

Chapter 2

Institutional Setting and Stylized Facts

2.1 Family Policy in Germany

Following a commonly used definition, family policy covers a broad field of different policy measures and includes all governmental expenditures that contribute to the well-being of families with dependent children. Family policy instruments consist of direct monetary support such as child benefits, parental leave benefits or tax allowances, as well as in-kind benefits or services such as childcare institutions and provision of school and university education. According to this comprehensive approach, Rosenschon (2006) quantifies the overall public expenditures to 240 billion Euro for the year 2005, which amounts to 11 percent of GDP. As an international comparison shows (see OECD (2007a)), Germany ranks well above the average of OECD countries as far as expenditures on family benefits and tax breaks for families are concerned. In the field of public expenditure on education, however, statistics show that Germany ranks below the OECD average. In particular, spending on primary education is low compared to similar European countries such as Austria, Belgium, France, the Netherlands or the Scandinavian countries. As far as expenditures on childcare and early education are concerned, Germany ranks above the average of OECD countries. As will be shown later on, this is due to the high

subsidies for center-based childcare for children between three years and school-age.

The way how family policy measures affect well-being of households with dependent children, however, is not only determined by the extent of overall public expenditures targeted at families but also by its structure. Germany constitutes a prototype example of a conservative welfare regime (see Esping-Andersen (1990)), and its labor market and social policy institutions, as well as the income tax system have long been following the “male breadwinner model” (see Ostner and Lewis (1995), Pfau-Effinger (2001) and Wersig (2006)). This model is also reflected in a whole range of other family policy institutions: For example, family support within the income tax puts a strong weight on horizontal redistribution¹ through measures such as the income splitting for married partners or the child tax allowance, although vertical redistribution is also achieved through the child benefit. Families following the “male breadwinner model” are supported through the income tax system and other benefits, such as the parental leave benefit, at least in the form that has been in existence until the end of 2006 (see Gornick et al. (1997)). On the other hand, the needs of two-earner families have long been neglected, which is reflected by the low provision of childcare for children under three years and afternoon care for children of all age groups. Presently, family policy institutions are at change and more reforms are likely to come about that will affect the distribution of family support by income, working status of the parents, as well as number and age of children.

In the following sections, I will describe several important features of German family policy that are relevant for households with children up to six years. Thereafter, I will present some stylized facts on the employment patterns of mothers with young children and the utilization of childcare. Finally, this chapter concludes with an overview of recent changes in family policy institutions and reform proposals that are currently discussed.

¹*Horizontal redistribution* is defined as redistribution between households with equal income but of different size. *Vertical redistribution*, on the other hand, implies redistribution between households of different incomes.

2.1.1 Joint Taxation with Income Splitting for Married Spouses

In Germany, married spouses are taxed jointly within the personal income tax. Up until the late 1950s the joint income of married spouses was subject to the same tax tariff as the income of non-married individuals. This led to a marriage penalty in the case of two-earner couples. In order to avoid this marriage penalty, Germany introduced full income splitting for married couples in 1957. Income splitting implies that the income tax of a married couple is calculated by applying the tax function to half of the sum of taxable incomes of the spouses, and the resulting amount is then doubled to determine the tax liability of the couple. Formally, the system can be described as follows:

$$T(Y_M, Y_F) = 2 \cdot t\left(\frac{Y_M + Y_F}{2}\right) \quad (2.1)$$

while individual taxation would be a system described by

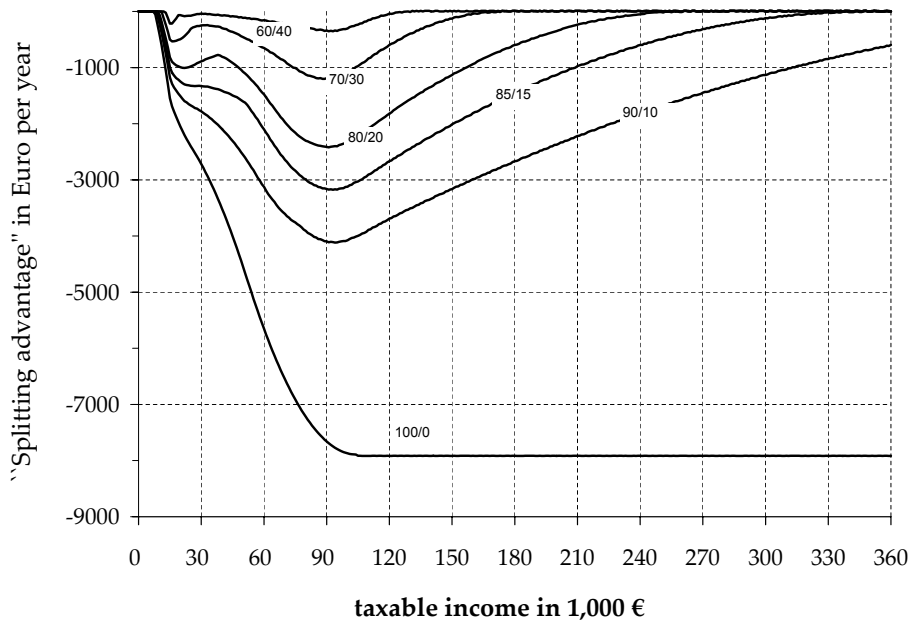
$$T(Y_M, Y_F) = t(Y_M) + t(Y_F) \quad (2.2)$$

$T(\cdot)$ denotes the total tax amount due of a married couple, Y_M and Y_F denotes the gross income of husband and wife and $t(\cdot)$ refers to the tax tariff. Joint taxation with full income splitting implies that no married couple will pay higher income taxes than a single individual with the same level of household income.² Moreover, given the progressivity of the income tax, this system leads to a lower tax burden compared to individual taxation if household income is unequally distributed between spouses. This so-called “splitting advantage”, defined as the difference between the amount of income tax a married couple has to pay under income splitting and the amount

²Note that unlike in the US, married couples are taxed according to the same tax schedule than individual persons in Germany. Married spouses are not required to file jointly, but can also choose to file individually. This option is more favorable compared to joint filing only in the case that one spouse has income that is subject to progression proviso (“Progressionsvorbehalt”), for example unemployment benefits.

the same couple would have to pay in case of individual taxation, is shown in Figure 2.1 for the tax schedule 2005.

