This paper provides a general discussion of the effects of preferential tax treatments of market produced household services, as well as a discussion of the paper 'The Service Voucher in Belgium' prepared by the independent experts Dr. Anneleen Peeters and Ann Gevers. The disposition of the paper is the following. In the first section, I discuss the potential effects of preferential tax treatments of household services based on the existing research literature. What could we in general expect from such policies in terms of employment, wages, underground activity, and women’s position on the labour market? In the second section, I take a closer look at the discussion paper 'The Service Voucher in Belgium' prepared by the independent experts. And last, I take a Swedish perspective of the policy in focus, and describe the situation in Sweden.

1. Effects of preferential tax treatments on household substitutes

This section takes a research perspective when looking closer at the effects of tax reliefs and subsidies on household substitutes.

1.1 Efficiency in the tax system

The most elaborated argument put forth in the research literature in favor of preferential tax treatment of household services is that efficiency improves. Similar to the argument that an income tax rate distorts the individual time use between leisure and market work, will the income tax rate distort the time use between home work and market work. The individuals will carry out too much work in their home and too little work on the market, as market work is taxed and home work is not. Tax reliefs or subsidies on market produced household services will therefore improve efficiency by stimulating the more productive market work.

However, preferential tax treatments of household substitutes induce an excessive consumption of household services at the expense of other types of goods and services. Thus although subsidies tend to stimulate labor supply, which improves efficiency as labor supply is suppressed by taxes, it also distorts the consumption choice between household services and other types of goods and services. As the subsidy reduces the relative cost of household services, it stimulates a socially excessive consumption of household goods at the expense of other types of goods and services. Finding the most efficient subsidy is a matter of balancing the two distortions against each other.
The economic literature on taxes and household production seem to be rather coherent on this issue. It is welfare improving to introduce subsidies or tax reliefs on market produced household services, but too large subsidies will eventually reduce welfare.

Although this is the argument most investigated and elaborated on in the research literature (see Rosen (1997), Sorensen (1997), Kleven (2004)), this is an argument less often brought up in the political debate. The political debate has been more concerned with whether such policy could create job opportunities for those who are currently looking for a job, but seem to have a hard time finding one. So let us turn to the issue of involuntary unemployment.

1.2 Wage formation and involuntary unemployment

The impact of preferential tax treatment of household services on involuntary unemployment is a less investigated issue. This may be surprising considering the political interest in the question. Although there are rather few studies investigating the effects of these types of policies on unemployment, the picture this literature draws of the effect on employment is positive. Employment tends to increase with preferential tax treatments of household services. The reason being that wage demands determined in wage bargains are restrained by these types of policies.

One reason for expecting restrained wage demands is that the demand for these types of services are more sensitive to price changes. As the demand for services are more sensitive to price changes, the demand for labour in these sectors also tend to be more sensitive to wage changes. This tends to restrain union wage demands leading to a lower level of unemployment. Another reason for expecting wage demands to be lower following preferential tax treatment of household substitutes is that the value of having a job increases. The employed workers thus become more keen on keeping their jobs, and are therefore willing to reduce their wage demands in order to do so. In addition, the unemployed tends to search more intensively for a job. Both effects improve the matching of workers and firms which reduces the equilibrium rate of unemployment. See Engström et al (2005).

1.3 Women's position in the labour market

There has been even less research conducted on the effects of preferential tax treatments of household substitutes on women’s position in the labour market. It is straightforward to show that introducing tax reliefs or subsidies on household substitutes enables, in particular, women to work more in the labour market as they can substitute market purchased household services for own household time (see Kolm and Lazear, 2006).

To have access to a market with household substitutes may be of potential importance for female labour market attachment. In fact, Freeman and Schettkat (2005) propose this as a potential explanation for the EU-US employment and hour differences that is observed. As they argue, in the US there has been a more extensive shift of traditional household production to the market than in Europe, providing an explanation for why women in the US in general work more hours than women in Europe.

To have tax reliefs or subsidies on household substitutes may thus be one way to strengthen women’s position on the labour market. Such policy enables women to have a family but at the
same time proceed a successful market career. This policy could then help improve the female representation in the upper end of the income distribution.

However, one should here also keep in mind that it is highly likely that mainly women will work in the sector supplying household substitutes. This is also confirmed by the discussion paper of the Belgium economy. This tends to increase women’s representation in the bottom end of the income distribution. However, earnings inequality also follows due to differences in employment status. To have a strong labour market attachment is usually a key factor to a better income than living of benefits. It may thus be better to have a low paid job than not to have a job at all. One can also note that it has been shown that labour market attachment strengthens women’s position within the marriage.

### 1.4 Underground work

Related to section 1.1, based on models with a perfectly competitive labour market one can argue that untaxed household production carried out in the underground economy induce an inefficient use of resources. Tax reliefs or subsidies on household substitutes would then improve efficiency by stimulating labour supply. However, preferential treatment of these service at the expense of other types of goods and services may also induce a distorted consumption mix.

Also in models with an imperfectly competitive labour market where wages are set in bargains and unemployment feature in equilibrium, one can, although based on very few research observations, argue that employment is likely to increase with tax reliefs on formal production of household services.

