation rate of older individuals is also noteworthy. For instance, although it remains below that of the 25-54s age group, in Spain the participation rate of the 55-59s has risen by 3.3 pp, to 78%, since end-2019, while that of the population aged 60-64 has done so by 8.2 pp, to 57%. Overall, the participation rate of the 55-64s in Spain has caught up with the euro area average rate, with the gap of -2 pp in 2019 Q3 closing almost entirely, to -0.2 pp by 2023 Q4.

Given the better education levels of the new population cohorts, the working population with high levels of education has also risen markedly. The share of the workforce with low education continues to shrink, while growth in the labour force with medium levels of education remains scant, a shortcoming traditionally associated with the limited availability of vocational training.

On the whole, these trends are set to gather pace in the longer term. The various projections tend to envisage an easing of migration flows, with these failing to offset the effects of population ageing on the labour market, leading to a significant reduction in the proportion of the population of working age. According to these projections, population ageing will accelerate in Spain over the coming decades, outpacing both the EU and the euro area as a whole.[14] Moreover, far from being a temporary phenomenon this will become a permanent trend, as illustrated by a dependency ratio that is set to remain above 50% from 2045.

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Sixth, these developments led to a slight increase in the unemployment rate during the pandemic, followed by **a sharp fall in joblessness** that saw unemployment rates reach all-time lows in many advanced economies.

In Spain, at end-2023 the unemployment rate stood at 11.8%, down by 2 pp on end-2019, **albeit well above the lows recorded before the outbreak of the global financial crisis in 2008** (8%).

In the euro area, the unemployment rate stood at 6.3% in December 2023, just 0.1 pp off its all-time low and 1.1 pp below its 2019 level. In any event, Spain's unemployment rate remains almost double the euro area average.

[14] Banco de España (2023).

The favourable unemployment performance has been broad-based across population groups. As compared with pre-pandemic levels, the jobless rate has fallen more sharply among the under-25s (-2.1 pp, although this group still has the highest unemployment rate, at 28.4%) and in the 25-54 age group (-2.3 pp) than for the over-55s (-1.6 pp). Similar patterns have been seen in the euro area, albeit with more even declines across age groups.[15]

Long-term unemployment developments likewise show a strong labour market performance. For instance, in Spain the long-term unemployment rate was 4.7% at end-2023, down by 0.5 pp on end-2019, while the long-term unemployment share stood at 40.3%, down by some 3 pp on 2019 levels. Comparable developments were seen in the euro area as whole, with the long-term unemployment rate declining from 3% at end-2019 to 2.3% in 2023 Q3.

By level of educational attainment, in Spain less educated workers have the highest rates of unemployment (17.3% in 2023 Q3, albeit down by nearly 2.5 pp on four years earlier).[16] In any event, the gap to the highest-qualified cohorts remains sizeable, with an unemployment rate for the university-educated group of 7.6%.

Likewise, the lowest-qualified cohorts have the largest unemployment gap against the euro area, at 6 pp for those with primary education and 6.5 pp for those with secondary education, around twice the gap observed for the university-educated cohort.

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Seventh, despite the high unemployment rate, **the Spanish labour market has come under some strain in recent years.** Specifically, the proportion of unfilled openings (the so-called "vacancy rate") has increased and Spanish firms are finding it hard to hire workers.

According to the latest Banco de España Business Activity Survey (EBAE), 43% of the firms surveyed in 2023 Q4 reported that labour shortages were negatively impacting their activity.

These difficulties appear to stem from a mismatch between the skills needed by firms and those offered by the workforce, with more than half of the affected companies reporting a shortage of suitably qualified workers for the positions advertised. This problem is somewhat more marked in jobs requiring intermediate or higher vocational training and, by sector of activity, in industry, construction and transportation.[17]

Indeed, these considerable differences in unemployment rates across educational attainment levels point to significant discrepancies in the skills composition of the employed and the unemployed. While more than 50% of unemployed individuals have a low level of education, that figure is less than 30% among the employed.

[15] Specifically, -0.4 pp for the under-25s, -1.0 pp for the 25-54 age group and -0.7 pp for the over-55s.

