

Employment effects of reduced employer non-wage labour costs

Introduction

Labour taxes make up a substantial share of overall labour costs in all developed countries. Reducing taxes on labour, in particular on the employer side, could be one way of inducing employers to hire more workers or to retain staff that might otherwise have been let go. Employment subsidies for hiring new workers operate in a similar way by increasing incentives for employers to create new jobs. Both types of measure – employment incentives and reducing employer non-wage labour costs – have been deployed in many EU Member States since the onset of the crisis. They have been used either as a general labour demand-enhancing measure or else targeted at specific categories. These are often groups with limited labour market attachment such as the young, low-skilled or low-paid and the long-term unemployed.

The main aim of this report is to assess the effectiveness of employer-side incentives in generating positive labour market outcomes. The report summarises the current state of knowledge on the effectiveness of shifts in employer social security contributions, employer payroll taxes and functionally equivalent employer incentives as employment-generating policy interventions. The assessment involved a review of 68 methodologically robust evaluations of specific policy interventions, including a detailed meta-analysis. The evaluations covered relate largely to policies implemented in EU Member States from 2000 onwards. The report also presents an overview of more recent (2008–2014) policies implemented in different Member States.

Policy context

In a period of high unemployment, strong fiscal pressures and low growth, EU policymakers have underlined the importance of identifying policy reforms – including labour taxation reforms – that are growth- and employment-friendly. This has been a common theme of the EU's European Semester policy coordination process. Country-specific recommendations to many Member

States in recent years have included specific guidance about reform to the system of labour taxation, with the emphasis on shifting taxes away from labour to other tax bases. These include property, consumer spending and environmental taxes. In a context of depressed labour demand, the policy emphasis was on reducing the tax burden on employers, especially from 2011 to 2013–2014. As the policy review indicates, there has been a greater tendency than previously to target measures – even if the targeted categories are not always those where the evaluation literature indicates the likelihood of more positive employment impact.

Key findings

Across the evaluation studies covered, the employment effects from lower employer social contribution rates or functional equivalents such as hiring subsidies tend to be modest. In just over 40% of the employment effect estimates covered in the meta-analysis, no significant positive impact was identified. However, the policy is effective when it works: in cases where there was a positive employment outcome, it was strongly positive.

Policies targeted at a specific group were more effective than general or non-targeted policies. The target groups most likely to benefit are the long-term unemployed and fixed-term contract employees (conversion to permanent status). Reforms targeted at younger and older workers were less effective, as were measures targeting specific groups of companies (categorised by sector, company size or region).

The meta-analysis results indicate that positive employment impacts are more likely to be observed in the short term rather than over the medium or long term, suggesting that employment effects may tend to dissipate over time.

The report also highlighted potential drawbacks that limit the effectiveness of such measures. There were particular concerns about waste or inefficiency in implementation, opportunistic behaviour by benefiting companies, and the

potential countervailing or distortionary impact on non-participating companies or economic players. Each can potentially undermine the cost-effectiveness of the measures or compromise policy objectives. Deadweight losses (jobs created that would have been created anyway without the subsidy) in particular are likely to be considerable, though well-targeted measures are likely to reduce such losses.

Policy pointers

- Employer-side incentives were successful from an employment perspective in a majority of the individual evaluation estimates, but not an overwhelming majority.
- Strong positive employment impacts were more likely from policies based on reduced employer social security contributions (compared with measures such as hiring subsidies) and from policies embedded in a package of reform measures (compared with standalone measures). Overall, however, there was little to suggest that any one policy out of all those considered systematically led to better employment outcomes than any other.

- Reduced employer taxes or increased subsidies need to be financed. The requirements of budget neutrality, an especially important constraint at a time of severe public spending restrictions, may require new taxes, for example on consumer spending. Second-order employment effects from these may offset positive gains resulting from employer tax reductions.
- Such potential countervailing impacts – as well as deadweight and displacement effects – are not easy to estimate, but are critical to making an effective cost-benefit assessment of such policy interventions. Very few existing evaluations include such calculations.
- A positive macroeconomic context appears to enhance the probability that employer cost reduction measures achieve their goal of stimulating employment.

This final point could be an argument against the use of such measures when they are in theory most appropriate and in practice most needed – in recessionary or post-recessionary periods of depressed labour demand. It also implies that they may be more effective at times such as the present – with modestly improving output and employment growth.

Further information

The report, *Employment effects of reduced employer non-wage labour costs*, is available at <http://www.eurofound.europa.eu/publications>

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