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International Studies Program
Andrew Young School of Policy Studies
Georgia State University
Atlanta, Georgia 30303
United States of America

Phone: (404) 651-1144
Fax: (404) 651-4449
Email: ispaysps@gsu.edu
Internet: <http://isp-aysps.gsu.edu>

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Social Protection and Social Security Contributions in Spain

Ignacio Zubiri
University of the Basque Country

Introduction

In the last thirty years Spain has undergone a radical political, economic and social change. Dictatorship has been transformed into democracy, a closed overprotected and underproductive economy has given rise to a modern and highly competitive economy, and a country with low social expenditure has been turned into a very generous welfare state.

One of the most important changes has been the development of an ample social protection safety net. At present, the Spanish pension system is one of the most generous of the world (in terms of replacement rate), healthcare is free for everyone (in practice even for illegal immigrants) and unemployment benefits are substantial. This social protection is financed by both Social Security contributions and general taxes.

These changes in the social protection safety net, however, have taken place in an economic context that has not been always favourable. On the one hand, just after the so called *transition* (from dictatorship to democracy) there was a long period of sluggish growth.¹ On the other hand, during the last 30 years Spain has had one the highest levels of unemployment among OECD countries. Only in the last 10 years has unemployment decreased significantly and it is still high in comparison with other countries.

The purpose of this paper is to analyze social protection in Spain and its financing, paying special attention to the possible relationship between social protection and unemployment. I will first describe the evolution of the social insurance system in Spain and compare it with that of other countries (section 2). Section 3 describes the evolution of unemployment in Spain and explores its causes. In section 4, I analyze Social Security contributions and their possible impact on unemployment. Finally section 5 contains the conclusions.

Social Insurance in Spain

Social insurance programs in Spain date back to the beginning of the 20th century. For instance, the first old-age program was established in 1921. The Constitution approved in 1931 recognized the right of all workers to old-age pensions, health coverage, unemployment benefits, invalidity and illness pensions, and so on. In any case, the actual insurance programs have a more recent origin, because they were started after the Spanish civil war (1936-39). The old age program was created in 1940, the health insurance program in 1942 and unemployment insurance in 1961.

The two main contingencies covered by the present system of social insurance are old age and unemployment. The insurance system also covers many other contingencies

such as illness, invalidity, survivors, wages unpaid by firms (because a bankruptcy), etc. Health coverage was part of the National Social Insurance Program until 1986. This changed in 1986 with the approval of the *General Health Law* which, among other things, established that healthcare would be provided free to the entire population, and would be financed exclusively by general taxes in the medium term. The *General Health Law* of 1986, therefore, transformed the existing social insurance system of public healthcare (healthcare was financed by contributions and restricted to contributors) into a National Health System (healthcare is financed by taxes and free for the entire population). Following the enactment of the Health Law of 1986, the amount of Social Security contributions used to finance healthcare services started to decrease. This transition process ended in 2000, and all healthcare expenditures of the National Health System since this time have been financed exclusively by taxes².

Expenditure

Expenditures on social protection depend on both the generosity of the benefits and the number of beneficiaries. The two main insurance programs- pensions and unemployment³- offer quite generous benefits, at least in comparison to other countries of the European Union and the United States.

In the case of pensions, benefits have been increasing since the early seventies in to the nineties and have remained basically stable afterwards. In this process, the replacement rate⁴ of pensions increased from less than 50 percent in 1969 to almost 100 percent in 1989, where it has remained to present As a result Spain has become the country with one of the most generous public pension systems (in terms of replacement rate) of the OECD. As Table 1 shows, the replacement rate (net of taxes) in Spain is

much higher than the replacement rate in the United States or even in France or Germany. This does not mean, however, that all pensioners in Spain receive high pensions. In fact, during the last 25 years unemployment has been very high, and as a result of this many retirees could not contribute all the years required to receive a full pension.⁵ Many were not even able to contribute the minimum years of service⁶ and, therefore, received only assistance pensions. In addition, survivor pensions have been quite low.

Table 1. Net Replacement¹ Rates of Old Age Pensions

Country	Net Replacement Rate
France	87
Germany	77
Italy	80
United Kingdom	40
Average EU-4	71
Spain	101
United States	58

Notes: ¹ Replacement rates (pension as percentage of last wage) for an Average Production Worker net of taxes and Contributions

Sources: Casey et al (2003)

As for unemployment, Table 2 shows the evolution of unemployment benefits in Spain and other countries. In the case of Spain, despite the high level of unemployment or perhaps because of it, unemployment benefits have increased from a replacement rate⁷ of 20 percent in the mid-seventies to 30 percent in the nineties. The current rate remains around 30 percent. This replacement rate is similar to that of Germany and Italy, but is 50 percent less than the rate of the French unemployment system. As in the case of pensions, the benefits of the unemployment systems of the United States and the UK are significantly smaller. For instance, the Spanish system offers close to twice the amount of benefits compared to the United States or the UK.