[16] Again, the euro area has seen similar declines: -2.2 pp for low-educated workers, -0.8 pp for medium-educated workers and -0.5 pp for high-educated workers.

[17] Difficulty retaining employees is also relatively common in relation to workers with high levels of educational attainment, although here firms are more likely to report difficulties in offering a competitive salary. See Fernández and Izquierdo (2023).

Given this, one key aim of employment policy should be to improve both active and passive employment policies to help bring unemployment significantly down towards rates more in keeping with those seen in other advanced economies.

Ensuring that the necessary protection of the most vulnerable out-of-work cohorts is combined with suitable incentives for job seekers is key to meeting this goal.

As things stand, Spain's passive policies offer relatively limited coverage while, compared with other countries, it devotes very limited resources (measured in expenditure per unemployed person) to training initiatives to make the jobless more employable. For instance, Bertheau et al. (2023) report that jobs losses are more costly for Spanish workers because they face greater difficulties in finding alternative employment, partly as a result of lower investment in active employment policies.

This, combined with conditions for receiving unemployment benefits (in terms of the need for the unemployed to prove that they are willing and looking for work) that tend to be relatively lax when compared with those seen elsewhere,[18] makes job-seeking a less attractive prospect and helps keep the unemployment rate high.

In the light of the best practices implemented in other European countries, the following options may be worth exploring: i) introducing changes to the duration of the benefits/subsidies, which could be conditional on the economic cycle, or decreasing their amount over time, without reducing the level of protection ex ante;[19] ii) allowing certain benefits/subsidies to be compatible (for part of or their entire duration) with employment, to make returning to work a more attractive prospect; (iii) improving the integration of the different income policies rolled out by the different tiers of general government, strengthening the integration of active and passive labour market policies,[20]; and (iv) properly profiling job seekers and vacancies and rigorously assessing training and vocational integration programmes, and allocating the funds to these on the basis of this assessment.

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Eighth, the temporary employment ratio has declined notably in the most recent period, following the approval of the labour market reform in 2021.

This reform reduced the scope for using temporary contracts and broadened permanent hiring options. As a result, the temporary employment ratio has declined sharply, especially in the private sector, approaching the levels observed in other European countries.

The fall in temporary employment has been accompanied by a notable rise in permanent seasonal contracts, which would appear to account for almost a quarter of the decline in

[18] OECD (2022).

[19] See, for example, the Banco de España *Annual Report 2022*, Landais et al. (2018) and Rebollo and Rodríguez Planas (2020).

[20] AIReF (2019).

temporary hirings. Although permanent, these contracts are characterised by frequent rotation between periods of employment and inactivity over the course of the year.

Meanwhile, the increase in other full and part-time permanent contracts (other than those of a permanent seasonal nature) has coincided with a rise in the destruction rate of such jobs since the reform.[21]

In short, the information available to date points to an increase in job stability, but an even larger decrease in the temporary employment ratio, given the higher labour turnover among workers on permanent contracts.

In any event, a comprehensive assessment of the impact of the labour market reform will have to consider multiple issues, such as those relating to employment, unemployment, wages, productivity and other key macroeconomic aggregates, such as consumption and household saving. This assessment will also require a longer time frame and data analysis that is performed with as much granularity as possible, since the reform is expected to have asymmetric effects on different groups of workers and firms.

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Lastly, this period is notable for the moderate growth in the wages agreed in collective bargaining processes. That said, given the faster growth in total labour costs and low productivity, this has meant that Spanish unit labour costs have grown more than those of our European partners, thus making the economy less competitive on price.

Indeed, the sharp rise in inflation observed since 2021 H1, following a long period of very low inflation, has coincided with moderate wage rises agreed in collective bargaining processes (e.g. just above 3% in 2023).

Moreover, marking a departure from the pattern generally seen in the Spanish economy in previous decades, the degree of wage indexation to past inflation in collective agreements appears to have declined significantly. The percentage of workers covered by indexation clauses against inflation has risen only slightly, to around 25% in recent months, far below the coverage once provided.[22] Furthermore, the degree of protection afforded by these clauses is also lower than before, for the most part only partially offsetting higher inflation.[23]

In this respect, the 5th Employment and Collective Bargaining Agreement, signed in March last year, set out general recommendations for wage increases during the term of the agreement (2023-2025). This will help recoup some of the purchasing power lost, thus contributing to sustaining employment growth while substantially mitigating the risk of second-round effects via prices and wages.

