Wages, Work Hours, and Work Effort: A Closer Look at How Tax Changes Distort Taxable Income

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Abstract

While labor studies of taxation have often focused on labor force participation and work hour decisions, some economists have pointed out that individuals ultimately want to adjust taxable income in response to tax changes and may do so through various channels. Some of these channels include the intensity of work, career decisions, and types of compensation. So far, there is still a dearth of evidence on how taxes distort these margins. In this paper, I examine how individuals adjust their wages, work hours, and work effort in response to tax changes, by estimating effects on occupations of the switch from separate to joint taxation at the federal level in 1948. My results show that joint taxation reduced labor force participation rates among wives, and induced wives who stayed in the labor force to choose occupations that paid lower wages, required lower effort, but involved the same level of full-time work. These results reveal that under some circumstances, the intensive margin of labor supply that responds to tax changes takes the form of work effort rather than work hours. Joint taxation had the largest effects on middle-age married women, who faced the largest husband-wife earning gap among all wives in my sample.

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