As in the case of pensions, the fact that unemployment benefits in Spain are high does not imply that most of the unemployed are well protected. On the contrary, many long-term unemployed citizens have exhausted their unemployment benefits and only receive minimal unemployment assistance or do not even meet the contribution requirements to receive unemployment benefits in the first place.

Table 2. The OECD summary measure of unemployment benefits¹

	1971	1975	1981	1991	2001
France	24	26	31	38	44
Germany	29	29	29	29	28
Italy	2	2	1	3	34
United Kingdom	25	22	24	18	17
EU-4	20	20	21	22	30
Spain	12	21	28	34	31
United States	11	12	15	11	14

Notes: ¹ The OECD summary measure is defined as the average of the gross unemployment benefit replacement rates for two earnings levels, three family situations and three durations of unemployment

Source: OECD, 2004, Benefits and Wages: OECD Indicators.

In summary, even though the benefits of the Spanish social insurance system are reasonably high, only a fraction of the population has historically received full benefits. In the future, however, most of the population will have full coverage.

Figure 1 compares the evolution of Social Insurance expenditure in Spain, the United States and the EU-4 in the period 1980-2001. As already mentioned this expenditure is the result of generosity (of the system) and need (number of beneficiaries). As Figure 1 shows, during the eighties and beginning of the nineties social expenditure in Spain raised steadily from a 15.2 percent of the GDP (in 1980) to a maximum of 21 percent (in 1993). During this period the expenditure in Spain increased at a similar pace to that of the main European countries (EU-4). Afterwards, social expenditure in Spain decreased while the expenditure of the EU-4 remained basically constant. As a result the

expenditure gap between the Spain and the EU-4 increased substantially. This should, however, not be interpreted as a reduction of social protection in Spain (in comparison to EU-4) as most of the reduction of expenditure is due to the improvement of economic conditions (high increase of GDP, reduction of unemployment, slowing of the ageing of population, and so on.)

As for the comparison with the United States, the social insurance expenditure in Spain has always been much higher. At the beginning of the nineties, Spain spent 50 percent (as a percentage of GDP) more than the United States on social insurance. Even after the decrease of the expenditure in the last couple of years, Spain still spends almost 30 percent more in terms of GDP than the United States on social insurance.

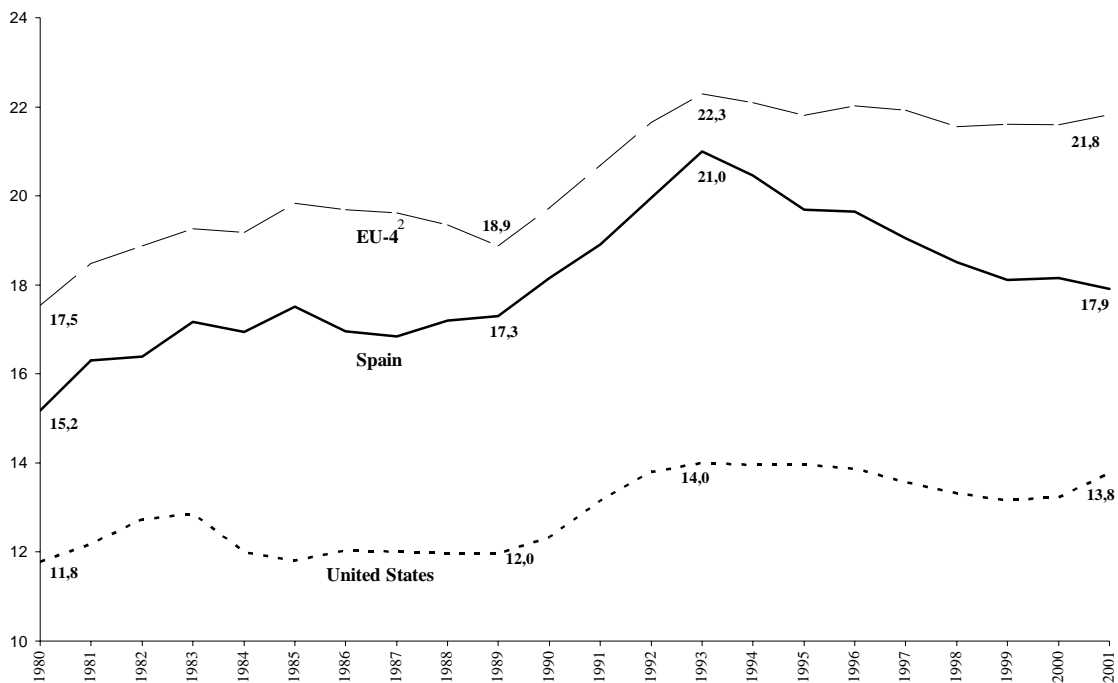


Figure 1. Social Insurance Expenditure¹ 1998-2001

Notes: ¹ Pensions, unemployment and health. ² EU-4 = Average of Germany, France, Italy and UK.