[21] Thus, the aggregate decline in the rates of transition to inactivity since early 2022 is associated with the composition effect stemming from the higher share of permanent contracts.

[22] Around 70% of workers were covered by collective bargaining agreements in the early 2000s.

[23] See Izquierdo and Herrera (2023).

However, since early 2023, total labour costs in Spain have risen more sharply (by around 6%), reflecting the substantial increase in non-wage cost components, mainly concentrated in social security contributions following the various regulatory changes approved.

Meanwhile, the average wage increases are higher than the wage settlements in collective agreements, possibly reflecting different composition effects stemming from the labour market tightness, such as the one I mentioned earlier.

The successive increases in the minimum wage, with an overall rise in real terms of 4.7% between the onset of the pandemic and 2023 and of 34.5% since 2017, have led to an increase in the share of workers subject to this minimum wage of just over 10 pp since 2017, accounting for around 12.7% of the total at end-2023.[24] Thus, the minimum wage now stands close to 60% of the average wage in the economy[25] and at just over 60% of the median wage,[26] although in some provinces (such as Almería, Ourense, Badajoz, Lugo and Cuenca) it exceeds 80% of the regional median wage, while falling short of 60% in Álava, Guipúzcoa, Vizcaya and Navarre.

Overall, compensation per employee in Spain now appears to have recovered its pre-pandemic real purchasing power, and is expected to do so in the rest of the euro area early next year, according to the Eurosystem's latest projections.[27]

Given the Spanish economy's poor labour productivity, its unit labour costs have risen somewhat faster than elsewhere in the euro area. If this continues, it could negatively impact the performance of the external sector in the coming years and, by extension, the Spanish economy's ability to grow and create jobs.

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As we have seen, one of the most striking features of advanced economies, including Spain, in recent years, is the resilience of their labour markets. Looking ahead, this resilience should not be taken for granted in a setting such as the current one, characterised by high uncertainty and in which the prospects for potential medium and long-term growth are poor.

Moreover, we are now seeing transformations of a structural nature. The latest wave of breakthroughs in artificial intelligence, for example, poses major challenges when it comes to ensuring that such developments lead to improvements in productivity and, hence, in workers' wages, and not to the destruction of jobs. Population ageing also presents key

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[24] According to figures from the Continuous Sample of Working Histories (MCVL), 2.4% of workers were affected by the rise in the national minimum wage in 2017; see Lacuesta, Izquierdo and Puente (2019) for more details. The current rate has been estimated based on the information provided by the MCVL on the wage distribution in 2022, updated for 2023 with the average increase agreed for that year in collective bargaining.

[25] Specifically, 57% of the average wage of a full-time worker calculated based on the Structure of Earnings Survey (EES), which includes only workers that have been working for at least two months (including October) and without including the primary and domestic sectors, certain government employees and extra-territorial organisations and bodies.

[26] Specifically, 60% of the median wage calculated based on the MCVL with workers working the entire month on a full-time basis and including all salaried work arrangements. This cannot be calculated with the public information in the EES, since the National Statistics Institute (INE) does not publish figures on median salary by type of working hours (full-time or part-time).

[27] If we take the beginning of the rise in inflation as our starting point, the recovery is expected to take place at the end of this year in the euro area, having already done so in Spain.

challenges for job and productivity growth, far beyond the need to adapt the pension system to the new demographic context.

Furthermore, improving the functioning of the Spanish labour market is essential to correct the factors that have hindered convergence with per capita income in the euro area in recent decades, namely, low productivity and a low rate of employment. In fact, raising productivity and the employment rate is a key element of any strategy aiming to achieve a sustainable reduction in inequality.

Addressing these challenges calls for ambitious reforms, which include improving the institutional framework of the Spanish labour market, modernising active and passive employment policies, reforming the education system, adapting migration policies to cater to the new demographic context and tailoring social protection programmes to align them with the new technological and demographic context. In my opinion, these reforms should be among the economic policy priorities in the years to come.

Thank you.