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Distributional Effects of Reforming Joint Household Income Taxation in Germany. A Behavioral Micro Simulation Study

Abstract:

Labor supply of married women in Germany is very low in international comparison. One structural reason is that the current system of income taxation imposes low marginal tax rates on the (male) bread winner and high marginal tax rates on the (female) second earner by splitting joint household income into halves. Wives typically withdraw from the labor market, or choose employment in tax-exempted minor jobs.
Our paper analyzes the potential labor supply impact of various proposals for reducing the gender imbalance in the German income tax scheme. We estimate and simulate a structural discrete choice model of household labor supply on the basis of data drawn from the German Socio-Economic Panel and a detailed representation of the tax and transfer system.
The results indicate that revenue-neutral reforms introducing separate income taxation or alternative splitting schemes accounting for dependent children may raise female labor supply. However, the simulated labor supply effects are relatively weak at least at the extensive margin. Labor supply elasticities are especially small in families with more and younger offspring. For women in these families, decline in marginal tax rates is insufficient to compensate the fixed costs of working. The suggested reforms hence could only boost women's labor supply if they were complemented by measures reducing the price of childcare outside the household. We furthermore evaluate the distributive implications of the reform proposals. We observe that while generally households are better off in terms of income post reform this is frequently not the case in terms of (compensated) utility. Welfare losses are prevalent throughout the medium income range. This observation may explain why useful alternatives to the current income tax system find little support in the sphere of political decision making.