Source: OECD Social Expenditure Database

Financing

Traditionally, social expenditures have been financed by both Social Security contributions and revenue from general taxes. As already mentioned, after the 1986 *General Health Law*, the Health system became a National Health system and, as a result, after a transition period, it became financed exclusively by taxes. Social Security contributions are primarily used to finance pensions and unemployment benefits⁸. Table 3 summarizes the relative importance of Social Security contributions and other revenues (mainly general taxes) in the financing of social expenditure.

Table 3. Financing of Social Protection Expenditure in Spain (1980-2001)

	Social Protection Expenditure ¹ (A)	Social Security Contributions ¹ (B)	A-B	(A-B)/A
1980	15.2	11.2	4.0	73.8
1981	16.3	11.6	4.7	71.2
1982	16.4	11.5	4.9	70.2
1983	17.2	12.0	5.2	69.9
1984	16.9	11.5	5.4	67.9
1985	17.5	11.5	6.0	65.7
1986	17.0	11.3	5.7	66.6
1987	16.8	11.4	5.4	67.7
1988	17.2	11.2	6.0	65.1
1989	17.3	11.6	5.7	67.1
1990	18.2	11.8	6.4	65.0
1991	18.9	11.9	7.0	62.9
1992	20.0	12.6	7.4	63.1
1993	21.0	12.7	8.3	60.5
1994	20.5	12.5	8.0	61.1
1995	19.7	11.9	7.8	60.4
1996	19.6	11.7	7.9	59.5
1997	19.1	11.8	7.3	61.9
1998	18.5	11.9	6.6	64.3
1999	18.1	12.2	5.9	67.4
2000	18.2	12.3	5.9	67.7
2001	17.9	12.5	5.4	69.8

Notes: ¹ As a percentage of GDP

Source: OECD Social Expenditure database and OECD Statistical Compendium

As Table 3 shows, social expenditure (as percent of GDP) increased between 1980 and 1993 and decreased thereafter, while Social Security contributions have remained basically constant⁹. As a result, the share of social expenditures financed by contributions has been decreasing up to mid-nineties, and increasing afterwards. In any case, Social Security contributions have always financed less than 75 percent of social expenditures and, at times, they did not even cover 60 percent of the expenditure. At present they finance about 70 percent of social expenditure.

Employment

Without any doubt, unemployment has been the basic economic problem of Spain during the last 25 years. Figure 2 shows the evolution of the unemployment rate in Spain, the EU-4 and the United States between 1970 and 2003. At its peak in 1995, the unemployment rate in Spain reached 23,9 percent.¹⁰ In contrast, the unemployment rate in the EU-4 was 10,3 percent and only 6 percent in the United States. Even at the present time, after a substantial reduction, the unemployment rate in Spain (11,3 percent) is well above the EU-4 rate (8,1 percent) and the United States rate (6,0 percent).

In the seventies Spain had a very low unemployment rate compared with other countries. For instance, in 1975 the unemployment rate was 4,5 percent, while it was 4.3 percent in the EU-4 and 8.3 percent in the United States. At the time of the *transition*, unemployment started to mount, and almost 2 million of jobs were lost in just ten years (see Figure 3). This, along with a moderate increase in the size of the labor force, led to the unemployment of 3 million people in 1985, which was equivalent to an unemployment rate of 21 percent. Certainly, the decade 1975-85 was a period of economic crisis in most advanced economies due to the oil crises of 1973 and 1979. The

increase in unemployment in Spain was, however, much higher than in any other European country. For instance, between 1975 and 1985 the unemployment in Spain increased by 14 percentage points, while the increase was only of 5.7 percentage points in the EU-4. This suggests that, beyond a general world oil crisis, there were factors specific to Spain that amplified the unemployment effects of the economic crisis.



