Borradores de Economía - Labor Demand Responses to Payroll Taxes in an Economy with Wage Rigidity: Evidence from Colombia

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Publication Date: Friday, 10 of January 2025 **Abstract**
This paper analyzes the effect of payroll taxes on the formal sector labor demand in the presence of wage rigidity. In particular. We study the impact of a reduction of payroll taxes on the creation of formal jobs in Colombia, where about 40 percent of formal-sector workers earn the minimum wage. Using a reform that granted tax credits to firms hiring workers younger than 28 years of age, we obtain estimates of the effect of payroll taxes on formal-sector employment and wages. We show that payroll tax incidence is borne by formal-sector employers. The reduction in payroll taxes increased Formal-sector employment and did not affect wages. Using the estimation results, we recover an estimate of the elasticity of the formal-sector labor demand between ?0.53% and ?0.87%.

A 1% decrease in payroll costs would increase employment in the formal sector by between 0.5% and 0.9%. This implication is specific to the Colombian context, where the minimum wage is binding for a large portion of formal sector workers, making it likely that formal labor demand drives these results.

Fuente: https://d1b4gd4m8561gs.cloudfront.net/en/publications-research/working-papers-economics/labor-demand-responses-payroll-taxes