

# Spain's Persistent Unemployment in a Growing Economy

Jack Freimann

Macroeconomics Fall 2025

Joe Anderson

## **Introduction**

Spain stands out amongst advanced economies for a striking contradiction. In recent years, Spain's GDP has consistently outperformed most of its European counterparts, supported through favorable financial conditions. Yet unemployment remains extremely high at around 10-11 percent, nearly double the Eurozone average, and highest amongst all European countries. This combination of strong growth and persistently high unemployment is unusual among advanced economies and suggests a deeper economic problem.

This paper argues that Spain's unemployment issue is predominantly structural rather than cyclical. In other words, unemployment persists not because the economy is weak or experiencing a slowdown, but because long-standing features of Spain's labor market and growth structure have prevented economic growth from translating into jobs.

To explain this, the paper relies on two standard macroeconomic models, both of which were covered intensively in class. First, the Solow Growth Model is used to show why economic growth driven by capital accumulation and demand recovery alone cannot sustainably reduce unemployment when productivity growth is weak. Second, a simple automation and taxation framework explains why Spain's labor market institutions encourage firms to respond to growth by substituting toward machines rather than hiring workers. Based on these insights, the paper proposes a policy package aimed at reducing labor market duality, raising productivity, and correcting hiring distortions. These reforms would raise long-run output and employment without sabotaging sustainable growth.

## **Current Labor Market Conditions**

Spain's unemployment rate remains the highest in all of Europe despite several years of strong GDP growth. While unemployment across the Eurozone has fallen close to historical lows, Spain has struggled with unemployment rates above double digits. This has the largest effect on young workers and long-term unemployed individuals, increasing the risk of persistent skill loss and labor market detachment.

A defining feature of Spain's labor market is its historical reliance on temporary contracts. These contracts are easier for firms to terminate but provide little employment security or training for workers. As a result, employment relationships are short-lived, labor turnover is high, and firms have little incentive to invest in workers' long-term skills. Spain's reliance on temporary contracts has had a slight decline since the 2021 labor market reform, with the temporary employment rate dropping sharply by about 12-13% by 2024. With this being said, Spain's temporary labor market is still alarmingly high at about a 15% employment rate at the end of the quarter 2 in 2025, about 3% above the European average.

Employment is also heavily concentrated in service-based sectors such as tourism, hospitality, and retail, which are highly sensitive to economic shocks and, on average, less productivity-intensive than Spain's manufacturing and financial sectors, even though some have improved productivity since the pandemic.

## **Why Persistent Unemployment Matters**

High unemployment is not just a number on a chart, rather it affects how much a country can produce, how much the government can spend on public services, and how secure people feel about their futures. In Spain, this is especially important because unemployment has remained at

a high level for many years, even when the overall economy has been growing quickly. When many people who want to work cannot find jobs, the country produces less than it could if everyone who was willing and able to work had a job. That “missing” production shows up as slower growth in goods and services. At the same time, fewer people working means the government collects less in taxes from wages, while often paying more in unemployment benefits or other support programs. This combination makes it harder to fund things like schools, hospitals, and infrastructure without increasing debt or raising other taxes.

High unemployment also affects how income is shared across society and can create disconnection within the workforce. People with secure, well-paid jobs can keep earning and saving, while those who are unemployed or stuck in unstable work struggle to pay bills or build any financial cushion. Over time, this gap can widen, leading to more visible differences between those who are “inside” the labor market and those who are left out.

When young people cannot get a stable first job, they miss out on crucial early experience that helps them learn skills, build professional networks, and move up to better positions later on. Instead of progressing, they may move between short-term jobs, unpaid internships, or periods of inactivity. This can lead to “scarring”: even years later, they may earn less and be more likely to be unemployed than peers who entered the job market smoothly. Long periods without work also affect people’s confidence and mental health. Some may eventually stop looking for work altogether because they feel there is no point, which is what economists call “labor market detachment.” When many young people feel shut out in this way, frustration and distrust can grow, putting pressure on social cohesion and political stability.

In a typical economic slowdown, unemployment rises when growth is weak and then falls again when growth returns. If that were the whole story, strong recoveries and expansions would eventually pull unemployment back down to low levels. In Spain, however, unemployment has stayed high even during periods when the economy is growing faster than many of its European neighbors. That tells us something deeper is going on. This pattern suggests that the main cause of Spain's unemployment is not just temporary ups and downs in the business cycle, like a recession or a financial crisis. Instead, it points to more persistent features of how the economy is organized: the types of jobs that are created, the way contracts are structured, how easy or hard it is to hire and fire workers, how well workers' skills match employers' needs, and how productive firms are. Economists call these "structural" factors.

