

LECTURE:

LABOR MARKET RESPONSES TO PAYROLL TAX REDUCTIONS

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Campus Griebnitzsee, house 1, room 2.31

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Payroll tax reductions are a popular tool to lower the minimum labor cost and encourage employment and job creation. Effects of these tax reductions go beyond the directly affected. A particular concern about such policies is that more productive jobs may be replaced with less productive ones. We examine payroll tax reductions using an equilibrium search-and-matching model estimated from the French administrative data. We find that lowering taxes on low-paid work induces low-productivity workers to enter the labor market and low-productivity firms to post more vacancies. These behaviors congest the labor market, resulting in lower employment among high-productivity workers and negative impacts on aggregate production. We find that, rather than reducing taxes for a wide range of jobs, restricting payroll tax reductions to minimum wage jobs helps low-wage workers, but the resulting congestion effect is also stronger. Taking this trade-off into account, we determine the optimal targeting of payroll tax reductions.

(joint with Thomas Breda and Luke Haywood)