Figure 2. Unemployment Rate in Spain 1970-2003

Source: Economic Outlook, OECD

There are several reasons that explain why unemployment grew in Spain so much more than in other European countries. The more important reasons were the inflexibility of the labor market, the lack of mobility of workers,¹¹ the high proportion of people still working in agriculture in the seventies and even eighties,¹² the poor education of the population, the existence of many inefficient producers protected by tariffs and export subsidies and, as mentioned, a moderate increase in the labor force. The adverse effects that these factors had on employment were amplified by the fact that Spain was in

transition in the late seventies¹³ from a dictatorship to democracy¹⁴. It is worth mentioning that, even during this period of increasing unemployment, GDP grew slowly.

Therefore, there was a substantial increase in lar productivity.

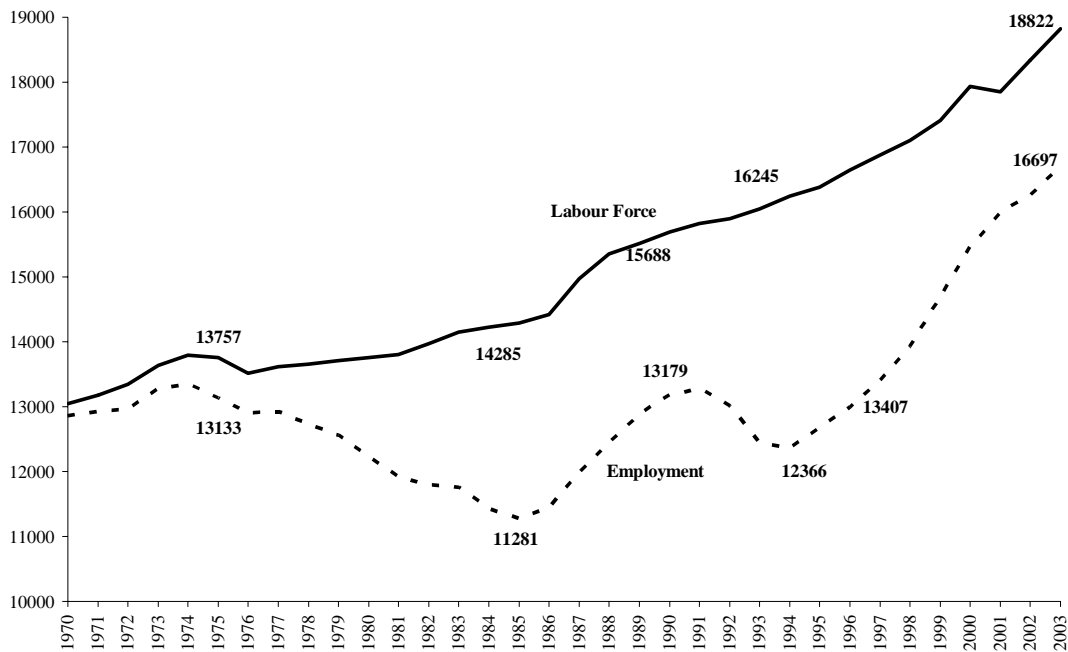


Figure 3. Labor Force and Employment in Spain 1970-2003 (in thousand)

Source: OECD Statistical Compendium

In 1985 the unemployment rate reached an historical maximum of 21 percent for this time period. The following year, however, the Spanish economy started to grow at a high rate¹⁵ and five years later in 1990, the 2 million jobs lost in the previous decade were recovered. The general growth of the world economy and the stimulus provided by the accession to the European Community in 1986 were some of the factors behind the Spanish economic expansion in that period. However, despite the increase in the number of jobs, the unemployment rate dropped only to 16 percent (well above the 7,9 percent of the EU-4) because the labor force increased substantially (by almost 1.5 million people).

The period from 1991-94 brought a sizeable loss of employment. More than 800,000 jobs were lost in just a couple of years. The main reasons were a world economic crisis combined with an overvalued Spanish currency. Furthermore, the labor force increased by almost 600,000 people. As a result the unemployment rate skyrocketed to an historical high of almost 24 percent.

The year 1995 was a turning point for unemployment in Spain. Employment started to grow at a very high rate and in a few years the unemployment rate dropped to 11.3 percent, where it stands now. Such a low level (by Spanish standards) of unemployment had not been seen in Spain since the early eighties. Some of the causes behind this fall in unemployment were the buoyancy of the world economy, the moderation of prices and wages, the consolidation of public finances (due to the requirements of the Stability and growth pact) and the reforms of the labor market regulations (e.g. a reduction of firing costs).

Social Security Contributions

As pointed out above, Social Security contributions cover pensions, unemployment benefits and other contingencies (for instance, unpaid wages in bankruptcies). Until 2000 some of the proceeds from Social Security contributions were used to finance the Healthcare system. Table 4 shows the evolution of Social Security tax rates between 1978 and 2005. Table 5 compares the tax rates in Spain with those of other countries.

