Household Taxation, Fertility, and Labor Supply

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Abstract

We investigate the effects of the family tax splitting system on French households’ decisions to marry, have children, and participate in the labor market. The taxation system may affect all the household decision process, starting from the decision to marry and its timing. From a theoretical perspective, we would expect the splitting tax system to provide 1) positive fertility incentives for married couples, 2) negative work incentives for secondary earners (typically wives). The question whether family tax splitting can act as an explanation for the relative high fertility rate in France does not find exhaustive answers in the existing literature. There is evidence that family policy can in fact affect fertility, however, it is not clear whether the effects stem from a successful policy mix of child care, parental leave, tax allowances and child benefits rather than from the tax system itself. We aim to size the importance of the taxation system on the decision of having a (or an additional) child. It is also questionable whether the high labor force participation rate of French married women with young children is attributable to the system of joint taxation or to the widespread presence of public child care. In particular, for spouses with low labor income, this taxation system generates negative work incentives. We aim to shed some light on distinguishing the contribution of the incentives provided by the tax system and those of the child care services and child policies.

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We propose a two-sided marriage matching model with non-transferable utility. At any point in time, there are agents who are either single or married and endowed with a certain labor market income (or other income). Single agents meet bilaterally, observe the expected payoff that would result from marriage, and decide whether to accept the marriage offer or not. Once married, they cooperatively choose their labor market supply and the number of children. Matches are exogenously destroyed. In this case, both partners become singles and enter the pool of searchers.