

# The Tax System Reduces Motivation to Return to Work among Mothers with Young Children: Recommendations and Evaluation<sup>1</sup>

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## Summary

- In the Czech Republic, the overall taxation of work, i.e. individuals' income tax together with social security and health insurance contributions, places a heavy burden even on the relatively low earnings of so-called second earners in households, i.e. partners with lower earnings. These peoples' work activity is, however, generally very sensitive to the level of taxation. A large group of these earners is made up of mothers with young children.
- Mothers who are the second earner in their household are subject to a participation tax rate (PTR) up to 30 % higher than their partners, and yet a higher PTR results in lower motivation to work. Women with children and low earning potential are subjected to the highest PTRs in comparison with their partners.
- The current system of taxing work thus contributes, together with the conditions for paid parental leave and low availability of nurseries and pre-schools, to Czech mothers with young children having the highest employment drop-out rate in the whole of the EU. The share of Czech mothers with children under six years of age who are in work is thus the second lowest in the EU and almost half the equivalent share in the Netherlands. That is despite the fact that the level of economic activity

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among older women and men in the Czech Republic is one of the highest in OECD countries.

- Parenthood thus interrupts the working careers of Czech mothers for a very long time, partly as a result of the way work is taxed. This has a negative effect on their careers after they return to work, limits their opportunities for career development, raises the risk of unemployment and reduces their future earnings. As a result, the Czech gender pay gap is one of the highest in the EU. Women's lower earnings reduce their household's income, as a result of which the public budget misses out on income tax and insurance revenues.
- To improve motivation to work among women with young children we propose that the social security contribution rate be reduced by 5 percentage points (p.p.) for parents who are the primary carer of a child aged 11 or younger.
- The proposed measure has the potential to raise these women's motivation to work, because it would increase their household's net income from their work. It would reduce their PTR by 3.1 p.p. The PTR would be most reduced for women with low incomes, by 3.7 p.p.
- The result of such a targeted reduction in insurance contributions would be a limited drop in income to the public budget. The extent of this loss would depend on the number of women who started to work thanks to the measure. If 0 %, 1 % or 5 % of economically inactive women with young children started to work, revenues to the public budget would immediately fall by 3.52, 3.17 or 1.77 billion CZK respectively.
- This immediate negative effect on the public budget would be partially compensated by the measure's longer-term effects. A higher employment rate among women with young children would positively influence their future professional careers, which would be positively reflected in their earnings and via taxation also in increased revenues to the public budget and reduced expenditures on benefits. The present analysis however does not examine these effects, nor any possible, though very speculative, positive effect on the birth rate.