As shown in Table 4, despite the increase in social expenditure, Social Security tax rates have remained remarkably stable during the last 30 years (between 36 percent-39 percent). This simply means that a good deal of the social protection has been paid with taxes instead of with Social Security contributions. For instance, as Table 3 above shows,

Social Security contributions financed more than 70 percent of social in the early eighties, but by the mid nineties the percentage had decreased to 60 percent.

Table 4 also shows that even though the total Social Security tax rate contributions have not changed, due to the increases in unemployment, about 5 points of the rate has been shifted from common contingencies to unemployment protection.

Table 4. Social Security Tax Rates in Spain (1978-2005)

	1978	1980	1990	2000	2005
Common contingencies	34.3	34.05	28.8	28.3	28.3
employer	29.15	28.55	24	23.6	23.6
employee	5.15	5.5	4.8	4.7	4.7
Unemployment	2.7	4.0	6.3	7.8	7.55
employer	2.35	3.48	5.2	6.2	6.0
employee	0.35	0.52	1.1	1.6	1.55
Other	1.1	1.1	1.2	1.1	1.1
TOTAL	38.1	39.15	36.3	37.2	36.95

Notes: ¹ Old Age, survivors, sickness, invalidity and up to the year 2000, health

Even though the total tax rate for Social Security contributions has not changed dramatically, due to the high level of unemployment, there have been always a large number of different reductions in the tax rate for employers hiring workers (and offering indefinite jobs) belonging to groups with special difficulties in finding jobs . Most of the reductions are temporary (generally for one or two years) and have been applied to groups such as the long term unemployed, women over 45, or workers finding their first job.

Since 2002, the Social Security System has been utilized to induce workers to stay in the labor market after they have reached the age of 65. To this end, workers with 65 years or more are exempted from Social Security contributions¹⁶. They also receive a 2 percent increase of their pension for every year worked after 65¹⁷. The objective of these measures is, obviously, to reduce the cost of the system of pensions¹⁸.

Table 5 compares the rate of Social Security contributions in Spain with that of other countries. The tax rate in Spain is 35 percent lower than in France and about a 10 percent lower than in Germany and Italy. On the other hand, it more than doubles that of the UK and the United States. In general, Social Security contributions in almost all the EU countries are substantially higher than in the United States. The trivial observation that these non wage labor costs are much higher in the EU, and that the unemployment rate is much lower in the United States, is the basis of the EU Commission recommendation to reduce the Social Security contributions in the member countries¹⁹.

Table 5. Social Security Rates¹ in its Distribution (2003)

	Total Rate	Share of Employee	Share of Employer
France	55.18	24.65	75.35
Germany	42.10	50	50
Italy	42.27	21.7	78.26
United Kingdom	18.37	46.22	53.78
EU-4	39.48	33.14	66.86
Spain	36.95	17.19	82.81
United States	15.30	50	50

Notes: ¹ For the Average paid Worker

Source: Taxing Wages (2004), OECD

Figure 4 shows that the revenue from Social Security contributions has remained stable since 1980 at around 11.5 percent of the GDP. This is a result of the constancy of tax rates combined with the incapacity of the Spanish economy to create employment. Only in recent years (and in the early nineties) when employment has risen sharply have Social Security contributions grown above 12 percent of the GDP. At present they stand at 12.7 percent which is basically the same as in the EU-4²⁰ and 80 percent higher than in the United States.