### 1.5 To sum up

Preferential tax treatment of market produced household services has support in the existing research literature. It is likely to improve efficiency in the tax system by stimulating individuals to work more time in the market. Note however that large tax reliefs or subsidies on these services induce other distortions. Moreover, as it is usually women doing the household work, such policy is likely to increase women’s representation in the top end of the income distribution by stimulating women to move from part-time work to full-time work. Also wage demands are likely to be moderated by such policy inducing a lower level of structural unemployment.

### 2. Comments on the discussion paper

This section comments on the discussion paper ‘The Service Voucher in Belgium’ prepared by the independent experts Dr. Anneleen Peeters and Ann Gevers. The comments are listed below.

- Belgium has a voucher system where the hourly price of the service is fixed for the user to 6.7 euros. The subsidy is set to 14.3 euros per hour. As the user price is fixed (and adjustments in hours, wages, etc, are not likely), the price mechanism cannot be used to solve problems that we usually want it to solve. For example, problems brought up by the employers such as “it is difficult to find adequate service voucher workers”, “lack of work
motivation among work candidates”, “lack of required skills among work candidates”, etc. These are problems that usually are solved by increasing the wage for workers and increasing the price on the service. Clearly such adjustments may reduce the demand for the services and reduce the employment effects of such policy. However, deviating from the price mechanism takes out an important way of solving allocation problems.

- Clearly evaluation of the system in Belgium, and other countries, are extremely important. One would like to capture the effects of this policy on individual behavior. For example, will women increase their working time as a consequence of that these services are easily available and affordable? How did the probability of leaving unemployment for any job change with the program? As it is very important to empirically evaluate the effect of the program on individual behavior, one may ask if it is not possible to construct some kind of experiment that enables such evaluation. An experiment with a treatment group and a control group. There are many experts on evaluation of social experiment that can advice on this possibility (such as extending the program in some regions but not others, or extending to certain groups and not to other, etc). When constructing the system, make sure it also is possible to evaluate it.

- Clearly allot of macro economic effects are not considered in the discussion of the service voucher system. Although these effects are difficult to evaluate empirically, one need to be aware of these effects and acknowledge them as far as possible.

1. For example, as more workers in the economy becomes employed, one usually expects a wage push. As it becomes easier to get a job, it also becomes less problematic to become unemployed, which induces wage demands to increase in general. Thus wages in other industries tends to increase, which reduces employment opportunities in those sectors, thus reducing the net effect of the policy on employment. That is we have indirect crowding out of jobs. However, one could perhaps argue that the indirect crowding out effect on other sectors are likely to be small in this case. The reason being that workers becoming employed in this sector are very low skilled and where not really competing with the ordinary unemployed workers for jobs even prior to the implementation of the program. Thus the fact that this group where unemployed did not work as a wage moderating effect on the employed workers in the first place. Them leaving the unemployment pool for a job in the service sector will then not induce a wage push in the economy in general. This reduces the potential negative effect on the indirect crowding out.

2. Other macro economic effects are: how informal sector jobs in this sector is exchanged for formal sector jobs, how other low skilled sectors are affected as this sector competes for their workers, etc.

- To have information about the users of these services are important in case equality aspects between men and women are to be considered. As mentioned earlier, to have access to affordable market produced household services enables, in particular, women to move from part-time work to full-time work. I could not see any information of that kind pulled out from the evaluations. The aspect of this policy in terms of enabling users to increase their working time is also important for tax revenue aspects. Increased working time among users increase the tax revenue. It is therefore important to know if users increase their working time when they use less own time for household work, or if they choose to consume more leisure.
3. Preferential tax treatments of household substitutes in Sweden

Sweden don’t have a system of tax reliefs or subsidies on household substitutes. However, the last ten years have seen an intensive debate over whether Sweden should implement preferential tax treatments of household services or not. In general the discussion has focused on the desire to reduce the VAT or the payroll tax rate in sectors producing household substitutes. Clearly this debate has been inspired by the policy initiatives, as well as by the discussions, in other European countries.

As the right wing parties are forming the new government (October 6th, 2006), some type of policy with preferential tax treatment of market produced household services is likely to be implemented within this election term. How such a program will be constructed is, however, less clear. Prior to the election, the largest right wing party sketched on a program of tax reliefs on household substitutes (see table 1). It is not clear at the moment, whether such program violates Swedish or EU legislation in some ways.

Table 1. A sketch of the suggested system of tax reliefs on household substitutes in Sweden

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<th>Suggested service to be included in the program of tax reliefs on household substitutes are: household service carried out in private homes, market purchases of laundry service from households, and help with picking up and leaving children at the childcare centers. Also services related to personal care in the household such as older persons hair care, and help with personal tasks are to be included in the program. The suggested program implies that firms selling these services have the rights to deduct half of the labor costs from the firm’s value added tax payments each month. A person can buy these subsidized services for a maximum of 100,000 SEK a year. Only registered firms can carry out the subsidized services.</th>
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One can note that this suggestion differs from the Belgium system as prices are not fixed. Rather that tax reliefs creates incentives for firms to reduce the price on these services making it possible to compete with the illegal production of these services and gaining customers that have not used these services before.
References


