Unemployment in Spain:  An Analysis of Labor Mobility and Young Adult Unemployment

Victoria Garcia-Rubiales
Stanford University, Stanford CA 94309 USA
e-mail: vgarc@stanford.edu

ABSTRACT

In this paper, I investigate the underlying reasons for the high levels of unemployment in Spain. To do so, I compare the labor markets in Spain, the European Union, and the United States to determine which idiosyncratic factors in Spain contribute to the high unemployment level. Then I center my analysis on institutional factors, labor mobility, including geographic labor mobility and the ease with which people transition between unemployment and employment, and young adult unemployment. I conclude that contrary to popular belief, institutional factors are not the main reason for the high unemployment rate in Spain, and in fact, labor mobility has a considerable effect on unemployment. Furthermore, the high unemployment rate for young adults increases the attractiveness of pursuing further schooling rather than entering the labor force, resulting in an overqualified workforce and further increasing the unemployment rate.
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1. Introduction

Persistently high levels of unemployment have become a common trend throughout most of the European Union and contrast drastically with the relatively low unemployment levels in other developed nations, and in particular those of the United States and Japan.\(^1\) This has led to a great deal of research with the goal of finding the common idiosyncratic characteristics of European nations that have led to this disparity in unemployment levels.

However, despite the fact that high unemployment is a common problem throughout the European Union, there are also significant differences in the unemployment rates of each of its members. In fact, in March 2004, unemployment rates in among the members of the European Union vary from a low of 4.1% in Luxembourg to a high of 11.1% in Spain.\(^2\) Therefore, there are clearly other factors idiosyncratic to each of those nations with high unemployment that contribute to this problem. This must be particularly true in the case of Spain since it has persistently had the highest level of unemployment of all of the European Union member nations, and there have even been times during which its unemployment rate was twice the EU average.

In this paper, I analyze the causes for the high level of unemployment in Spain. I first explain the importance of studying this problem and take note of possible causes for unemployment. Then I discuss studies that have compared unemployment in the European Union to that of the United States and Japan and explain possible causes for this difference. After that, I center on Spain for the rest of my analysis. I first compare the Spanish labor market to that of the European Union in general, and take note of any idiosyncratic features of the Spanish labor market. I then discuss the possibility that institutional factors may have had
an impact on the Spanish unemployment rate. Then, I focus on labor mobility. I explain the importance of having a flexible labor market, and then note the disparity in unemployment rates across different autonomous communities and discuss the geographic immobility of labor in Spain. I also discuss the lack of mobility from unemployment to employment. Finally, I describe the problem of young adult unemployment since this is the group of the population with the highest unemployment rate. Finally, I conclude with some suggestions for improvement while noting the obstacles that must be overcome.

2. The Significance of the Unemployment Problem

High unemployment is currently a problem shared by all the nations of the European Union. In fact, the high level of unemployment in European Union member nations is one of the most important characteristics that distinguishes the economies of these countries from that of the United States. This is problematic because when workers are unemployed, there is an underutilization of resources so the total production of goods and services is less than what it could potentially be. Furthermore, if people cannot find jobs in their country or if the pay is lower than in other countries, they may be tempted to relocate to another country where there is a higher demand for labor and wages are higher. This can potentially be disastrous for the future of a nation, particularly if other nations are attracting its top talent. Therefore, if this problem continues to persist in Europe, it could become a decisive factor in the future economic development and political power of these nations compared to the United States.

In addition, chronic unemployment not only affects the status of a nation in comparison to others, it also leads severe domestic problems. Long-term unemployment has

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1 The average rate of unemployment for European Union member nations in March 2004 was 8.0% while the
been shown to lead not only to financial hardship, poverty, dept, homelessness and crime, but also to several other often overlooked key problems such as family tensions and breakdown, social isolation, loss of confidence and self-esteem, and feelings of shame and stigma, which can all lead to the erosion of a healthy society. Furthermore, it is particularly problematic for a society when the unemployment rate for young adults is very high because if young people are consistently unemployed, they may never learn marketable skills or the ones they have obtained through their education may become obsolete before they are employed.

Taking into account all of the negative effects that high unemployment can have on the economy and morale of a nation, it is not surprising that unemployment is currently considered one of the most significant national problems in Spain. In fact, even with the uproar created by Spain’s support of the United States’ involvement in Iraq, a survey by TV1, the national TV station, in March 2003 when the war in Iraq was most controversial, ranked unemployment as the number one concern among Spanish citizens before both domestic terrorism and the war in Iraq. Furthermore, this issue is not new in Spain. Ever since the death of Franco in 1975 and the establishment of a constitutional monarchy, unemployment has been a persistent issue.