Figure 2.1: Splitting gain resulting from the tax schedule 2005



Note: The lines refer to different distributions of taxable income within the household.
 Source: Adapted from Bach et al. (2003).

The amount of this splitting advantage depends on the income distribution between husband and wife and on the absolute level of household income. At its maximum, the splitting advantage amounts to roughly 8,000 Euro under the 2005 tariff, and it is reached at a yearly taxable income exceeding 100,000 Euro. The splitting advantage declines quickly as the secondary earner's share of total taxable household income increases, and becomes zero if both spouses contribute equally to family income. For the fiscal year 2005 the splitting advantage has been estimated to amount to 21 billion in total, of which about two thirds were spent on married couples with dependent children (see Bach et al. (2003)).

It should be mentioned at this stage that some strands of the public finance

literature (see, for example, Homburg (2000)) define the “splitting advantage” not as a form of subsidy towards married couples, but rather as a logical consequence of the ability-to-pay principle of income taxation. Within a marriage, spouses have maintenance obligations that reduce their ability to pay. Moreover, it is argued that the joint taxation with full income splitting is the only way how neutrality towards the income distribution can be achieved as far as tax liabilities are concerned. The fact that the tax gain is an increasing function of taxable income is not seen as a subsidy to high-income married couples but rather as the result of a progressive tax system. Althammer (2000) and Spahn, Kaiser, and Kassella (1992) provide a detailed overview of this discussion (see also section 4.2.3).

2.1.2 Tax Allowances for Single Parents

Up until 2002, unmarried parents, who were not eligible to income splitting, were granted a so-called “household tax allowance” (“Haushaltsfreibetrag”) that amounted to 2,870 Euro per year. According to a decision of the constitutional court, stating that the household tax allowance implied a discrimination in favor of unmarried parents, this tax allowance was reduced to 1,188 Euro in 2004. In 2005, it was abolished and substituted by a single parent’s tax allowance (“Entlastungsbetrag”) that amounts to 1,208 Euro per year. In contrast to the prior household tax allowance, the single parent’s tax allowance is only granted to single parents who can prove that they live without a spouse.

2.1.3 Child Benefit and Child Tax Allowance

In Germany, the subsistence level for children is exempted in the personal income tax. Thus, all parents are granted a child tax allowance (“Kinderfreibetrag”) that amounted to 2,924 Euro per year in 2006.³ In the case that married parents file jointly, this amount is doubled. The tax relief implied by this tax allowance naturally increases with taxable income, thus acting as an instrument for horizontal redistribution. In the tax law literature, however, the child tax allowance - in the same way as the income splitting for married partners - is not seen as “relief” or family support but being a result of the ability-to-pay principle (see Althammer (2000) for an overview of this discussion).

As Figure 2.2 shows, low-income families or families with a tax liability below the basic allowance (15,328 Euro for married couples) do not profit from the child tax allowance. In order to provide basic support for all children in Germany, the child tax allowance is substituted by the child benefit (“Kindergeld”) that amounts to 154 Euro per month (179 Euro per month from the fourth child onwards). This transfer is granted to all families for whom the tax reduction implied by the child tax allowance is below the child benefit. In other words, the tax allowance is granted if the resulting amount of the tax relief exceeds the child benefit, and vice versa. Formally, the tax liability of a married couple with dependent children can be described as

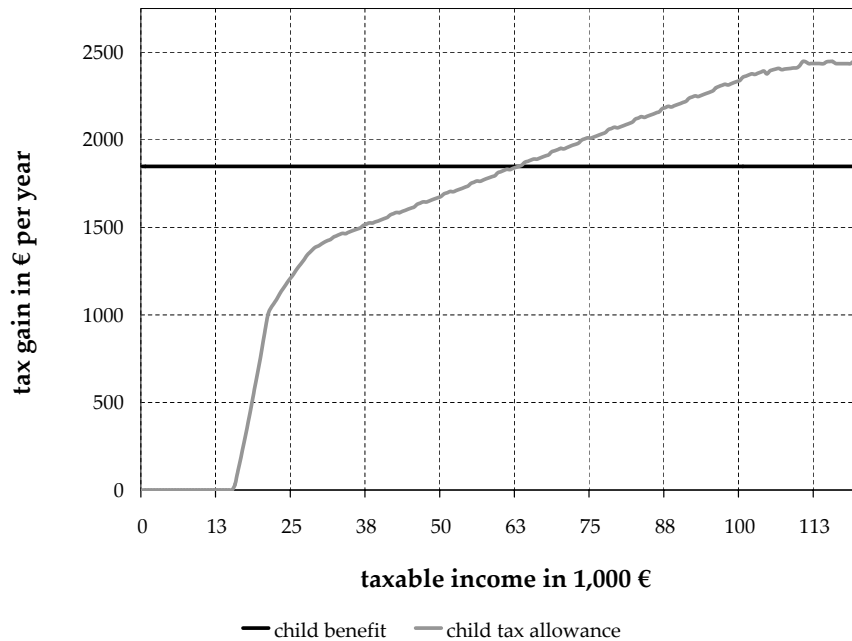
$$T(Y_M, Y_F) = \min \left[\left(2 \cdot t \left(\frac{(Y_M + Y_F) - CTA \cdot c}{2} \right) \right), \left(2 \cdot t \left(\frac{(Y_M + Y_F)}{2} \right) - CB \cdot c \right) \right] \quad (2.3)$$

where c denotes the number of children, CTA is the child tax allowance and CB is the child benefit. As shown in Figure 2.2 for the tax schedule of the year 2005,

