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I Z A
World of Labor
Evidence-based policy making

Do labor costs affect companies' demand for labor?

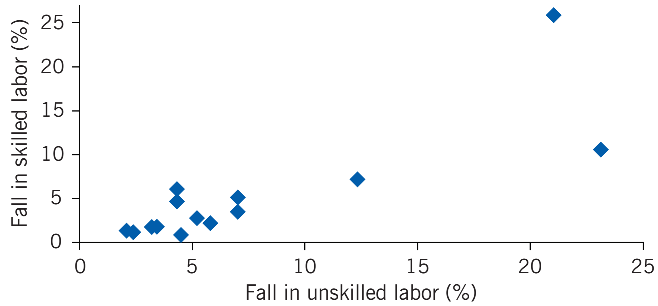
The effect of overtime, payroll taxes, and labor policies and costs on companies' product output and countries' GDP

Keywords: labor demand, wages, employee benefits

ELEVATOR PITCH

Higher labor costs (higher wage rates and employee benefits) make workers better off, but they can reduce companies' profits, the number of jobs, and the hours each person works. Overtime pay, hiring subsidies, the minimum wage, and payroll taxes are just a few of the policies that affect labor costs. Policies that increase labor costs can substantially affect both employment and hours, in individual companies as well as the overall economy.

Employment responses to a 10% labor-cost increase



Source: Author's own calculation.

KEY FINDINGS

Pros

- Increasing the minimum wage that employers must pay their workers prevents employers from exploiting workers who have few alternatives.
- Increasing the minimum wage that employers must pay their workers increases earnings among low-wage workers who retain their jobs.
- Increasing the penalty that employers pay for overtime work prevents employers from imposing long hours on individual employees.
- Increasing the penalty that employers pay for overtime work encourages new job creation that can reduce unemployment.

Cons

- Increasing the minimum wage that employers must pay their workers reduces total hours worked—jobs x hours/job—but with small impacts if minimum wage levels are low compared to average wages.
- Increasing the minimum wage that employers must pay their workers reduces employment and increases unemployment if not enough people give up looking for jobs.
- Increasing the minimum wage that employers must pay their workers has the biggest negative effect on the unskilled and minorities as well as young and older workers.
- Increasing the penalty that employers pay for overtime work reduces total hours worked—jobs x hours/job.
- Increasing the penalty that employers pay for overtime work reduces gross domestic product (GDP).

AUTHOR'S MAIN MESSAGE

Higher labor costs reduce employment and/or the hours worked by individual employees. Laws that raise labor costs can either increase total employment or increase hours per worker, but they cannot do both. They lower the total amount of work performed in the market—the total number of person-hours (hours per worker multiplied by the number working). This loss must be traded off against the benefits that higher costs might provide to specific groups of workers.

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