May 2019, *No.* 55

SNS RESEARCH BRIEF SUMMARY

Lower payroll taxes for the young*

Payroll taxes collect about 25 percent of total tax revenue in OECD countries, about as much as revenue from personal income taxes. In recent decades, cuts to the employer portion of payroll taxes are often discussed as a policy lever to reduce labor costs of firms, particularly targeted towards workers facing high unemployment rates such as low earners, the elderly, or the young. A potential drawback of employer payroll tax cuts is that firms instead pocket the tax cut as profit windfall.

In contrast, academic economists hold the received wisdom that the incidence of payroll taxes ultimately falls on workers' net wages. A payroll tax cut thus leaves firms' gross labor costs – and employment – unchanged according to this view.

This report sheds light on this debate by examining the payroll tax cuts for young workers in Sweden that were implemented in 2007 and in 2009. These reforms halved the payroll tax for workers aged 26 and below.

First, we find that the tax cut indeed reduced youth labor costs. Comparing contracted monthly wages for full-time equivalents before and after the reform, we find no differential growth of wages among the young and the slightly older. This means that labor costs were lowered.

Moreover, we find that the tax cut and the reduced labor costs among the young stimulated youth employment. Youth employment increased by around 2–3 percentage points and were larger in areas with a higher youth unemployment before the reform.

In the second part of the paper, our empirical analysis focuses on firms' responses to the payroll tax cut. Since wages of the young were unaffected by the reform, firms that generally hire many young workers received a windfall transfer as a result of the tax cut. Our empirical analysis compares firms with a large share of young workers in their workforce to firms with a moderate share young before the reform. Firms with many young workers received a larger tax cut windfall.

We find that firms with a large share of young workers before the reform grew faster than those with a moderate share. The tax windfall helped firms grow and the windfall was not just pocketed as firm profits. We find growth effects along many margins: they increase employment and capital assets; sales, value added and profits increase. We also document that financially constrained firms appear to respond somewhat more strongly to the tax windfall.

The policy was proposed as a way to stimulate both employment among the young and business activity. It was criticized by opponents – who ultimately repealed the tax cut in 2015 when elected – as a costly give-away to employers. Our results suggest that targeted employer payroll tax rates may be an effective tool to

Design: Patrik Sundström / Allan Seppa

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stimulate youth employment with. Moreover, the windfall gains to firms that the policy induced were actually used constructively, lending support to the former view of the effectiveness of targeted payroll tax cuts.

The report was presented at an SNS seminar in Stockholm on May 15, 2019.

Author
David Seim, Associate Professor of Economics, Stockholm University.

* This is a summary of a research brief in Swedish "Sänkta arbetsgivaravgifter för unga", which is a publication within the SNS research project "Taxes in a Globalised World".