³The “Kinderfreibetrag” actually consists of two components, one tax allowance for the minimum subsistence level (“sächliches Existenzminimum”) amounting to 1,824 Euro and a tax allowance for expenses concerning childcare and education (“Betreuungs- und Erziehungsaufwand”) amounting to 1,080 Euro.

married couples with one child are better off claiming the child benefit until they reach a taxable annual income of about 63,000 Euro.

Figure 2.2: Comparison of the tax gain through the child tax allowance and the child benefit (Tax schedule 2005)



Source: Adapted from Althammer (2002) for the tax schedule of the year 2005.

This system of dual family support (“Dualer Familienleistungsausgleich”) has been in existence since 1996 and constitutes the most important part of monetary transfers towards families with dependent children.⁴ According to Rosenschon (2006), expenditures for the child benefit and tax allowance amounted to about 37 billion Euro in the year 2005.

⁴See Althammer (2002) for more details on the development of the child benefit and the child tax allowance within the so-called “Dualer Familienleistungsausgleich”.

2.1.4 Other Transfers

In addition to the child benefit and the child tax allowance, there is a set of other transfers for families with children. First and foremost, there is the parental leave benefit, called “Erziehungsgeld” that was introduced in 1984 and has been replaced by the “Elterngeld” only recently, in January 2007. Since the empirical analysis in Chapter 3 and 4 draws on data from the years 2000 - 2002, the “Elterngeld” does not play any role in the incentive structure created by the tax-transfer system.⁵ I will thus describe the “Erziehungsgeld” as it has been existing in the year 2002.

This transfer was a means-tested benefit amounting to 307 Euro per month per child aged less than 24 months. In the first six months after birth of the child, the benefit was granted for parents with an annual net income below 51,130 Euro per year. In the case of single parents, the income threshold amounted to 38,350 Euro per year. For each additional child, the threshold was increased by 2,454 Euro. Families with an income exceeding this threshold did not receive the transfer. In the following 18 months, the full amount of the parental leave benefit was granted only for families with an annual net income up to 16,470 (13,498 Euro for single parents). Above this threshold, the transfer was withdrawn at a rate of 62.4 percent. In addition to the income threshold, there was an hours restriction: The parental leave benefit was only paid if at least one parent reduced working hours below 30 hours per week.⁶

Besides this set of explicit family benefits, children also play a role in the amount of social assistance that a family is eligible to. Moreover, the replacement rate of the unemployment benefit also depends on the presence of children within a household. Another example is the housing benefit, which also depends on the number and the age of family members.⁷

In addition to monetary transfers, there are many other policy instruments that

⁵See Spiess and Wrohlich (2006) for a detailed description and evaluation of the new benefit.

⁶Up until 1999, this hours restriction amounted to 19 hours per week.

⁷A more detailed description of these transfers can be found in Steiner et al. (2005).

directly or indirectly aim at supporting families with dependent children. Examples are the non-contributory coverage of dependent family members within the compulsory health insurance and the consideration of years of childcare within the old-age pension insurance. Rosenschon (2006) provides a detailed overview of family policy instruments in the social security system and other institutions.

2.1.5 Childcare Institutions

Germany's "childcare market" is characterized by low parents' fees for formal childcare, and at the same time low availability of these slots, in particular for children under three years. On the one hand, childcare facilities are highly subsidized, and the share of costs that parents have to bear is relatively small, lying between zero and thirty percent of total cost. As can be seen from Table 2.1, parents on average pay for less than 25 percent of total costs of formal childcare.

Table 2.1: Total childcare costs and parents' fees of center-based childcare

	Children aged 0-2		Children aged 3-6	
	total costs	parents' fees	total costs	parents' fees
	<i>part-time care</i>			
east Germany	not available	74	226	57
west Germany	not available	82	295	64
	<i>full-time care</i>			
east Germany	512	115	384	70
west Germany	590	161	443	110

Note: Childcare costs refer to Euro per month.