3. **Causes for Unemployment**

To determine which differences in the labor markets in Europe and in the United States may have led to high unemployment in Europe, it is first necessary to determine what factors may lead to high unemployment. Nickell (1997) studies this relation between unemployment and measures of labor supply and labor market institutions by running three

unemployment rate in the United States was 5.7% and that in Japan was 4.7%. (OECD)
regressions based on two cross-sections: one from 1983 to 1988 and one from 1989 to 1994. He uses as dependent variables employment protection, labor standards, the benefit replacement rate, the benefit duration, active labor market policies, union density, the union coverage index, coordination between unions and employers, the payroll tax rate and the total tax rate and as independent variables total unemployment, long-term unemployment and short term unemployment.

From these regressions, Nickell concludes that high unemployment is associated with three features: 1) high unemployment benefits which do not put a lot of pressure on those unemployed to find work along with little government intervention to increase the marketability and willingness to work of those unemployed, 2) a high degree of unionization such that wages are bargained collectively however with little coordination between unions and employers, and 3) poor education at the lower end of the labor market. However, the following features have little effect on unemployment: 1) tough employment legislation, 2) high unemployment benefits accompanied by pressure on the unemployed to find jobs and resources to train those unemployed to increase their ability to find jobs, and 3) a high degree of unionization such that wages are bargained collectively with a great degree of coordination between unions and employers.

Plaza (1993) performs a similar study of what factors determine unemployment. She states that from a neoclassical perspective, several such elements can be identified, the first being factors related to the actual job search. The job market is always in a situation of constant change as workers change jobs or enter or exit the pool of those searching for a job. However, the source of the problem lies when these changes take a long time due to the heterogeneity of the workforce and the job openings, the lack of perfect information, and the

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costs of retraining, leaving people unemployed for extended periods of time. Another factor that contributes to unemployment is wage rigidity, due to labor legislation and the influence of labor unions. In fact, the effect of wage rigidity on unemployment is particularly noticeable when prices fall due to a decrease in the demand for products so the marginal productivity of workers decreases. In this case, if labor supply is rigid in the short run and wages don’t change, unemployment results.

4. The United States, European Union and Spanish Labor Markets

4.1 Comparison of the European Union and United States Labor Markets

One of the most drastic differences between the labor markets of the European Union and the United States is the difference between the unemployment rates in these two communities. In fact, Bean (1994) notes that a trend common to all of the members of the European Union, but which is not shared by European nations not in the European Union, the United States, or Japan, is a drastic increase in the unemployment rate from less than three percent before the first oil price shock to a peak of eleven percent in 1985, and its characteristically high level since. To determine which factors have led to this large difference in unemployment between the European Union and the United States, I must first analyze the underlying differences between their labor markets. Nickell (1997) addresses precisely this question. However, he states that this is a hard comparison to make because there is a lot of variation in the labor markets of different European nations.

Nickell compares labor market characteristics in different nations, and concludes that the countries in southern Europe have the toughest laws concerning hiring and firing workers,
working time, fixed-term contracts, employment protection, minimum wages, and employees’ representation rights and that these regulations get weaker further north. In particular, Switzerland, Denmark and the United Kingdom have the weakest laws, and the United States has even weaker laws than these nations. Therefore if inflexibility is equated with legal regulations, it is true that those nations with the least flexible labor force are also those with the highest rate of unemployment. However, the generosity of unemployment benefit systems and the amount of expenditure on active labor market policies varies greatly among all nations, and even these two measures are not always correlated. Furthermore, the importance of unions and the extent of coordination between unions and employers varies greatly as does the payroll tax rate. However, some general trends are apparent. Namely, American workers are more mobile than most European workers both geographically and between jobs. On the other hand, rates of job turnover are not higher in North America than in Europe and overall wages are not more flexible.