## **Explaining the Puzzle Using the Solow Growth Model**

The Solow Growth Model provides us with useful information for understanding why economic growth does not always lead to lower unemployment. It starts from the basic idea that an economy produces output using three key inputs: labor (workers), capital (machines, buildings, and equipment), and productivity (how effectively labor and capital are being used). Capital accumulation can boost output in the short run, but because of diminishing returns, each additional machine or investment adds less to production than the previous one, this source of growth eventually halts. Sustained long-term growth depends rather on rising productivity, which comes from better skilled workers, technologies, and ways where workers produce more with the same resources.

In its simplest form, the Solow model assumes full employment where everyone who wants a job can find one. However, the model can be adapted to better capture real-world

situations by zooming in on effective labor, instead of total labor. Effective labor is the portion of the labor force that is actually utilized productively. If labor markets function poorly due to rigid contracts, high firing costs, unskilled workers, or whatever else it may be, then effective labor input would fall below the available labor supply. In these circumstances, economic growth may occur without fully absorbing the unemployed, as firms face barriers that make hiring less attractive or efficient.

In this framework, lower effective labor—driven by weak productivity growth and underutilized workers—shifts the investment curve downward, as shown by the move from the “higher effective labor” to the “lower effective labor” schedule in Figure 1. The intersection with the depreciation line therefore occurs at a lower level of capital per effective worker, implying a lower steady-state level of output even as aggregate capital and GDP continue to rise. In other words, Spain’s combination of sluggish productivity, limited human-capital investment, and high structural unemployment is consistent with an economy converging to a steady state where too little effective labor is employed relative to its capital stock, mirroring the lower steady-state equilibrium depicted in Figure 1.

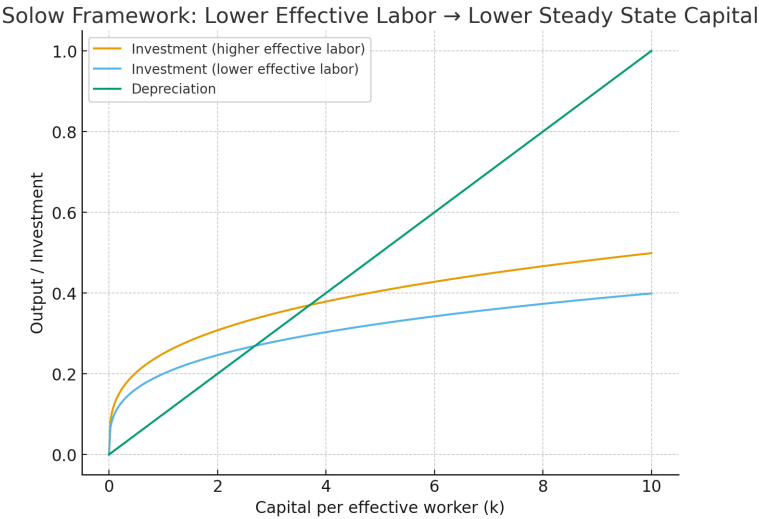


Figure 1

Put simply, Spain's economy can grow without creating enough jobs. Without stronger productivity improvements and more flexible, efficient labor markets, further expansion will not be sufficient to reduce unemployment to the levels seen in their European counterparts.

## **Why Growth Leads to Automation Instead of Hiring: The Automation and Taxation Model**

Another way economists think about Spain's labor market is to focus on how firms choose between hiring workers and investing in machines or software. Firms compare the total cost of labor with the cost of capital, including the risk and rigidity associated with each option. Taxes on wages, social security contributions, regulations, and firing costs all raise the expected cost of employing workers and therefore influence this choice.

In Spain, payroll taxes and employment protection rules make permanent employment relatively costly, while temporary contracts reduce some risks for firms but also create instability and weaker attachment for workers. As the economy expands and wages and demand rise, firms may find it more attractive to introduce labor-saving technologies or reorganize production rather than expand permanent employment to the same extent.

In this framework, institutional features that raise the relative cost and risk of hiring can help explain why strong growth does not always translate into proportionate, stable job creation. Growth does reduce unemployment, but without changes to these incentives, it may not be enough to bring joblessness down to the low levels seen in other advanced economies.

## **Policy Proposals**

After addressing Spain's unemployment issue there are three proposals presented below, aimed to help bring Spain's double digit unemployment rate to the single digits.