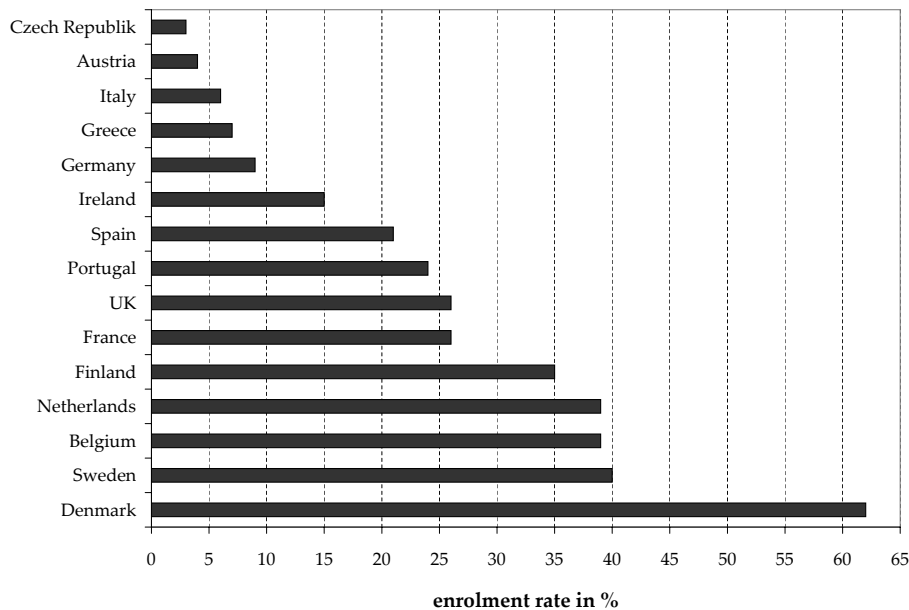
Source: Total childcare costs are taken from Schilling (2004), parents' fees from SOEP, wave 2002.

According to Schilling (2004), a full-time slot for a child under three years costs 590 Euro per month on average in the western German states. The average parents' fees for this slot only amount to 161 Euro. Thus, it is not surprising that in comparative studies on childcare costs that measure these costs as average parents' fees, Germany usually ranges at the lower end of the distribution of childcare costs

as percent of household income (see, for example Immervoll and Barber (2005) and OECD (2007b)).

On the other hand, availability of childcare slots is limited compared to other European countries. As Figure 2.3 shows for the year 2004, about 9 percent of all children under three years in Germany were enrolled in childcare centers. Enrolment rates of children in this age group are considerably higher in other European countries, such as for example in France (26%), Belgium (39%), the Netherlands (39%) and the Scandinavian countries (62% in Denmark, 35% in Finland, 40% in Sweden). Lower levels of enrolment rates to childcare of children in this youngest age group are only found in Austria (4%), the Czech Republic (3%), Greece (7%) and Italy (6%).

Figure 2.3: Enrolment rates into childcare centers of children under three years in selected European countries (2004)



Source: OECD (2007a).

The national average of 9% of children under three years enrolled in center-based childcare hides the strong differences that still prevail between east and west Germany. In west Germany, childcare for children under three years used to be seen as a private matter (see Bien et al. (2006)). Accordingly, the availability of childcare slots for children in this age group was very low in west Germany until 2002, as can be seen from Table 2.2. In contrast, full-time public childcare for children in all age groups was provided as part of the explicit policy to foster mothers' employment in the former German Democratic Republic (see Hank et al. (2001)). Therefore, availability of childcare is still much higher in the eastern German states. In 2002, there were 37 slots available per 100 children under three years.

As Table 2.2 shows, availability of center-based childcare slots does not only differ between east and west Germany, but also within west Germany. City states such as Hamburg and Bremen provide considerably more childcare slots per children in each age group than in other Federal States of western Germany. In 2002, Hamburg provided 13 and Bremen 10 slots per 100 children in the youngest age group, while states such as Northrhine-Westphalia, Baden-Wuerttemberg or Bavaria provided only 2 slots per 100 children.

While the number of childcare slots for children under three years hardly changed until 2002, availability of childcare for children in this age group increased sharply in the past few years, in particular in west Germany. As can be seen from Table 2.2, availability rates of childcare almost tripled in west Germany due to several reforms that have taken place recently. For example, Bavaria, Rhineland-Palatinate and Baden-Wuerttemberg have increased childcare slots from 2-3 to 9 slots per 100 children in the last four years (see Section 2.3.1 for an overview of recent childcare policy reforms).

Table 2.2: Availability of childcare slots by federal states

Federal State	Child care slots per 100 children aged 0-2				Child care slots per 100 children aged 3-6			
	1994	1998	2002	2006 ^a	1994	1998	2002	2006 ^a
Schleswig-Holstein	1	2	3	8	65	77	82	81
Hamburg	12	12	13	21	51	65	65	87
Lower Saxony	2	2	2	5	64	77	83	80
Bremen	6	7	10	9	66	82	82	85
Northrhine-Westphalia	2	3	2	7	63	82	85	84
Hesse	2	3	4	9	78	92	93	90
Rhineland-Palatinate	1	1	3	9	90	102	106	94
Baden-Wuerttemberg	1	1	2	9	92	107	104	95
Bavaria	1	1	2	7	76	83	88	99
Saarland	2	3	5	10	84	97	101	94
Berlin	29	32	36	38	70	78	81	81
Brandenburg	54	52	45	41	97	107	97	92
Mecklenburg- Western Pomerania	39	31	38	43	89	106	95	92
Saxony	33	24	29	34	98	114	105	93
Saxony-Anhalt	43	47	57	50	92	109	101	92
Thuringia	36	26	22	38	102	129	126	95
Average: Eastern Germany	56	41	37	40	113	117	132	93
Average: Western Germany	2	2	3	8	78	85	102	89

^a For 2006, the number of childcare slots per 100 children are not yet available. The numbers for 2006 refer to enrolment rates, including childcare centers as well as family day care ("Tagespflege").

Sources: Statistisches Bundesamt (2004), Buechel and Spiess (2002) and Regionaldatenbank des Deutschen Jugendinstituts auf Basis der Daten der statistischen Landesämter. Data for the year 2006 are drawn from press releases of the Statistisches Bundesamt (March 1st, 2007 and March 8th, 2007).