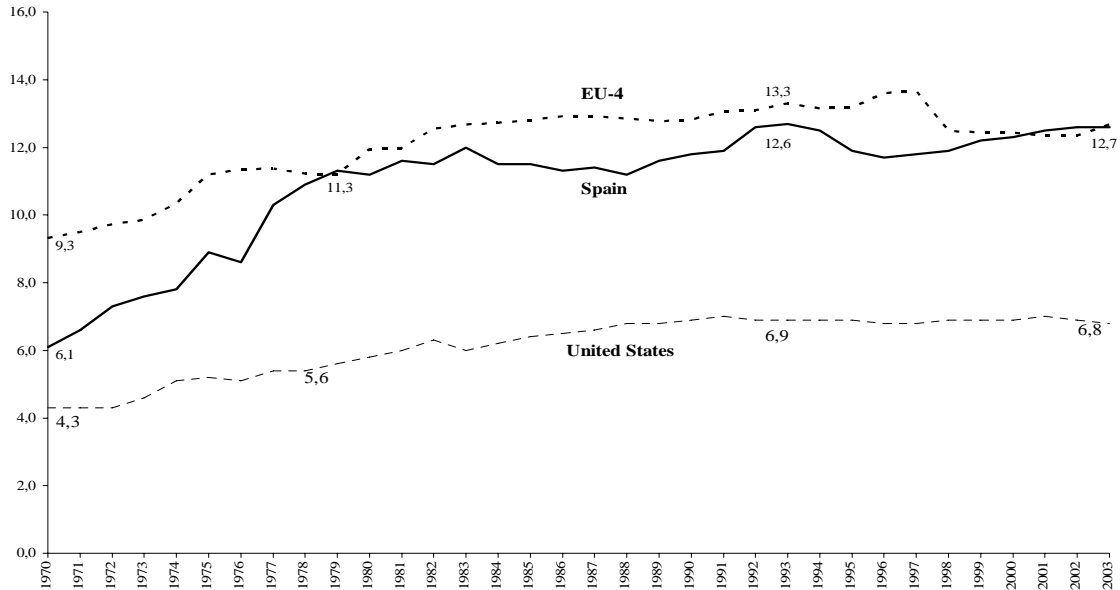


Figure 4. Social Security Contributions (as % of the GDP) 1970 -2003

Source: OECD Statistical Compendium

The Effects of Social Security Contributions on Employment

Social expenditure has grown quite rapidly in Spain. At the same time unemployment has been very high, at least in comparison with other advanced economies.²¹ A natural question to ask is if, to some extent, the financing of social protection is responsible for some of the unemployment. In other words, have Social Security contributions (or other wage taxes) resulted in high labor costs that have in turn caused some unemployment.

Theory

On theoretical grounds, the effects of Social Security contributions on labor costs and employment are indeterminate and, to a large extent, depend on factors such as the structure of the labor market, the bargaining power of trade unions, the elasticities of supply and demand of labor, and so on.

If there is perfect competition and either the labor supply is perfectly inelastic or the workers are fully aware of the future benefits they will receive for the present contributions,²² the Social Security contributions will be borne entirely by the workers in the form of lower wages and the distribution of the total contribution between employer and employee will be irrelevant. This general result has, however, two qualifications. First, it only holds true in the long run. Therefore, even under the assumptions of perfect competition and inelastic labor supply (or full awareness of benefits), an increase in the employer's Social Security contribution will be borne by the employer, at least in the short and medium run²³. The second qualification is that when a country has minimum wage laws, the employers cannot shift their Social Security contributions to workers earning this minimum wage or close to it. That is one of the reasons why it is usually assumed that Social Security contributions are especially harmful for low skilled workers.

On the other hand, when markets are competitive but labor supply is not inelastic or workers do not realize the future benefits of increased contributions today, both employers and employees will share the burden of the tax. The share of each will depend on the elasticities of supply and demand.

When labor markets are not competitive, the incidence of Social Security contributions is much less clear and, basically, anything can happen. The bargaining power of trade unions, the degree of centralization in bargaining,²⁴ the reservation wage²⁵ (which will depend, among other things, of the tax treatment of income sources such as unemployment benefits, and of the extent of the underground economy), market imperfections and the use of wages as incentives for productivity (efficiency wage models²⁶) are some of the factors that determine the incidence of the Social Security

contributions and may change the full shifting result obtained in the standard competitive model with inelastic labor supply.

Empirical Evidence

Theory cannot determine the effect of Social Security contributions on wages and employment. Unfortunately, the empirical evidence cannot resolve this ambiguity either. A widely held view is that the competitive model holds (with inelastic labor supply) and as a result Social Security contributions are borne by workers and have no effects on employment, at least in the long run. Many empirical estimations support this view and show that the effect of taxes on employment, if any, is small. For instance, Blanchard and Wolfers (2000), Gruber, (1997) and Nickell and Bell (1996) find that payroll taxes do not have any effect on employment. Elmeskov *et al.* (1998) and Nickell and Layard (1999), and Nickell (2004) find a moderate impact of labor taxes on unemployment. Nickell (2004), for instance, estimates that a 10 percentage point rise in the tax wedge will reduce overall labor input provided via the market by around 2 percent of the population of working age.

There are also studies suggesting a strong effect of taxes on employment. Daveri and Tabellini (2000), for instance, argue that taxes are responsible for a substantial part of unemployment in Europe.²⁷ Even though their estimations have been seriously questioned²⁸ their results are the support of many of the assertions of the negative effects of taxes on employment.

On the other hand, many studies suggest that institutions matter. For instance, Everaert and Heylen (2002) argue that, except in the case of strong, union bargaining at intermediate levels, there is a full shifting of Social Security contributions to workers.

In the case Spain most of the empirical studies conclude that Social Security contributions are fully shifted to workers²⁹ and that, as a result, they have little effect on labor costs, competitiveness and employment.