4.2 Reasons for the High Unemployment in the European Union

Bean notes that conventional macroeconomic theory would explain the increase in unemployment in Europe since the first oil shock as either a supply-side issue such as an increase in the natural rate of unemployment, or as a demand-side issue such as a negative demand shock. However, the experience of the European Community shows that there are many more determinants of the equilibrium unemployment rate and that there are also important persistence mechanisms not explained by conventional macroeconomic theory, that significantly contribute to this problem.
Dumenil and Dominique (1999) describe the decline in the profit rate in Europe as one possible reason for the high rate of unemployment. This not only explains the slowdown in the rate of capital accumulation, the main cause of unemployment, but also accounts for the difference in technical change between Europe and the United States which have resulted in the difference in unemployment between these two regions. Large profit in comparison to the amount invested in a business results in high levels of capital accumulation, which in turn, leads to the growth of output. However, if there are low profits, then the cash flow of firms decreases putting pressure on liquidity and making firms react more strongly to drops in demand. In this situation, firms will push to decrease the cost of labor, which can lead to unemployment. Particularly, once unemployment is already high, the firms can use their added leverage to obtain more favorable employment conditions from workers, and stagnating labor costs can be linked to decreases in the stimulus to labor productivity.

This explanation makes sense historically since the structural crisis of the 1970s led to a decline in the profit rate, thereby decreasing capital accumulation so that too few jobs were created, and unemployment increased. This dismisses the explanation that high unemployment resulted from an acceleration of technical change since technical change in fact declined in all countries. This also dismisses the idea that lack of demand caused high unemployment since, except for some short periods of time, productive capacity was generally used normally. Furthermore, the differences in the unemployment rate in Europe and in the United States cannot be explained by differences in the growth rates of these two nations since these weren’t particularly different. Actually, the main differences between Europe and the United States were in the unequal rates of mechanization. Europe tried to
catch up technologically during times of structural crisis, and in doing so, created unemployment by another channel.

However, the decline in the profit rate in Europe is not the single cause to which the increase in European unemployment can be attributed, as Bean notes that movements in the terms of trade and counter-inflationary demand policies are also definitely part of the cause. Furthermore, since wages are highly rigid in the European Community and the United States, these factors have had a much greater effect on the unemployment in these regions than in Japan and in European nations that are not part of the European Community. This demonstrates the significance of institutional differences in the process of setting wages. Furthermore, a significant reason for the higher level of unemployment in the European Community than in the United States is that the behavior of the unemployed in the European Community, which leads to the coexistence of unemployment and job vacancies, makes temporary shocks on unemployment have persistent effects, while this is not the case in the United States. This implies that although measures such as reducing hiring and firing costs, limiting union power, and improving training which increase the flexibility of the labor market may decrease the persistence of unemployment in the long-run, additional active labor market policies must be pursued to reduce the current high levels of unemployment.

Finally, as discussed by Nickell and Bell (1995), another possible reason for the increase in unemployment in Europe is the decrease in relative demand for unskilled workers. They note that both the demand and supply of unskilled workers has been falling across OECD countries for many years. They state that evidence shows that the decrease in demand is due to technological change and to an increase in competition from workers from Third World nations. Supply has decreased because more people in OECD nations reach higher
levels of education. However, although supply of unskilled workers has decreased, the decrease in demand has been so great that this seems to have contributed quite significantly to the level of long-term unemployment. In particular, until the 1980s in Britain, the decrease in relative demand for unskilled labor has contributed to about 20 percent of the long-run increase in unemployment.

4.3 Unemployment Characteristics in Spain Compared to the European Union

Martín (1997) notes that the problem of unemployment, which has reached worrisome proportions in all of the European Union has become particularly problematic in Spain, where unemployed reached a high of 21.9% in 1997 compared to the European mean of 11%. European unemployment predominantly affects particular segments of the population, namely young adults, women, and those already unemployed for a long period of time, and in all these cases the effect of unemployment on these groups is particularly strong in Spain.

Furthermore, Spain shares with the rest of the members of the European Union a specific institutional and legal system that implies important rigidities in the functioning of the labor market. Even considering the reforms carried out in 1994, all of these rigidities are even more exaggerated in Spain. In some cases this is due to a greater level of intervention of the government, and other times it is due to the inertia of legislation that has only recently been annulled. Furthermore, it is important to note that Spain is the European Union member with the highest level of temporary employment, which can be very negative for job creation due to its negative effects on productivity.
5. Institutional Factors

5.1 Institutional Factors Particular to Spain

Over time, there have been a series of institutional changes that have modified the differences in expected real wages and in available services between regions, most of which originated in 1975 during Spain’s transition from dictatorship to democracy. One important change has been political decentralization. Since 1975, Spanish provinces have enjoyed a tremendous increase in power through the establishment of provincial parliaments and governments. This is particularly visible in the increase in influence that the provinces have over public spending; in 1993 provincial government accounted for 23% of total public spending compared to 0% in 1980. This has important effects on citizens because it increase.