For children aged three to six years center-based childcare slots are available to a much larger extent, both in eastern and western states. As Table 2.2 shows, childcare slots for children in this age group have been increasing since 1994. This is partly due to the fact that since 1996, parents have a legal claim for a part-time slot for children in this age group (see Buechel and Spiess (2002)). The majority of these slots (82% in west and 13% in east Germany), however, are part-time slots only.

The number of childcare slots as shown in Table 2.2 refers to public or publicly subsidized slots. Profit-oriented child-care centers, that are not eligible for subsidies, hardly exist at all in Germany (Spiess (1998)). However, there is a growing sector of privately organized childcare in the form of family day care or child minders. Official

statistics on the prevalence of this form of childcare are not available. Estimations based on surveys shows that about 5 percent of children are cared for by child minders (see Evers et al. (2005) or own calculation based on SOEP data as presented in Table 2.5). Costs are estimated to amount to about 700 Euro per month for a full-time slot (Jurczyk et al. (2004)). This sector has been growing in the past few years and communities have started to provide subsidies also for this sort of privately organized childcare. For the years of the empirical analysis that follows in the next chapters (2000-2002), however, subsidies in this field are ignored.

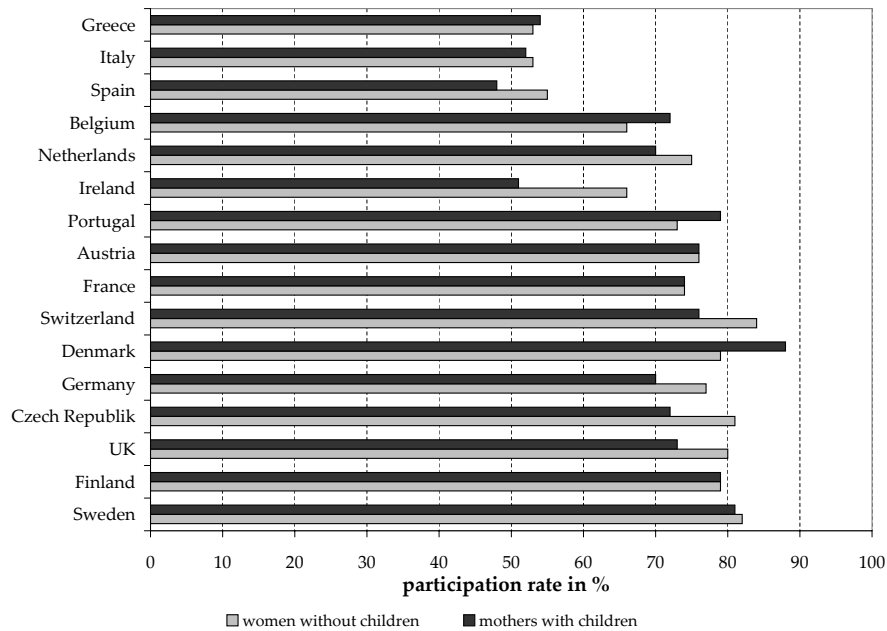
2.2 Stylized Facts on Mothers' Employment and Childcare Utilization in Germany

The employment rates of women without children is relatively high in Germany compared to other European countries. The participation rate of *mothers* with young children, however, is relatively low. Figure 2.4 shows employment rates of women with and without children under 14 years in selected European countries. While the employment rate of women without children is as high as 79 percent in Germany, the employment rate of mothers with children up to 14 years is only 70 percent. As the international comparison shows, only Ireland and southern European countries such as Italy, Spain and Greece show employment rates of mothers that are lower than in Germany. Moreover, the majority of working mothers are engaged in part-time or marginal employment ("geringfügige Beschäftigung"). The share of part-time working mothers in Germany is well above the European average. Only Switzerland and the Netherlands have even higher shares of part-time working mothers (OECD (2007b)).⁸

According to Pfau-Effinger (2001), the employment patterns of west German mothers that can be observed today have developed over time along with the change

⁸The part-time employment rate is much higher even compared to countries with similar participation rates and similar cultural and institutional background, such as Austria. See Dearing et al. (2007).

Figure 2.4: Employment rates of women with and without children under 14 years in selected European countries



Source: BMFSFJ (2005a).

of the dominating family role model. Up until the 1980s, in west Germany the male breadwinner model used to be the predominant model. Since then, the notion of a "1.5 breadwinner model" has been emerging. This model suggests that both spouses within a marriage are engaged in employment, however, if children are born, the mother is expected to interrupt labor market participation for a few years and continue with part-time employment thereafter up until the child(ren) is (are) not in need of care any more.⁹ Accordingly, employment rates of mothers with small children have been increasing steadily in the past decades in west Germany. While the employment rate of mothers whose youngest child is up to six years old amounted to 34% in the early 1970s, it has been rising up to almost 50% by the end of the 1990s (Buechel and Spiess (2002)).

⁹This pattern of distribution of market work and childcare duties within the family in Germany is different from countries such as France, Denmark or Sweden, where two-earner families using public or publicly subsidized childcare have been the predominant role model already since the 1970s.

Mothers in east Germany have been exposed to a very different institutional and cultural environment. Full-time employment of mothers with children of all age groups used to be the common model. East German family policies, in particular the overall availability of childcare, favored short employment interruptions in connection with the birth of a child.¹⁰ Thus, before reunification, women's labor force participation in east Germany was among the highest in the world. In the years since reunification, employment patterns of mothers in east and west Germany have converged to some extent, but differences still prevail. Overall, employment of mothers is still higher in the eastern parts of Germany, whereas part-time and marginal employment is more prevalent in the western parts. The following table shows employment rates of mothers in east and west Germany between 1991 and 2002 based on data from the microcensus.

