

REFLECTIONS ON PERSONAL INCOME TAX IN THE EUROPEAN
UNION FROM A GENDER PERSPECTIVE
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The absence of neutrality in the income tax systems within the European Union

From the beginning of the eighties, the European Commission has endeavored to achieve equity in the treatment of men and women in all the fields of Community policy. Thus, Action 6 of the New Community Action Programme 1982-1985 (European Commission 1981) drew attention to the need to take measures which would rectify the damaging effects of fiscal legislation in the job market, particularly in those Member States whose tax systems discouraged the incorporation of women to the job market.

The European Commission identified several aspects of the tax systems which had a negative effect on married women. Among the more relevant were some sensitive points such as the aggregation of incomes in the family unit, the a priori transfer of reductions and deductions to the husband, the impossibility that each spouse declare his or her own income, and the maintenance of the joint and several responsibility of the spouses. This report drafted in 1981 concluded by recommending individual tax payment as a fundamental factor to achieve the equal treatment of men and women, and so, it tried to encourage the Member States to include the reform of their tax systems in their agendas.

Likewise, the purpose of this paper is to empirically corroborate some of the recommendations of the report of the European Commission, especially the advantages of individual tax payment, from the point of view of equal treatment of men and women. The analysis verifies the tax penalization of the second income tax payer in the family unit when paying income tax in several countries of the European Union.

As from the tax harmonization in the European Union, the tax structure of the Member States has been standardized to a great extent, but personal income tax has not and continues to be an exception given the differences in its structure. Despite this, the acceptance of the individual model has become more general in recent years so that, at the present time, the majority of the Member States have implemented individual or optional tax payment.

Undoubtedly, it is not possible to make a simple, hypothetical classification of the tax systems, depending on whether they have adopted the individual, joint or optional tax returns. This is owing to the fact that the simplicity of this classification is only a mirage, since the only common feature of personal tax payment within the area of the European Union is its complexity and diversity. In fact, no individual tax payment system is the same as any of the others, and the joint tax returns system also differs in each country.

Based on these considerations and only taking into account the tax payer, that is to say, the person liable to pay tax, whether this is an individual person or a family unit, as a classification criteria, it is possible to establish a distinction between the *individual tax*

payment system and the *family or joint tax payment* system, which considers the income of all the persons who make up the family as a whole.

In turn, the accrual of income in the family unit can be designed in very different ways, and gives rise to diverse tax payment variants. It may occur that the sum of the incomes of the family members taken into account in the same way as the incomes of single persons subject to the same scale of fiscal charges, in which case the system is termed *accrued tax payment*. However, if the entire family income is divided by a coefficient due to an attempt to alleviate the excess fiscal charge, the system is called *splitting* if the coefficient is divided between the spouses, 2) and *family quotient* if the coefficient takes the total number of persons who make up the family unit into account. A third case can be added called *optional tax payment*, a system adopted by those countries which are evolving towards individualized systems and continue to permit joint tax payment, which is the Spanish case. This final variant permits the tax payers included in a single parent or two parent family to choose individual tax returns or joint family tax returns.

In the European Union, in accordance with the options explained above, it is possible to establish the following classification depending on the tax paying unit (table 1):

Table 1

<u>Tax Paying Unit</u>	<u>Tax System</u>	<u>Forms</u>
Person	Personal tax payment:	Individual
Family	Family tax payment:	Accrued <i>Splitting</i> Family Quotient
Person/family	Optional tax payment	Individual/Accrued Individual/ <i>Splitting</i>

Based on this classification, the tax systems of the countries of the European Union would fall within the following framework (table 2):

Table 2

Individual Tax Payment	Clarifications
Austria	Denmark
Finland	
Greece	The family members submit their tax returns in a single document
Holland	Accrual of capital income to the capital to the spouse with higher earnings
Italy	

United Kingdom
Sweden

Joint Tax Payment

Belgium (*)	“Spouse Quotient”: the incomes from work are levied separately. If one of the spouses does not earn any income, he or she is attributed a percentage of the other’s income.
France	Family Quotient
Luxembourg	<i>Splitting</i>
Portugal	<i>Splitting</i>

Optional Tax Payment

Germany	Individual/ <i>Splitting</i>
Spain	Individual/Accrued
Ireland	Individual/Accrued/ <i>Splitting</i>

(*) This is considered to be joint tax payment as the family is the tax payer.
(Source: drafted by the author based on the OECD *Taxing wedges*, Paris, 2005 and *Fiscalidad Europea Básica* [Basic European Taxation], Editorial CISS, 2004)

If the principle of tax equity entails that any income earned in the family unit must be taxed with the same tax quota, regardless of the person who obtains this income, any deviation from this principle is, undoubtedly, tax discrimination. The following section includes an index which attempts to measure the level of discrimination against the second earner in the different approaches to family tax payment currently in force in the European Union.