Another important change has been the consistent improvement of Social Security benefits. Government programs to promote the general well being of citizens have been expanded to such a degree that spending on Social Security programs such as pensions and welfare increased for 18% of GDP in 1980 to 24% of GDP in 1993. Unemployment compensation has also been expanded both in terms of who qualifies for it and in length of coverage. For example, those who qualified for unemployment compensation insurance increased from 43% of those identified as unemployed by Spain’s Active Population Survey in 1976 to 56% in 1993. Furthermore, a generous subsidy has been instituted to help those who are unemployed from the agricultural sector in the provinces of Andalucía and Extremadura.

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4 Bentolila, 172.
Finally, since trade unions were legalized in 1977, they have gained tremendous importance. In 1997, 80% of those employed belonged to a union. This is particularly important because trade unions have systematically exerted pressure to reduce salary differences between regions. Furthermore, the influence of trade unions has become even more significant since the Euro substituted national currencies. The Euro has made it very easy to compare the agreements that trade unions reach across countries, so trade unions have started to exert pressure on domestic governments so that the best agreement reached by trade unions anywhere in the European Union is also extended to their location. This has already had noticeable effects.

5.2 The Effect of Institutional Factors on the Unemployment Rate

However, although it may at first seem like institutional factors are clearly the behind the high unemployment rates in Spain, this is not necessarily the case. Cebrián (1996) analyzes the impact of unemployment insurance on the exit probability from unemployment. He finds some correlation between the length of benefits and the length of unemployment and an increased probability of exiting the unemployment at 6 months before the end of unemployment benefits. Therefore, this could indicate that unemployment benefits serve as a deterrent to returning to the labor force once unemployed. However, Cebrián finds that evidence from Spain does not fully support this view and suggests that this simply reflects the higher exit rate of groups with shorter entitlement periods because groups with the similar length of entitlement have even patterns of exit rates. In fact, Cebrián believes that, on the whole, “unemployment benefits do not exert a clear negative influence on the job search

5 Bentolila, 172.
behavior of the unemployed." Therefore, I will center my analysis on other possible causes for the high unemployment rate in Spain.

6. Labor Mobility

6.1 The Importance of a Flexible Labor Market

If a nation has a flexible labor market, this means that there is a fast turnover of unemployed people and that there is a tendency to move to those regions with lower unemployment, therefore decreasing the overall unemployment rate. This is always beneficial for a nation. However, having a flexible labor market has become particularly important since Spain became a member of the European Union. Joining the European Union imposed strict limits on Spain’s power to use an independent fiscal and monetary policy to combat fluctuations in the economic cycle. This is particularly significant in the case of asymmetric macroeconomic shocks that because it eliminated Spain’s ability to use the exchange rate to manage these shocks. With these restrictions, it becomes extremely important to have flexible prices, wages and labor market to prevent negative macroeconomic fluctuations from resulting in severe and persistent decreases in productivity and employment. Therefore, as well as being of tremendous importance due to the influence that they have on the unemployment rate, labor market flexibility, including the speed with which the unemployed find jobs and the geographic mobility of labor, and wage flexibility have become especially important to ensure a healthy economy.

6 Bentolila, 172.
6.2 Disparity in Regional Unemployment Rates

Large differences in unemployment rates are not limited to different European Union member nations. This same phenomenon is found when the unemployment rates of the different autonomous communities in Spain are compared. In fact, in March 2004, autonomous community unemployment rates varied from a low of 5.1% in Navarra to a high of 18.2% in Andalucía. This disparity in unemployment rates is not a new phenomenon and has actually been present since the democratization of Spain in 1975. Furthermore, these differences are characterized by being remarkably stagnant: those provinces with unemployment rates higher than average seem to maintain this characteristic throughout history as do those with lower than average unemployment rates. It is important to take this into account because this indicates that there must be some idiosyncratic factors that have made these differences in unemployment rates persist. This may be due to wages being very slow to adjust to shocks in the economy, shocks to the economy of individual regions or different responses to a shock to the Spanish economy as a whole may leave a lasting effect on the unemployment rate of a region.