Taking everything into account, the least that can be said is that there is not strong evidence that payroll taxes have a significant effect on labor costs and, therefore, on employment. It is not surprising, therefore, that most studies on incidence assume that Social Security taxes (both, the employer and employee part of the tax) are borne by the worker³⁰.

Taxes and Unemployment in Spain

Tax rates and the collection of Social Security contributions have remained basically constant since 1980 in Spain (see Tables 3 and 4). It is, therefore, obvious that Social Security contributions could not have had any effect on either the increase of unemployment that occurred up to 1995 or the decrease in the last years. As for other taxes, as Table 6 shows, the personal income tax has increased steadily up to the mid nineties and then has experienced a moderate decrease. Total taxation, however, has been almost constantly increasing in the last 30 years.³¹ In fact, the highest level of taxation took place between 1995 and 2003, precisely when unemployment experienced the steepest decrease. All this suggests that taxes have little (or nothing) to do with the reduction of unemployment in Spain that started in 1995 simply because taxes, if anything, increased during that period.

This does not mean, however, that a reduction in taxes would not decrease unemployment further. Nevertheless, most of the studies about the causes of unemployment in Spain do not consider taxes as a prominent factor.³² Some studies,

however, consider that the reduction of wage taxes is important to reduce unemployment. For instance, Bentolila and Jimeno (2003) estimate that the structural unemployment rate (as measured by the NAIRU) decreased 7.2 percentage points between 1995 and 2001, and that almost 50 percent of this decrease (3.6 percentage points) was due to the reduction of wage taxes. This result is somewhat surprising. First, the reduction of wage taxes, if any, was small, certainly too small to cause a reduction of 36 percentage points in the unemployment rate. Second, in the same paper these authors estimate that of the 17 percentage point increase of the unemployment rate between 1970-74 and 1995-99, the (substantial) increase in taxes was responsible for less than 1.1 percentage points.³³ Given this information, it is surprising how a small decrease in wage taxes could reduce the structural unemployment so much during the period 1995-2001.

Table 6. Taxes in Spain, 1975-2003 (as a percentage of the GDP)

	1975	1980	1995	2000	2003
Personal Income Tax	2.7	4.7	7.7	6.6	6.8
Social Security Contributions	8.9	11.2	11.9	12.3	12.6
Total Taxation	18.8	23.1	32.8	35.2	35.8

Source: OECD Statistical Compendium

What are the reasons for this increase, and then later decline of unemployment in Spain? As mentioned in section 3, there are several potential causes that led to the increase of unemployment leading up to 1995: inflexibility of the labor market, lack of regional mobility of workers, high proportion of people still working in agriculture in the early eighties, poor education of the population, producers protected by tariffs and export subsidies, a moderate increase in the labor force, the political transition, and two world oil crises. In other words, the causes of the reduction of unemployment that started in 1995 are not all that clear. Nevertheless, some of the factors that have contributed to the

reduction of unemployment are economic growth, wage moderation, reduction of firing costs, and, probably, a more efficient economy.

Conclusions

This paper has analysed the development of social protection in Spain in the last 30 years. During that period, social protection has grown considerably and now Spain has one of the more generous social protection systems of the world: Healthcare is free for the entire population, pensions (as a percentage of the last wage) are among the highest of the world and unemployment benefits are generous. The result of these improvements is that social protection expenditures in Spain have risen considerably.

The expenditure in social protection is financed by taxes and Social Security contributions. The system has always introduced incentives (via temporary reduction of the tax rates) to hire workers with special difficulties to find a job and, since 2002, to workers over 65 (through the exemption of Social Security contributions and a 2 percent increase of pension for every year worked over 65). Despite these incentives, both the general tax rate and the collection of Social Security contributions have remained remarkably constant since 1980. The bulk of the increase in social expenditure has, thus, been financed by general taxes in the last 30 years. Depending on the year, taxes have financed between 60 percent and 70 percent of social protection.

The basic economic problem of Spain has been, and to a certain extent still is, unemployment. Since 1980 the unemployment rate has been well above that of any developed country. At its peak, the unemployment rate in Spain reached almost 24 percent and until 1995 it did not start to decrease significantly. Now it remains a little

above 11 percent. This is a somewhat higher than in most advanced countries, but it is also the lowest rate in the last 20 years.

There is little evidence that Social Security contributions (or other taxes) had any influence in the level or evolution of unemployment. Rather than taxes, the high unemployment is related to factors such as the inflexibility of the labor market and others already mentioned. On the other hand, the reduction in the unemployment rate started in 1995 is likely due to a variety of reasons including economic growth, wage moderation, reduction of firing costs, and probably, a more efficient economy.