Index of the level of discrimination with regard to family tax payment

If we start from the principle of tax equity in the family unit whereby earning a certain income must be subject to the same tax quota, regardless of the family member who obtains the earnings, and if this is not complied with, there will be discrimination against one or some of its members. This occurs in those tax systems in which the personal income tax is not per single taxpayer, in those systems where there is transference of income, deductions and reductions between spouses or, in the same way, in tax systems that offer a tax reduction for the “dependent spouse”.

Therefore, it is very interesting to measure the degree of discrimination and this also makes it possible to make comparisons between tax systems.

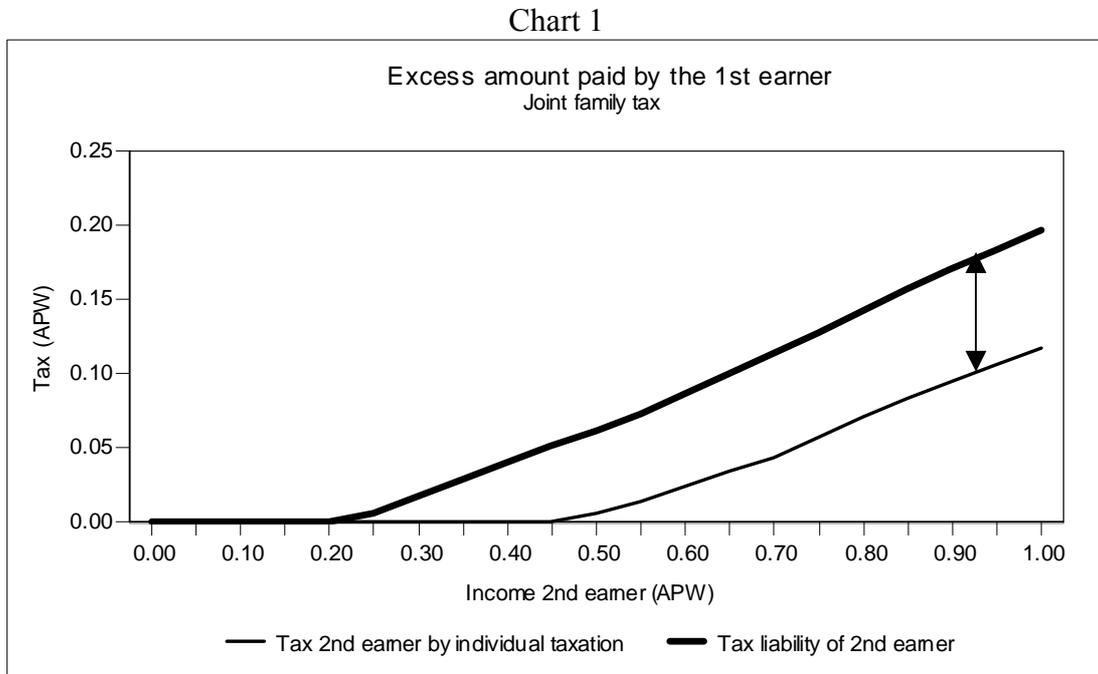
The characteristics of personal income tax are defined as the totality of the components and parameters which constitute this tax: taxable income, deductible expenses, reductions to the base, tax bill rate, deductions, etc. The tax penalization on the income obtained by the second earner can be determined through the excess tax payment, E, paid by this tax payer in comparison with the tax debt which should be addressed in the case of optional tax payment, and would be shown in the following formula:

E = tax liability quota of the 2nd earner – quota of 2nd earner as regards individual tax payment, which, expressed as a percentage of the quota of the second earner, would be the following:

$$E (\%) = \frac{\text{quota of tax liability of the 2}^{\text{nd}} \text{ earner} - \text{quota of the 2}^{\text{nd}} \text{ earner as regards individual tax payment}}{\text{[quota of the 2}^{\text{nd}} \text{ earner as regards individual tax payment]}}$$