Plaza (1993) analyzes the reasons behind this phenomenon. She studies the reasons for the disparities in unemployment for the time period from 1976 to 1985. She explains that from a purely neoclassical and traditional perspective, there are three elements that create unemployment: 1) factors related to the job search, 2) inflexible wages, and 3) fluctuations in the aggregate demand for products. At any particular time, there are always some people looking for jobs and some employers looking for workers to fill up vacancies resulting from workers who quit or are fired, or from an expansion of the business. The reasons for the lag

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8 La Caixa.
in matching up those looking for a job with available openings up are the heterogeneity of the
workers and employers, the lack of perfect information, and adjustment costs such as the costs
associated with retraining. This unemployment caused by factors related to the job search is
denominated frictional unemployment, and is inevitable even in competitive labor markets.

Inflexible wages also contribute to the mismatch between supply and demand for
labor. This inflexibility usually results from some combination of government policies, such
as the minimum wage, and union agreements which establish wages above competitive ones
through collective negotiation. In fact, there is a direct relationship between the standardized
salary in a region and its unemployment rate, which may indicate that in some regions wages
are fixed by the government or unions to be significantly higher than the competitive level,
resulting in a disequilibrium between the supply and demand for labor. Inflexible wages also
contribute to unemployment when there are fluctuations in the aggregate demand for
products. If aggregate demand falls, the price of the products falls as well, resulting in a
decrease in the marginal product of labor. Since labor supply is fixed in the short run, if
wages don’t decrease, this will create cyclical unemployment due to a lack of demand for
labor.

Plaza then uses this theory to analyze the situation in Spain by identifying which
factors would contribute to each of the elements that create unemployment which of these
factors may account for the disparity in regional unemployment rates. She notes that in
addition to this disparity, there is a great deal of consistency in the distribution of the
unemployment rates, and in fact, the correlation coefficient between the unemployment rates

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9 In 1985, unemployment rates in different provinces varied between a low of 5.4% in Lugo to a high of 34% in
Badajoz, while the national average unemployment rate was 22%. (Plaza, 124)
in 1985 and 1976 is 0.84. This suggests that the difference unemployment rates must be the result of “stable” characteristics of the economy.

Finally, Plaza observes that those variables that characterize the institutional structure of the workforce have a great influence on the geographical distribution of unemployment although the significance of these variables is ambiguous because they could indicate the rigidity of the labor market resulting from unions or regional differences in human capital. Consequently, although we do not currently have enough information to determine what the institutional effects are on the unemployment rates in different provinces, we can conclude that the variations in the unemployment rate between provinces is the result of both factors of related to the competitive characteristics of the workforce and to some institutional factors.

However, although this study attempts to find reasons for the disparity in the unemployment rates of different autonomous communities, it centers solely on the inherent differences between the autonomous communities that may have led to this phenomenon. It simply assumes that if these characteristics persist, then the disparities in unemployment between the regions will persist as well. In particular, it does not question why these disparities have not been eliminated by immigration from those autonomous communities with high unemployment rates to those with little unemployment. I will study this question in the following section.

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6.3 Geographic Labor Mobility

A persistent characteristic of the Spanish labor market since Spain became democratic in 1975, has been a very low rate of interregional immigration. Spain’s experience in 1994, the worst year of the mid-nineties recession, is particularly illustrative of this fact. In 1994, unemployment in Andalucía, the southernmost autonomous community in Spain, reached 34%, the highest level that Andalucía has experienced in recent history. On the other hand, another province, Aragón, had an unemployment rate of only 16%, which is very low compared to the country’s mean unemployment rate of 23%. Normally, one would expect this to result in a surge of immigrants towards other autonomous communities with relatively low unemployment rates, such as Aragón. In fact, this prediction is even reinforced by the fact that Andalucía has the second lowest per capita in the nation. However, this immigration did not take place. On the contrary, Andalucía had a net increase in its population of 2,327 people, which although small is still surprising.

In a competitive economy, movements of labor would be generally expected to equalize a nation’s regional unemployment rates since workers would be expected to move from regions with high unemployment to those with lower unemployment. However, even taking into account the fact that there may be some differences in unemployment rates between different regions to compensate for differences such as different quality of life, the reality in Spain is far from this ideal. In fact, there is a tendency for autonomous communities that had relatively high unemployment rates in 1975 compared to the other autonomous communities, to continue to do so in 2003 and for those that had relatively low unemployment

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11 Bentolila, 168.
12 Bentolila, 168.
rates in 1975 to continue to do so in 2003, and this is particularly true for those regions with the highest and the lowest unemployment rates.