The first one of these is to reduce labor market duality. There is a sharp division within Spain's workforce between secure, permanent jobs and short, unstable temporary jobs, especially for young and low-skilled workers. Simplifying contract types and further narrowing the gap in cost and protection between temporary and permanent contracts would lower the risk firms face when offering stable positions. This would encourage employers to convert more workers into permanent roles, reduce excessive turnover, and allow workers to invest and build experience and skills over time. In the long run, a less segmented labor market supports higher effective employment and makes growth more likely to translate into durable jobs. Over time, a workforce with higher and more transferable skills also helps reduce unemployment, as workers who were previously stuck in temporary positions become more productive and gain access to a wider range of stable job opportunities.

The second proposed solution is to encourage productivity-enhancing investments. To generate better jobs, Spain needs more than just buildings and basic equipment, it needs employers willing to invest in stronger skills and more innovative firms. Expanding high-quality training, apprenticeships, and reskilling programs would help workers move into higher-productivity occupations and adapt as technology changes. At the same time, directing EU and national funds toward digitalisation, innovation, and firm scaling—particularly for small and medium-sized enterprises—would help raise productivity instead of locking the economy into low-value activities. Higher productivity makes it profitable for firms to pay better wages and sustain more employment at a given level of demand.

The third and final proposal presented on Spain's behalf is to reform labor taxation and hiring costs. Non-wage labor costs and strict rules on firing make it extremely costly for employers. Hiring workers into standard, permanent jobs in Spain can be relatively costly and complex, especially for small firms. Gradually reducing labor taxes and social contributions on low and middle incomes, would lower the cost and risk of creating formal jobs. Well-designed reforms can still protect workers and public finances by relying more on taxes that distort the economy less, such as consumption taxes or environmental taxes. By making it cheaper and less risky to hire, these changes would strengthen the link between economic growth and job creation, allowing expansions to reduce unemployment more effectively.

## **Constraints and the Role of the IMF**

Spain's situation is challenging, but it is not hopeless. With the right mix of policies and support, it can turn strong growth into real gains for workers, not just better numbers in reports. Spain already carries a high level of public debt, which means the government cannot simply spend freely on every good idea. Spending more today without new revenues or savings elsewhere could weaken trust in Spain's ability to repay its debt and raise borrowing costs. That is why many of the reforms discussed for Spain focus on being "revenue-neutral", shifting how money is raised and spent rather than just adding new spending on top of what already exists. For example, the government could lower some labor taxes that make hiring expensive and pay for that by adjusting other taxes or cutting less effective programs.

Reform is also politically difficult. Changes to labor rules, taxes, or benefits can create winners and losers in the short run, even if the whole country is better off in the long run. This is something extremely difficult to get a nation on board with. Workers may fear losing protections;

firms may worry about new rules; and governments may hesitate if they think voters will punish them. In addition, some reforms cause short-term pain. For example, firms may need time to adjust, workers may need retraining, and some sectors may shrink as others grow. These “transition costs” make it tempting to delay or water down changes, even when the status quo is clearly not working.

In this context, international institutions like the IMF can play a helpful supporting role. The IMF cannot and should not replace domestic decisions, but it can offer technical advice on how to design reforms that work in practice, based on experience from many countries. It can also regularly review Spain’s progress and point out risks early, which helps keep policy on track. When the IMF publicly supports a reform plan as realistic and responsible, that can reassure investors and other countries, giving the Spanish government more room to act without triggering doubts about stability. The IMF’s support can also ease the short run “losers”, hopefully gaining the support of Spain’s residents.

## **Conclusion**

Spain’s unemployment problem is not mainly about a lack of economic growth. In recent years, the economy has grown faster than many of its European neighbors. The real issue is how that growth is created and how it interacts with Spain’s labor market rules, skills, and institutions. Growth based too heavily on temporary jobs, low-productivity activities, and high hiring costs will not automatically pull everyone into stable work.

The Solow Growth Model, in simple terms, says that long-run progress depends on productivity—on people and firms becoming better at using resources—not just on adding more machines or spending. If productivity grows slowly, an economy can expand for a while but

eventually hits limits. Firms cannot profitably employ everyone who wants a job, and unemployment stays high. A separate way of thinking, which focuses on firms choosing between workers and machines, shows that when labor is relatively costly and risky to hire, firms may respond to growth by investing in technology and equipment rather than offering more permanent jobs.

Putting these ideas together, Spain's problem is that strong growth has not been matched by equally strong improvements in productivity, skills, and labor market institutions. As a result, growth does reduce unemployment, but not enough to bring it down to the low levels seen in many other advanced economies. Too many people—especially young workers and those in unstable contracts—remain stuck on the margins of the labor market.