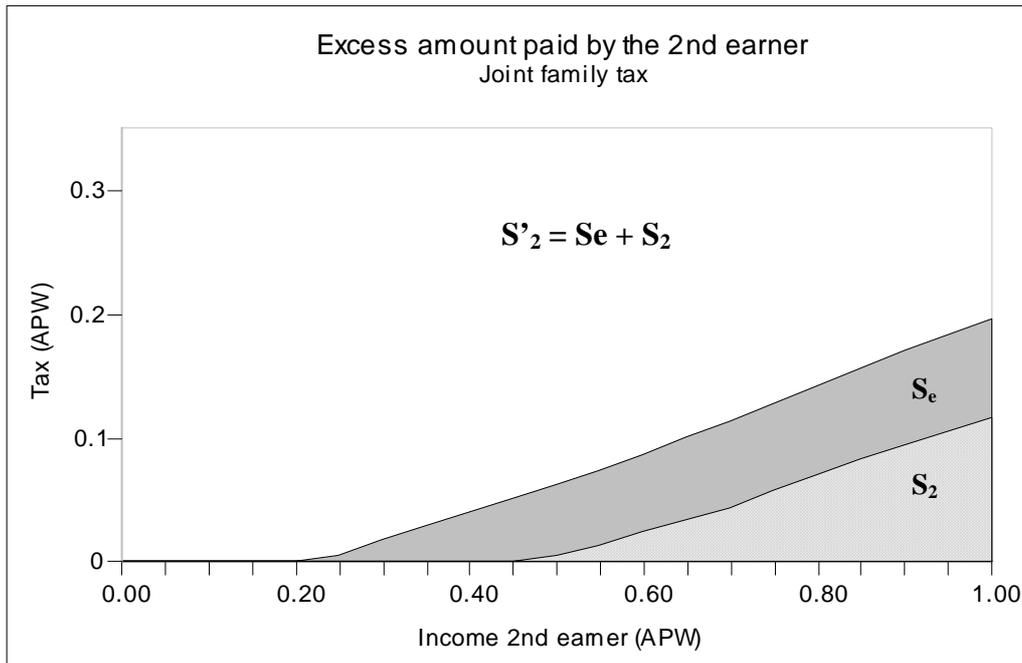
(The “tax liability quota” of the 2nd earner refers to the real tax payment for this earner’s income)

Chart 1 shows this excess with regard to accrued family tax payment for different levels of APW income², where the thick line shows the tax debt of the second earner and the thin line shows the debt which would be payable in the event that this person pays income tax individually. The difference between both lines delimits the excess tax payment (vertical arrow).



Thus, the excess tax payment borne by the second earner in accrued tax payment is shown in the area enclosed between the curves representing both quotas (S_e), as shown in chart 2.

Chart 2



(Source: drafted by the author)

When there is no excess tax payment, both curves merge and the area enclosed between these is equal to zero, but if discrimination occurs, the area appears and makes it possible to appreciate the existing excess tax payment.

The relationship between the area S_e (excess tax payment) and the area enclosed by the line corresponding to the tax liability quota of the second earner S_2 allows us to know the level of discrimination in these cases.

Its intensity can be measured through the index (I), which determines the relationship between both areas, that is to say

$$I = S_e / S_2$$

Values of S_2 will oscillate from zero to S'_2 (area defined by the values of the tax liability of the 2nd earner equal to $S_e + S_2$), consequently, the extreme values which I can take on will oscillate between a maximum of infinitum ($I = S_e / 0$) and a minimum of 0 ($I = S_e / S_2 = (S'_2 - S_2) / S_2 = (S_2 - S_2) / S_2 = 0 / S_2$)

The index calculated in this way provides a measurement of the relative discrimination as regards the income obtained by the second earner. Obtained as a relationship between areas, it is converted into an adimensional figure and constitutes a valid means to make comparisons between countries with diverse taxation structures

Analytically, it should be expressed as follows:

$$I = [\int f'_2(y) \cdot dx - \int f_2(y) \cdot dx] / \int f_2(y) \cdot dx \quad [1]$$

Where $f'_2(y)$ and $f_2(y)$ are the functions representing the individual tax quota liability of the second earner.

$$S_e = \sum (y_{i+1} - y_i) \cdot [(C'_{2(i+1)} - C_{2(i+1)}) + (C'_{2(i)} - C_{2(i)})] / 2$$