**Figure 1**

![Regional Unemployment Rates](image)

Furthermore, one of the key factors in determining the unemployment rate of a province seems to be its physical location since provinces nearby generally have similar unemployment rates. In addition, differences in unemployment rates among provinces seem to be largely due to equilibrium factors rather than non-equilibrium ones. Finally, the factors that cause these differences have changed over time. In the 1980s, differences in labor costs and the amount of specialization of labor were the main cause for differing levels of unemployment. However, by the end of the 1990s, these factors became less important and the key determinants of unemployment became the kind of industry found in that region, demographic factors, and the physical location of the province. Therefore, any attempts to fix the disparity

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13 Data from: La Caixa.
in levels of unemployment must take into account these factors. This leads me to believe that part of the underlying reason for the high rate of unemployment in Spain is the unwillingness of labor to move from those locations with higher unemployment to those with lower unemployment.

According to economic theory, the decision of whether or not to migrate depends on an individual’s valuation of the current and future costs and benefits of this move, in order to maximize their expected utility over their lifetime. In practice an individual’s decision to immigrate fundamentally depends on: 1) their expected current and future relative wage levels, 2) the relative unemployment rates and unemployment compensation, 3) the ease of finding a home, 4) the costs of immigrating, obtaining information, and psychological costs of abandoning one’s culture, and one’s friends and acquaintances. I believe that since unemployment is so high in Spain, this mitigates difference between expected wages in different provinces. I believe that this, coupled with strong psychological costs of moving due to cultural reasons are the factors most responsible for the small amount of interregional immigration.

Several studies analyze these phenomena. Bentolila (1999) proposes several reasons for the small amount of interregional immigration. However, first of all he notes the importance of taking into account the context when analyzing the implications of immigration rates because he notes that the increase in the national rate of unemployment has drastically reduced job opportunities in all of Spain, which has negatively affected migration. In other words, migration is more dependent on the relative rates of unemployment between provinces rather than on the absolute differences in these rates. Antolín (1999) expands on this by explaining that the difference in unemployment rates between two regions measures the
difference in the likelihood of finding a job in one region compared to another. Therefore, the amount of labor migrating from one region to another should depend on how large the difference in unemployment rates between regions is, such that the larger these differences, the larger the amount of migration. However, it is important to take into account that if the national unemployment rate is relatively high, then since the probability of finding a job anywhere in the country decreases, this decreases the importance of the relative unemployment rate differentials. This implies that in the case of Spain, in which the national unemployment rate has historically been high, it is important to take into account the relative difference in regional unemployment rates adjusted for the national unemployment rate at each time period.

Bentolila explains that a series of institutional changes resulting from the change to a democratic political regime, and which include the decentralization of politics, the regional redistribution of the taxes, and the increases in unemployment benefits has decreased the differences in expected real wages between provinces. The regional convergence resulting from these factors has mitigated the traditional incentives to migrate. Furthermore, he finds that since the mid-1980’s although interregional migration has increased, this migration is generally from those regions with the highest wages and the lowest unemployment rate to those with the lowest wages and the highest unemployment rates. Bentolila proposes several reasons for this new phenomenon. He believes that this generally occurs either because they are moving back to where they are originally from and where a large part of their family lives or because they value some aspect of the lifestyle in the region that they are moving to. He

14 Bentolila, 169.
also notes that those who migrate to regions with high unemployment are generally people who already have a job and are transferred to a new location rather than those who move in search for a job. This supports my proposal that cultural reasons such as a strong attachment to family or placing a high value on a particular lifestyle are important reasons for the lack of immigration to regions with lower unemployment, since Bentolila shows that they can actually even be reasons for moving to regions with higher unemployment.

6.4 Labor Mobility in Joining the Labor Force

In analyzing the factors that affect unemployment, it is crucial to study how mobile labor is in moving in between the three states of inactivity (not participating in the labor force,) unemployment, and employment. In particular, it is important to examine how quickly labor can shift between unemployment and employment because different flows of labor between these two states can lead to similar unemployment rates even though they would be indicative of different problems in the labor market, and would therefore call for distinct solutions. For example, an increase in unemployment of 10,000 people could be caused by 100,000 people who were previously employed becoming unemployed and 90,000 who were previously unemployed being employed or by 10,000 who were previously employed becoming unemployed and no one who was previously unemployed being employed. However, although these situations both result in the same change in the unemployment rate, they represent very different markets, with the second situation portraying a very stagnant labor market.