Table 2.3: Employment rates of mothers in east and west Germany by age of the youngest child

	East Germany			West Germany			National average		
	1991	1996	2002	1991	1996	2002	1991	1996	2002
Mothers with youngest child < 3									
- full-time	41	20	25	10	8	8	16	10	10
- part-time	6	5	7	11	7	8	10	7	8
- marginal employment	1	2	4	5	6	11	4	6	10
- unemployed	12	12	8	3	2	2	5	3	2
- not participating	41	60	57	71	76	72	65	75	70
Mothers with youngest child 3-6									
- full-time	64	55	51	18	14	15	31	21	19
- part-time	9	9	11	20	20	24	17	18	23
- marginal employment	1	1	3	8	12	17	6	11	15
- unemployed	11	23	22	3	5	5	5	8	7
- not participating	15	12	14	51	48	39	41	42	35
Mothers with youngest child 7-10									
- full-time	68	68	56	23	20	8	36	34	23
- part-time	9	8	12	25	26	8	21	21	27
- marginal employment	1	1	4	9	13	11	6	10	16
- unemployed	10	16	19	3	5	2	5	8	7
- not participating	13	7	9	40	37	72	32	28	27

Source: Analysis of the micro census (1991-2002) by Geisler and Kreyenfeld (2005).

¹⁰See Trappe (1995) and Rosenfeld et al. (2004) for a detailed overview of the development of female employment rates, women's policy and family policy in the GDR.

Shortly after reunification, full-time employment rates of mothers with at least one child under three years amounted to 41% in the eastern States (compared to 10.3% in west Germany). This rate has dropped to 24.5% in 2002, which is still three times the full-time employment rate of mothers with children in the same age group in west Germany (7.8%). For mothers with children between three years and school age, the decline in full-time employment rates was not as dramatic, dropping from 64% to 51% in 2002. A comparison with the full-time employment rate of mothers in west Germany that amounts to 14.5% in 2002 reveals that even more than a decade after reunification, patterns of mothers' employment rates differ considerably between east and west Germany.

For west Germany, this disaggregate analysis for the 1990s and the early 2000 years shows that full-time employment rates have been declining by several percentage points, whereas part-time, and most importantly marginal employment has been rising. The marginal employment rate has doubled for mothers with children under three years, rising from 5.3% in 1991 to 10.7% in 2002, while the full-time employment rate has declined from 10.3% to 7.8% in the same period. As Table 2.3 shows, the employment rate of mothers with children between three years and school age follows a similar pattern.

The high prevalence of part-time employment, in particular in the western parts of Germany, reflects the childcare opportunities that have been characterized in section 2.1.4. For children aged 3 to 6 years, part-time care in a kindergarten is the common arrangement. For children below three years, center-based childcare is available to a much lesser extent. However, the employment rate of mothers whose youngest child is less than three years is considerably higher than the enrolment rates of children to childcare centers or family day care. As Table 2.4 shows, many children whose mother is engaged in full-time or part-time employment, are not enrolled in formal childcare. This is particularly true for children living in west Germany. For example, only 11% of children under three years who have a full-time working mother

are enrolled in childcare centers. Among children with part-time working mothers or mothers in marginal employment, only 8% are attending childcare centers. In east Germany, these shares are considerably higher. More than 90% of children in this age group, who have a full-time working mother, are enrolled in childcare facilities.

Table 2.4: Enrolment rates to center-based childcare by working status of the mother

Age of the child	All children		Children with full-time working mothers		Children with part-time ^a working mothers		Children with non working mothers	
	East	West	East	West	East	West	East	West
0-2 years	34%	4%	91%	11%	50%	8%	18%	2 %
3-6 years	87%	78%	95%	80%	92%	82%	77%	72%
7-10 years	30%	4%	36%	8%	34%	3%	19%	5 %

^a Including mothers who are marginally employed.

Source: SOEP, wave 2002.

As can be seen from Table 2.5, many families make use of other sorts of childcare arrangements. For example, more than 50% of all children are cared for by their grandparents for an average of 7 to 10 hours per week, depending on the age of the child. Thus, childcare provided by grandparents is - in addition to parental childcare - the most important childcare arrangement for children below 3 years. As a comparison, only for 5% of children aged 0-1 years some form of paid childcare (center-based or family day care) is used. For children in their third year after birth, however, paid childcare becomes more frequent: 35% of children in this age group are enrolled in a childcare center and 7% use family day care.¹¹

Another interesting fact is that the correlation between maternal employment and childcare utilization is not as strong as it could be expected. On the one hand,

¹¹This information is drawn from the new "Mother and Child"-Questionnaire in the German Socio-Economic Panel (SOEP). (More details on the Socio-Economic Panel are provided in section 3.2.). Every mother in the SOEP who has a new-born child is interviewed twice to gather detailed information on the child's health status, cognitive and emotional abilities, care arrangements etc. The first interview takes place in the year after the child is born and the second interview takes place 2 years later. This new questionnaire was started in 2002. Thus, in the SOEP wave of the year 2005, there is information on 812 children who were born between 2002 and 2005 and information on 257 2-3 year old children who were born in 2002 and whose mothers were interviewed in 2005 the second time.

Table 2.5: Prevalence of different forms of childcare in addition to care by the mother

	Children aged 0-1		Children aged 2-3	
	share of children cared for by ^b	average hours per week ^a	share of children cared for by ^b	average hours per week ^a
...father	78%	16h	78%	17h
...grandparents	51%	7h	55%	10h
...older siblings	10%	6h	15%	7h
...family day care or or child minder	3%	22h	7%	14h
...child care center	2%	26h	35%	21h
Number of obs.:	812 children born between 2002-2005		257 children born in 2002	

^a The weekly hours refer to the conditional average.

