Household Behavior and Optimal Property Division upon Divorce

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As divorce laws started to allow for unilateral divorce and/or the grounds for divorce have expanded, divorce has become widespread in most modern societies. At the same time, different countries (and even different states within the United States) have different legal conditions for property division upon divorce, and spouses face a significant amount of uncertainty about what share of joint wealth will be awarded to them by courts.

The objective of this paper is to study the optimal property division if the social planner maximizes the expected welfare of new couples or the expected welfare of new entrants to the marriage market. We first provide analytical insights in a simple framework to highlight the trade-offs between intra-household risk sharing and insurance across marital statuses. Second, we turn to a quantitative/empirical exercise, where the key parameters are estimated using panel data from the United Kingdom. Then the optimal policy, as well as counterfactuals are computed.

The main feature of our model is two-sided limited commitment, as in Kocherlakota (1996). In our analytical framework, marriage is beneficial for two reasons: (i) it provides (partial) insurance against individual income shocks, and (ii) spouses may enjoy direct individual benefits from the match, 'love,' which is stochastic, as in Voena (2015).

In order to be able to study meaningfully the optimal property division rule, we allow for asset accumulation by households. As in all models with (individual and/or household) income risk, households save for precautionary reasons. In our framework, there are two further reasons for savings. First, as Ábrahám and Laczó (2014) have shown in a generic limited-commitment environment, saving by the household alleviates endogenous market incompleteness, under some conditions. Further, following insights from Voena (2015), given that separation may be an equilibrium outcome due to 'love' shocks, individuals have an incentive to save to smooth their consumption across marital statuses; hence the division of assets upon divorce will influence the asset accumulation incentives of the couple as well.

The analytical framework of the paper extends Ábrahám and Laczó (2014), where there are no 'love' shocks, but there are idiosyncratic shocks, limited commitment, and household-level (and potentially individual-level hidden) wealth accumulation. Analytically, the introduction of 'love' shocks is essential, because it makes divorce possible along the equilibrium path. In the absence of these shocks, the analysis of Ábrahám and Laczó (2014) implies that the optimal property division rule allocates no household assets to the party filing for divorce, and hence it makes divorce as unattractive as possible. In the presence of love shocks this policy is not optimal any more, and there is a trade-off between providing insurance while married and consumption smoothing for divorcees.

To understand better the quantitative significance of this trade-off, we then build a quantitative version of the model, where we consider labor supply, the life cycle, household scale effects, home production, and the role of children as well. We use household survey data from the United Kingdom, namely, the British Household Panel Survey (BHPS) and its extended version Understanding Society, from 1992[1] to 2013. Several institutional changes occurred around the turn of the century, which are useful for identification purposes. The income tax system was modified, in-work benefits were extended, and family policy was greatly altered, for example government spending on child-contingent benefits increased by fifty percent (Brewer, Ratcliffe, and Smith, 2012). These policy changes were due to a transfer of power from the Conservative to the Labour Party. In addition, a House of Lords decision in 2000 (White vs. White) made the distribution of assets on divorce more equal in England and Wales. In Scotland assets acquired during marriage have been divided equally since the Family Act Law enacted in 1985. Then, we compute the optimal asset distribution rule upon divorce using our estimates and also consider the welfare and asset accumulation impact of some of the proposed and/or implemented divorce law reforms.

[1]The BHPS started in 1991, but included no questions about housework in its first year, therefore we drop that wave.

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