When the economy suffers a negative shock, the flow of workers shifting from employed to unemployed will increase, so the number of unemployed workers will increase.
However in a dynamic labor market, following the negative shock, the flow of workers shifting from unemployed to employed will also increase so the unemployment rate will return to its original equilibrium level. Therefore, in a single economic cycle, the increase in each of these flows will tend to be about the same size. If the economy of a nation acts as previously described, labor mobility between the states of unemployment and employment will be high, and consequently, the duration of unemployment for most workers will be short.\textsuperscript{16}

However, the Spanish labor market does not act in this way. Antolín (1999) analyzes the Spanish labor market and reaches the conclusion that the problem of unemployment in Spain is reinforced by the fact that there are large flows of workers moving from employment to unemployment that are not caused by an economic downturn and are consequently not subsequently balanced by flows of workers becoming employed. Therefore, the Spanish labor market is unable to cope with large increases in the number of workers becoming unemployed, which makes part of these increases in the unemployment rate persist over time.

7. Young Adult Unemployment

Since 1975, the group with the highest rate of unemployment in Spain has persistently been young adults between the ages of 16 and 24. Therefore, it is important to study this group in more detail to determine the particular characteristics of this group that have led to this phenomenon.

The supply of young workers is determined by their decision to enter the work force, and once they have decided on this, by that of whether to accept or reject a job offer. Castillo

\textsuperscript{16} Antolín, 472.
and Duce (1997) discuss factors that affect the supply and demand of young adults in the labor force. They conclude that despite the fact that the generous unemployment compensation schemes that exist in Spain, this is not one of the main factors that affects the supply of labor. In Spain, unemployment compensation is only received once one has been part of the labor force for a certain amount of time. Therefore, since most young adults have not previously worked, when they are deciding on whether they should enter the labor force, unemployment compensation should not factor into their decision because they would not be receiving any anyways. In fact, in 1997, over 82% of unemployed young adults was looking for their first job, so unemployment compensation was only really relevant to 18% of unemployed young adults.\(^\text{17}\)

Castillo and Duce state that there are two main factors that affect supply for workers. First of all, legislation on minimum wages affect the decision of firms to hire workers. Although they do not believe that the mere existence of a minimum wage really has an effect on the decision of firms to hire young adults, they do believe that the level at which this minimum salary is set has a direct effect on unemployment. Secondly, they argue that the quality of governmental programs designed to fight unemployment has a substantial effect on their unemployment rate. These programs have the objective of increasing labor force mobility, improving the qualifications of the unemployed, and providing services that facilitate the job search. Castillo and Duce explain that it is important to take into account not only the amount of money designated for these programs, but also how it is spent, since both of these factors determine their quality.

According to Castillo and Duce, the most important factors that have led to such a high unemployment rate for young adults are institutional demand side factors through which the government influences the demand of companies for young adult labor. However, in their study, they do not address the mismatch that exists between the skill sets demand by companies and the actual skills that young adults have. I believe that this mismatch exists because the high unemployment rate for young adults increases the attractiveness of pursuing further schooling rather than entering the labor force and this has resulted in an overqualified workforce.

According to the Theory on Human Capital, an individual will choose to invest in further schooling if its expected utility is higher than that of entering the labor force if he had a job offer. Therefore, the decision to pursue further schooling will depend on three factors: 1) the probability of finding a job once a higher level of education has been obtained compared to the probability of finding a job while having a lower level of education, or in other words, the difference in unemployment rates for different education levels, 2) the expected salary for workers with different education levels, or in the other words, the difference in mean salaries for different education levels, and 3) the quality and duration of the schooling.

A cultural feature particular to Mediterranean nations is the large support system that families traditionally provide. It is very common in these nations for young adults in their 20s and 30s to continue to live at home and be supported by their parents. In fact, most people live at home until they get married, and in extreme cases they may even continue to do so after marriage until they are certain that they can provide for themselves without any extra help. Consequently, despite the fact that young adults are those with the highest
unemployment rates, due to this familial support system, most young adults do not suffer severe economic hardship as a result of unemployment.