^b The mother is asked the following question: "If you think about a normal week, are there any other people than you taking care of your child? If so, who are they and how many hours per week are they responsible for child care?"

Source: SOEP, wave 2005, "Mother and Child"-Questionnaire.

more than 70% of all children whose mother is not working are enrolled in childcare centers. The reason for this is that part-time care for children aged 3 - 6 is seen as preschool education and not so much as a means to provide the possibilities for both parents to work (Kreyenfeld (2004)). On the other hand, not all working mothers purchase formal childcare, but use informal, often unpaid childcare arrangements, as has been explained above. While this might be the preferred choice over non-relative childcare for some families¹², it might also indicate access restrictions to subsidized childcare facilities. As will be shown in the next chapter, there is in fact empirical evidence for considerable excess demand for subsidized childcare in Germany, in particular for children under three years.

¹²Joesch and Hiedemann (2002) have found that in the US, more than 40 percent of families prefer relative care to non-relative care for infants and toddlers independent of the cost of non-relative care options.

2.3 Recent Family Policy Reforms and Reform Proposals

As has already been described in the Introduction, family policy is presently a topic that gains a lot of public attention. In Germany, family policy institutions are currently under transformation. Many family policy instruments have been reformed in recent years. The most important of these is the introduction of the so-called “Elterngeld” to replace the former parental leave scheme. Moreover, several reforms in the context of childcare availability have been undertaken. As part of the “Hartz IV” labor market reforms, a small scale in-work credit for parents with dependent children (“Kinderzuschlag”) has been introduced in 2005. As far as the family components within the income tax are concerned, several alternatives to the current system of joint taxation with full income splitting have come up as reform proposals recently, most prominently the “family tax splitting” such as practiced in France.

Since the empirical analysis of this study focusses on reforms in the field of childcare and family taxation, I abstain from a more detailed discussion of the new parental leave scheme and the in-work credit for families. Details on these reforms are described in Spiess and Wrohlich (2006) and Steiner and Wrohlich (2006a), respectively. The following outline of the ongoing discussion on family policy reforms will be restricted to childcare and family tax issues.

2.3.1 Childcare Policy Reforms

In the past couple of years, the German federal government has been stressing the importance of childcare opportunities, not least due to the declining fertility rates and the low labor force participation of mothers. Recently, as a consequence of the poor performance of German pupils in the PISA study, also the positive effects of childcare on later school outcomes have been emphasized. As a reaction, the govern-

ment passed a law in 2005 that aims at increasing the provision of childcare slots for children under three years. According to this law ("Tagesbetreuungsbaugesetz - TAG"), childcare slots have to be provided for all children in this age group whose parents both work or wish to work. It was passed in January 2005 with the aim to provide all necessary childcare slots by 2010. Many federal states have already reacted to this reform and considerably increased the supply of childcare for children in this age group, as has been shown in Table 2.2 above. Very recently, the Federal Ministry of Family Affairs has argued that the increase in childcare slots implied by the "TAG" law should be exceeded. In April 2007, the Federal Ministry and representatives of the Federal States agreed to increase availability to 33 percent until the year 2013.

More recently, the possibility to deduct childcare costs from taxable income has been formulated more generously. Since 2002, childcare costs can be deducted from taxable income up to a ceiling of 1,548 Euro per child per year if they exceed a yearly amount of 1,500 Euro per child. The condition for these deductible expenses is, however, that both parents are working or in education. From January 2007 on, the amount of deductible expenses has been increased up to 4,000 Euro per child per year. For children under the age of 6, only two thirds of all expenses are deductible, whereas for children between 6 and 14 years, all expenses can be deducted. The precondition regarding employment status is abolished for children between 3 and 6 years.

Another issue of current discussion concerns the amount of parents' fees to center-based childcare. The free provision of childcare for children between 3 and 6 years has been proposed several times in the past years, e.g. by the German Council of Economic Advisors in 2004,¹³ by the Expert Commission on Children and Youth in 2005,¹⁴ and by the Federal Ministry of Family Affairs. Some Federal States have already decided to provide free childcare, starting for 5-year old children, as for

¹³see Sachverstaendigenrat (2004)

¹⁴see BMFSFJ (2005b)

example in Rhineland-Palatine. Even in the Federal State of Berlin, which has the highest availability of public childcare slots and where parents' fees for childcare costs have been increased in the past years, the free provision of public childcare for two years before school entry is planned to be implemented in 2010.

2.3.2 Reform Proposals of Family Taxation

The current system of taxing married couples jointly has been under critique for quite a long time due to its degressive distributional effects and the resulting negative work incentives. While other European countries such as the UK, Italy, Austria as well as the Scandinavian countries have moved to individual taxation many years ago,¹⁵ this does not seem to be a political option in Germany at the moment. Proponents of the current system argue that the favorable tax treatment of married couples as compared to non married partners is required by Basic Constitutional Law. Serious reform proposals of past years have thus not aimed at abolishing joint taxation with income splitting altogether but at limiting the splitting advantage for couples with very high incomes. This could be achieved, for example, through a sort of "real income splitting" (see Steiner and Wrohlich (2004)).

More recently, various versions of a "family tax splitting" have been proposed that take the French "Quotient Familial" as an example. The French version of family tax splitting consists of joint taxation with a splitting procedure that - in addition to the two spouses - also takes the number of children into account. As in Germany, the splitting factors equal 1 for each spouse. For the first and the second child, a splitting factor of 0.5 per child can be added, and from the third child onward the splitting factor per child amounts to 1. Thus, the third child is "subsidized" at twice the amount of the first or the second child. This is the result of a long tradition of explicit pro-natalist family policy in France.¹⁶

¹⁵See OECD (2005b) for an overview of family taxation in different European countries.