Notes

1. According to OECD data, between 1975 and 1983, GDP per capita in Spain decreased from 61.1 percent of the average of EU15, to 52.9 percent. Afterwards it started to recover. Now it stands at 75 percent (almost 90 percent if adjusted by purchase power parities).
2. In the process, the Social Security contribution rate was not decreased. This increased the resources available for pensions and unemployment.
3. Healthcare is provided to the entire population free of charge. Prescriptions, however, have a 40 percent copayment (pensioners and those suffering from a chronic illness are not required to pay for prescriptions)
4. This is the percentage of the wage that is replaced by the pension previous to retirement (for a worker receiving a full pension).
5. To receive full benefits a worker should have contributed for 45 years.
6. To receive some pension a worker has to contribute a minimum of 15 years.
7. Unemployment benefits as a percentage of the wages lost.
8. The rest of expenditure is financed by taxes. Also, if Social Security contributions cannot cover all the cost of pensions and unemployment benefits the "deficit" is financed by central government transfers; that is, by taxes.
9. See section 4 for further details.
10. It should be noted that unemployment has varied considerably across regions, age groups and according to gender.
11. In Spain there have always been tremendous differences in the unemployment rate of regions. These differences, however, didn't give rise to significant migrations within the country. These differences persist today. For instance, in December 2004 the unemployment rate in the region of Navarre was 4.6 percent, while in Andalusia it was 19.2 percent.
12. In 1975, 22.1 percent of the workers were in the agricultural sector. By 1994 the share of workers in agriculture had decreased to 9.9 percent and in 2003 is 5.6 percent. In fact, according to some studies the main cause that explain the much higher unemployment in Spain (as compared to other European countries) is the importance of agriculture. Simply, the agriculture lost more than a million and a half jobs and other sectors couldn't absorb such a large labor force (see for instance, Marimón (1997) and Marimón y Zilibotti (1998)).
13. The *Transition* is the name of the years that followed the death of the dictator Franco and turned Spain into a democracy. It should be recalled that Franco died in 1975 and the existing Constitution was approved in 1978 (the first Spanish constitution dates back to 1812)
14. The political instability and the climate of social unrest made difficult to take certain policy measures.
15. In 1986 Spain's GDP growth rate was 3.3 percent. In 1987 it increased to 5.5 percent. The growth rates of 1988 and 1989 were, respectively, 3.8 percent and of 3.5 percent.
16. As long as previously they have contributed to the system at least 35 years.
17. Also, to discourage early retirement, the reduction of the pension for every year of retirement before the age of 65, was increased to 8 percent.
18. For an analysis of the Spanish pension system, see Zubiri (2003).
19. See, for instance, the Broad Economic Policy Guidelines 2000 and 2001.
20. This average is however misleading because the Social Security contributions in the UK, 6.4 percent are very low relative to the other countries (France, 16.7 percent, Germany 14.7 percent, Italy 12.9 percent).

21. One of the surprising things about Spanish unemployment is that Portugal, which suffered shocks similar to those of Spain (including a political transition to democracy), always had very low unemployment rates. So far there is not a generally accepted explanation for this difference.
22. This simply means that they realize that paying more contributions today will entail receiving more benefits (pensions, unemployment benefits, etc) in the future.
23. One of the reasons is that the shift of the tax from employers to employees will be done, not by reducing today's wage, but by increasing less (even below inflation) future wages. This way, the shifting takes time.
24. Calmfors and Driffill (1988)
25. Pissarides (1998); Nickell and Layard, (1999); Daveri and Tabellini (2000)
26. Shapiro and Stiglitz, (1984) Akerlof, (1984).
27. According to their estimates, the rise of 14 percentage points in labor taxes between 1965 and 1995 in the EU could account for a rise in EU unemployment of roughly 4 percentage points and a growth slowdown of about 0.4 percentage points per year.
28. See, for instance, Everaert and Heylen (2002) and the references therein.
29. See, for instance, Argimón and González Páramo (1987), Escobedo (1991) and Herce (1996)
30. See, for instance, Mitrusi and Poterba (2000) or Pechman (1985). Pechman, however, considers also the possibility that half of the Social Security contributions (the employer share in the USA) are shifted to consumers.
31. To be precise, taxation in Spain increased sharply between 1976 and 1988 (1 point of the GDP per year) and moderately between 1988 and 1993 (0.4 points a year). After a small decrease (due to the economic slowdown) of 3 years, in 1997 total taxation started to increase again very slowly.
32. See for instance, Marimón (1997), Dolado and Jimenez (1997) and Toharia (1999)
33. They impute 1.1 points of the increase of unemployment to both wage taxes and active employment policies.

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