And the area S_2 is expressed as

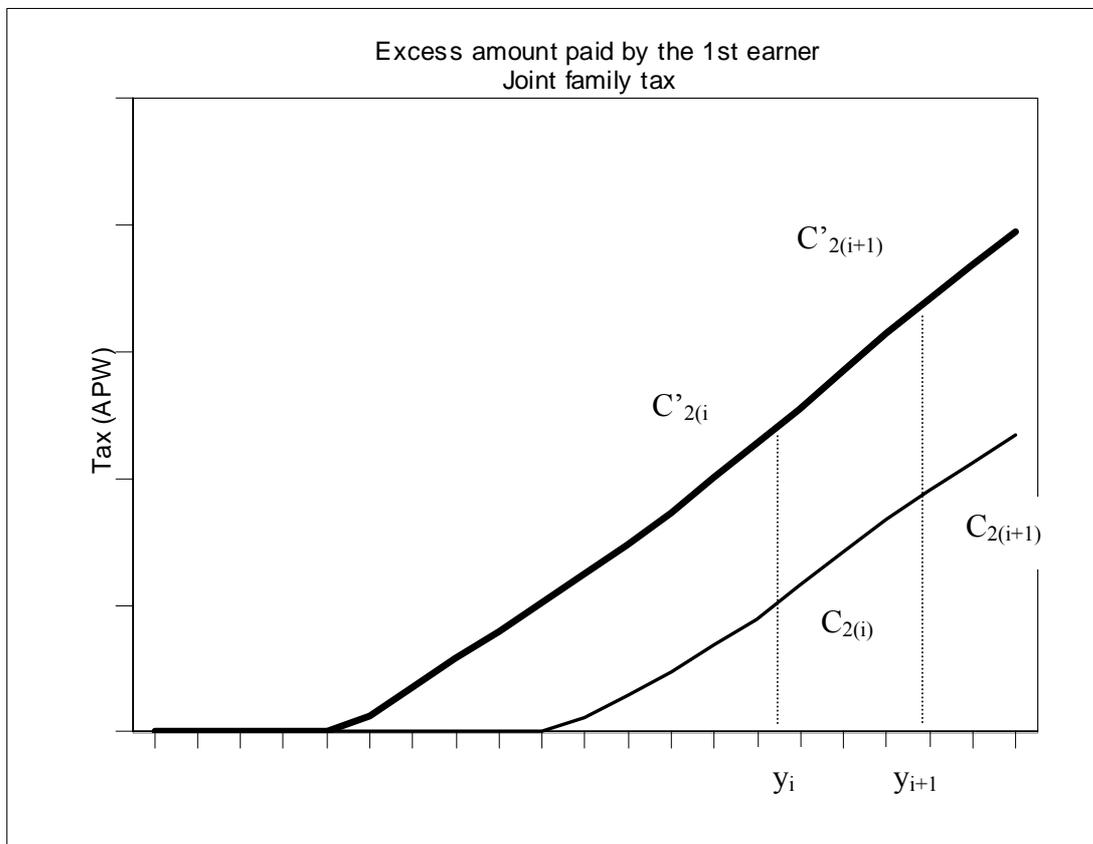
$$S_2 = \sum (y_{i+1} - y_i) \cdot (C_{2(i+1)} + C_{2(i)}) / 2$$

As regards discontinuous functions, such as those used in this paper, the following expression must be used

$$I = S_e / S_2 = [(C'_{2(i+1)} - C_{2(i+1)}) + (C'_{2(i)} - C_{2(i)})] / (C_{2(i+1)} + C_{2(i)})$$

Which the following chart 3 shows:

Chart 3



(Source: drafted by the author)

Up to now it has been considered that the earnings of the main earner remain constant and equal to 1 APW, but in some tax systems the discrimination undergone by the second earner also depends on the income obtained by the main earner (Z).

Nevertheless, the personal income tax is evidently very complex, and consequently several factors may penalize the 2nd earner. For example, in the tax models based on family taxation (joint income, splitting, familial coefficient, etc.), the amount of income received by the main earner determines the degree of discrimination suffered by the

spouse's income, since the marginal rate of the first earner affects the second. Therefore, it can be asserted that the excess taxation is reflected by the expression

