Abstract
This paper uses administrative data to analyze a large payroll tax cut for young workers in Sweden. The employer payroll tax rate was cut in two steps in 2007 and 2009 from 32% to 16% for workers aged 26 or less. We obtain two main results on market level tax incidence and employment effects. First, in contrast to the standard model of tax incidence, the payroll tax cut has zero effect on net-of-tax wages of young treated workers relative to slightly older untreated workers, implying that employers do not adjust wages based on age in response to the tax reform, perhaps because of wage rigidities. Hence, the labor cost to firms of employing younger workers falls relative to other workers. Second and related, we find large positive employment effects for young workers. Next, we analyze the effects of the tax cut on firms by comparing firms with many vs. few young workers just before the reform as firms with many young workers receive a larger tax cut windfall. We obtain two results on firm level effects. First, firms with many young workers increase the wages of all workers (young and old) after the reform suggesting that the payroll tax cut benefits workers collectively perhaps through rent sharing. Second, firms with many young workers grow faster and hire more after the reform, consistent with liquidity effects (although growth effects are present for all types of firms based on conventional credit constraints proxies). Our paper highlights the key role of firms in understanding the effects of payroll taxes.