

JEL Classification Numbers:
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Summary of
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"Explaining Unemployment in Spain: Structural Change,
Cyclical Fluctuations, and Labor Market Rigidities" by Jeffrey Franks

This paper explores the characteristics and causes of unemployment in Spain and provides a brief discussion of recent labor market reform measures and their likely impact. Three characteristics distinguish the Spanish unemployment problem: (i) its magnitude (over 24 percent in early 1994); (ii) its persistence (above 15 percent since late 1981 despite a major economic boom in 1986-91); and (iii) the strength of the cyclical variation in unemployment (nearly 9 percentage points in the last cycle). The roots of the unemployment problem lie in a rapid demographic transformation over the past 15 years that has produced a large increase in female labor force participation and a substantial reduction in agricultural employment. Although the job creation record in Spain in the 1980s compares favorably with that in other European countries, it was insufficient to absorb the increasing nonagricultural labor force.

Two sets of explanations for high and persistent unemployment are explored. The first, called "market-clearing" explanations, looks at reasons why the reported unemployment rate would be high despite well-functioning labor markets. Little evidence is found in support of equilibrium business cycles theories, but between 6 and 12 percentage points of Spanish unemployment could be attributed to workers "voluntarily" unemployed owing to generous unemployment benefits and to those reportedly unemployed but really working in the underground economy.

The second set of explanations, denominated "market-failure" theories, looks at unemployment caused by rigidities in the labor market. Legal restrictions on hiring, firing, and employment mobility have created a labor market extremely unresponsive to fluctuations in the unemployment rate. Econometric estimates demonstrate that the unemployment rate has a unit root--an extreme manifestation of persistence that constitutes evidence in favor of unemployment hysteresis. A simple error correction model of wage determination shows evidence that the wage rate in Spain does not moderate when unemployment increases and does not respond positively to improvements in productivity.

The paper concludes with a brief discussion of recent reforms in the labor market introduced by the Spanish government. While a number of positive steps have been taken, particularly in reducing the generosity of and ease of eligibility for unemployment benefits, it is likely that additional reforms will be necessary if unemployment is ever to fall below 10 percent.