Although the familial support system benefits those young adults who are unemployed and those who despite having a job are not making sufficient income to completely support themselves, it also has a huge drawback in that it contributes to the mismatch in the supply and demand for labor. In particular, it contributes to this mismatch in two specific ways: it decreases the consequences of being unwilling to accept job offers, and it results in an overqualified labor force because since young adults are not forced to support themselves, it becomes very appealing to pursue further schooling if it is hard to enter the labor force.

This is explained by the consequences resulting from the increase in unemployment in Spain at the end of the 1970s and the inherent rigidities in the Spanish labor market. First, individuals have increased the amount of time that they spend on their education with the objective of increasing their likelihood of finding a job. Second, this has led to a mismatch in the labor market between job openings and those looking for a job with differing levels of education. Furthermore, the fact that the education system in Spain has not developed in a steady fashion and that it has occurred simultaneously with an acceleration of technological progress and the opening of the Spanish economy, has also contributed to this mismatch. This has led to a drastic reduction in the relative demand for workers with low levels of education along with a radical increase in the demand for education. This increase in demand for education has resulted in a little planned increase in the amount of resources invested in educational purposes, particularly in higher education. This has led to a weakly-structured educational system.
The large amount of investment in higher levels of education has led to a situation of an excessively-educated labor force so that the supply of highly-educated labor has grown much more rapidly than its demand. This has led to an increase in the unemployment rate of highly educated workers and a decrease in the wage differential between these workers and those with low levels of education. Furthermore, this has led to the substitution of highly educated labor for unskilled labor in those jobs which have traditionally served as a pathway to enter the labor force and as a stepping stone to rise in the labor market. In fact, Jose Garcia-Montalvo notes that around 30% of the Spanish labor force has an education level superior to that required for their job. As a consequence, the unemployment of unskilled labor has increased even more drastically than that of skilled labor. However, the decrease in the benefits received from having a higher degree of education has not resulted in a decrease in investment in this kind of education. Therefore, the result has been a substitution of high skilled for unskilled labor with a consequent increase in unemployment of both of these kinds of labor.

Therefore, the Spanish system of education has contributed to the difficulty that young Spaniards have in entering the labor force because it is centered on education at the university level with very little investment in technical education. This has resulted in a labor force with an excessive number of people with higher education degrees resulting in an overqualified labor force for certain administrative jobs. This problem has been exacerbated by the institutions that are supposed to match labor supply and demand because they are obsolete, so they do not do a good job fulfilling this purpose.

8. Concluding Remarks
Although it is often assumed that institutional factors are the main reason for the high levels of unemployment in Spain, this does not seem to be the case. The lack of labor mobility, both geographically and in moving between unemployment to employment, have demonstrated to be more significant in contributing to the unemployment problem. Therefore, programs should be instituted to promote immigration to regions with low unemployment. One such program that would provide this incentive would help those who immigrate find homes and provide incentives such as government subsidies for buying homes where they immigrate.

However, due to institutional and cultural factors it would be very hard, and impossible in the short run, to eliminate the disparity in unemployment between different regions simply by increasing the mobility of labor. Therefore, other programs should also be used to try alleviate the problem of unemployment by developing the economies of those regions with the highest unemployment rates to create jobs and thereby decrease unemployment. This economic development can be achieved through investment and entrepreneurial initiatives either domestically or by people from other regions, and both of these methods should be considered as options to promote economic development.

Furthermore, the situation of young adults in Spain is particularly worrisome since they are the segment of the population with the highest unemployment rate. This problem is predominantly due to a mismatch in the skill set demanded and that supplied due to an overqualification of the workforce. To combat this, it is necessary to improve to Spanish education system by increasing the number and appeal of technical schools and improving those institutions that match the unemployed with jobs. Furthermore, the problem of the high rate of unemployment for young adults would be drastically reduced if the overall
unemployment rate decreased because if it were easier for young adults to find jobs this would decrease the appeal of pursuing further schooling, therefore reducing the overqualification of the workforce and the consequent mismatch in the skill sets demanded and supplied.

Finally, although there has been no improvement in the unemployment rate in Spain, there is a favorable trend in the value of the profit rate. Companies have begun to economize on fixed capital, and this has led to an increase in the profit rate. Although this has not yet led to an increase in the profit rate or capital accumulation, and has therefore not yet affected unemployment in Spain, this has led to an increase in information investment, and therefore presents hope for the future.
Bibliography