¹⁶See Dell and Wrohlich (2006) or Fagnani (2005) for more details on the motivation and the development of the French "Quotient Familial".

Under a family tax splitting, the tax liability of a married couple $T(Y_M, Y_F)$ with c number of dependent children changes to

$$T(Y_M, Y_F) = (2 + \alpha \cdot c) \cdot t \left(\frac{Y_M + Y_F}{2 + \alpha \cdot c} \right) \quad (2.4)$$

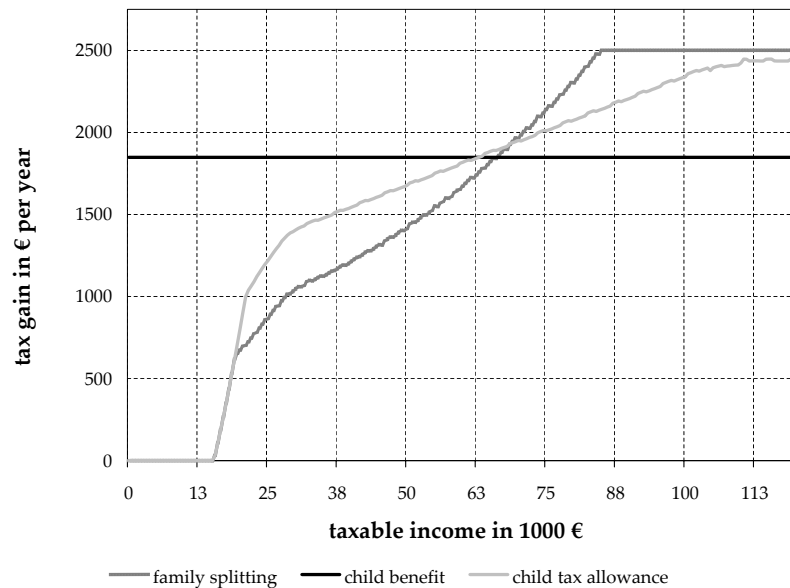
where α denotes the splitting factor per child. In the French version of the family tax splitting, however, there is an important restriction compared to the family tax splitting as denoted in equation 2.4 that is usually not mentioned in the public debate: In France, the tax gains resulting from the child splitting factors are limited to 2,100 Euro per year. For the third and every subsequent child this amount is doubled. The French “Quotient familial” is thus more accurately described as

$$T(Y_M, Y_F) = \max \left[\left((2 + \alpha \cdot c) \cdot t \left(\frac{Y_M + Y_F}{2 + \alpha \cdot c} \right) \right), \left(2 \cdot t \left(\frac{Y_M + Y_F}{2} \right) - c \cdot M \right) \right] \quad (2.5)$$

where M denotes the maximum amount of splitting gain granted per child. Since the tax gain for the children’s splitting factors is limited, this system becomes very similar to the German system of joint taxation with income splitting for married couples and the child tax allowance.

Figure 2.5 illustrates the similarity of the French and the German system for the example of a married couple with one child. For families with a taxable income up to about 15,000 Euro, there is no tax gain neither from the child tax allowance nor from a family tax splitting. The reason is that the taxable income of these families does not exceed the basic tax allowance that amounts to more than 15,300 Euro for a married couple. From 15,300 to 19,000 Euro, the tax gain is exactly the same under both regimes. Above this threshold, the child tax allowance leads to a higher tax gain than the family tax splitting. This can be explained by the fact that a child splitting factor of 0.5 is equivalent to an increase of the basic allowance by

Figure 2.5: Comparison of the tax gain through the child tax allowance, child benefit and family tax splitting



Source: Adapted from Steiner and Wrohlich (2006b).

3,832 Euro, whereas the child tax allowance amounts to 5,808 Euro. Only families with a taxable income of 69,000 Euro per year or more would benefit more from the family tax splitting than from the current child tax allowance. Whether the two lines intersect a second time, depends on the amount of the ceiling of the tax gain granted for the child splitting factors, which is set at 2,500 Euro per year in this example.

There are, however, several important differences between the French and the German system. In France, also non married partners - whether they have dependent children or not - are eligible to joint tax filing with full income splitting if they have signed the PACS.¹⁷ Moreover, single parents can add a factor of 0.5 in addition to the child splitting factors. This splitting factor for lone parents has a similar effect as Germany's single parent's tax allowance, however, it is much more generous. As

¹⁷Since 1999, couples who have cited the PACS (civil solidarity compact, also applicable to couples of the same sex) are treated like married spouses.

explained above, an additional splitting factor of 0.5 implicitly leads to an increase of the basic tax allowance by 3,832 Euro, while the current single parents' tax allowance only amounts to 1,308 Euro.

It is often argued that a family tax splitting such as practiced in France would provide more generous tax reliefs for families with children than the current German system.¹⁸ Proponents of a family tax splitting for Germany, however, have not defined important parameters of such a system yet. The amount of the child splitting factors, possible ceilings to the splitting advantage granted for children, the treatment of the existing child benefit and child tax allowance, as well as the financing of potential costs of this reform have not been specified so far.

¹⁸In fact, Baclet et al. (2005) have shown that the popular notion that high-income families with many children receive more tax reductions in France than in Germany is true, however not only due to the French family tax splitting but most importantly due to the different definition of taxable incomes.