The good news is that this situation is not fixed forever. Spain can choose policies that make growth more “job-rich.” Reducing the gap between temporary and permanent contracts would make it easier for firms to offer stable jobs and for workers to build careers instead of bouncing between short-term positions. Investing in training, innovation, and the growth of small and medium-sized firms would raise productivity, making it profitable to hire more workers at better wages. Gradually lowering the cost and risk of formal hiring, especially for low-paid and young workers, would make firms more willing to expand their workforce when the economy grows.

With this kind of targeted reform package, Spain can shift onto a growth path that creates jobs as well as output. Economic expansion would then show up not only in impressive GDP figures, but also in more people working in stable, productive jobs, ultimately lowering their unemployment rate. More broadly, Spain's experience teaches a lesson for other advanced economies: growth by itself is not enough. To turn growth into real opportunities for workers,

countries need to match it with reforms that improve productivity and make hiring attractive, so that prosperity is shared rather than leaving large groups behind.

## Citations

1. European Commission. “Economic Forecast for Spain.” European Commission – Directorate-General for Economic and Financial Affairs, [economy-finance.ec.europa.eu/economic-surveillance-eu-member-states/country-pages/spain/economic-forecast-spain\\_en](https://economy-finance.ec.europa.eu/economic-surveillance-eu-member-states/country-pages/spain/economic-forecast-spain_en). Accessed 11 Dec. 2025.
2. “IMF: Spain Remains the Fastest-Growing Advanced Economy.” Ara, [en.ara.cat/economy/imf-spain-remains-the-fastest-growing-advanced-economy\\_1\\_5528505.html](https://en.ara.cat/economy/imf-spain-remains-the-fastest-growing-advanced-economy_1_5528505.html). Accessed 11 Dec. 2025.
3. “A New Scenario for the Spanish Economy: Dynamism in a Fragile Environment.” CaixaBank Research, [www.caixabankresearch.com/en/economics-markets/activity-growth/new-scenario-spanish-economy-dynamism-fragile-environment](https://www.caixabankresearch.com/en/economics-markets/activity-growth/new-scenario-spanish-economy-dynamism-fragile-environment). Accessed 11 Dec. 2025.
4. Stevens, Pippa. “Why Spain’s Economy Is Doing so Well.” CNBC, 23 Aug. 2025, [www.cnbc.com/2025/08/23/why-spains-economy-is-doing-so-well.html](https://www.cnbc.com/2025/08/23/why-spains-economy-is-doing-so-well.html). Accessed 11 Dec. 2025.
5. “Spain Unemployment Rate.” Trading Economics, [tradingeconomics.com/spain/unemployment-rate](https://tradingeconomics.com/spain/unemployment-rate). Accessed 11 Dec. 2025.
6. “IMF Executive Board Concludes 2025 Article IV Consultation with Spain.” International Monetary Fund, 5 June 2025, [www.imf.org/en/News/Articles/2025/06/05/pr25183-spain-imf-executive-board-conclude-s-2025-article-iv-consultation-with-spain](https://www.imf.org/en/News/Articles/2025/06/05/pr25183-spain-imf-executive-board-conclude-s-2025-article-iv-consultation-with-spain). Accessed 11 Dec. 2025.
7. “Spain Economic Outlook. June 2025.” BBVA Research, 11 June 2025, [www.bbva.com/en/publicaciones/spain-economic-outlook-june-2025/](https://www.bbva.com/en/publicaciones/spain-economic-outlook-june-2025/). Accessed 11 Dec. 2025.
8. “Spain.” OECD Employment Outlook 2025: Country Notes, Organisation for Economic Co-operation and Development, 8 July 2025, [www.oecd.org/en/publications/2025/07/oecd-employment-outlook-2025-country-notes\\_5f33b4c5/spain\\_15376c66.html](https://www.oecd.org/en/publications/2025/07/oecd-employment-outlook-2025-country-notes_5f33b4c5/spain_15376c66.html). Accessed 11 Dec. 2025.
9. Spain: 2025 Article IV Consultation—Press Release; and Staff Report. International Monetary Fund, Country Report No. 2025/121, 6 June 2025,

[www.imf.org/en/Publications/CR/Issues/2025/06/05/Spain-2025-Article-IV-Consultation-Press-Release-and-Staff-Report-567439](http://www.imf.org/en/Publications/CR/Issues/2025/06/05/Spain-2025-Article-IV-Consultation-Press-Release-and-Staff-Report-567439). Accessed 11 Dec. 2025.

10. "Spain Unemployment Rate (Eurostat Data)." Trading Economics, [tradingeconomics.com/spain/unemployment-rate-eurostat-data.html](https://tradingeconomics.com/spain/unemployment-rate-eurostat-data.html). Accessed 11 Dec. 2025.