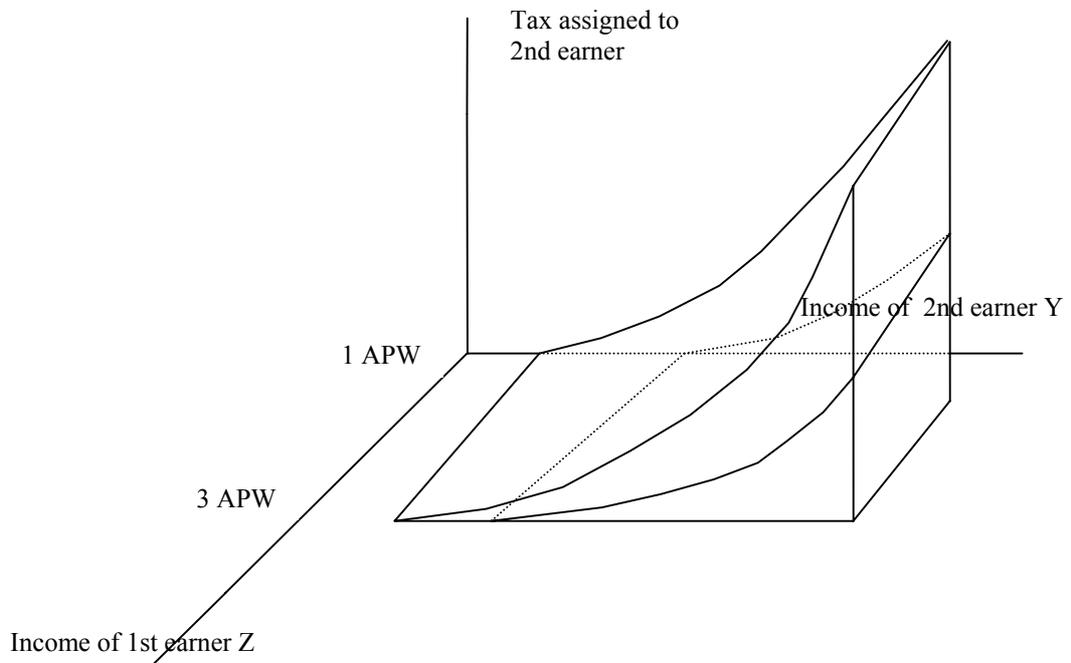
$$E = f(Y, Z)$$

where Z is the income of the main earner, therefore, expression [1] above converts to:

$$I = [\iint f_2(y, z) \cdot dx \cdot dz - \iint f_2(y, z) \cdot dx \cdot dz] / \iint f_2(y, z) \cdot dx \cdot dz \quad [3]$$

Whose graphic representation would take in a three dimensional space (chart 4), instead of an area as above, as shown in chart 4 which combines three variables: tax (c), income of the main earner (z) and income of the second earner (y).

Chart 4



Other variables affecting the determination of the tax payment attributable to the second recipient might exist.

In previous sections it has been shown how with some personal taxation, as in Spain or Italy, the number of sons and daughters alters the attributable tax payment, so that in these cases the index would really be determined by the relation between volumes defined by two tetradimensional hypersurfaces, which, owing to lack of space, it is not possible to include here. This highlights the enormous complexity of this taxation figure in some countries, as is the case with Spain.

As the values of the index outlined above fluctuate between infinity and one, the minimum (zero) will correspond to those tax systems which do not discriminate against the second recipient, and the values increase progressively under the protection of tax penalization.

As previously mentioned, the index calculated in this way varies between zero and infinity, something that often is awkward and needs to be standardized in order that the limits of its variation are zero and one.

To do so, for mathematical transformation, either

$$I' = I / (I + 1)$$

or

$$I' = 1 / (1 + 1 / I)$$

can be used. As a result, zero and one will be the extreme values of this transformed index:

If $I = 0$, it is verified that $I' = 0 / (0 + 1) = 0$.

If $I = \infty$, in the second expression:

$$I' = 1 / (1 + 1 / \infty) = 1 / (1 + 0) = 1$$

If the previous expression is worked out as $I' = I / (I + 1)$ and I is replaced by the value S_e / S_2 , the result is

$$I' = (S_e / S_2) / [(S_e / S_2) + 1] = S_e / (S_e + S_2) = S_e / S'_2$$

which is the relation between the areas of excess taxation and the tax liability quota of the 2nd earner.

Calculation of index of tax discrimination for different countries of the European Union

In this section the application of the index to the different income taxes of countries of the European Union for the year 2000 is set out: the diagram of the areas S_e and S_2 , in addition to the value of index I , calculated from the expression [3], in the case of a married couple with no children where the main recipient receives gross income equivalent to 1 APW. It must be borne in mind that in order to produce the index of discrimination proposed here only the income obtained by the members of the family unit is taken into consideration, Y_1 and Y_2 , all the rest being omitted.

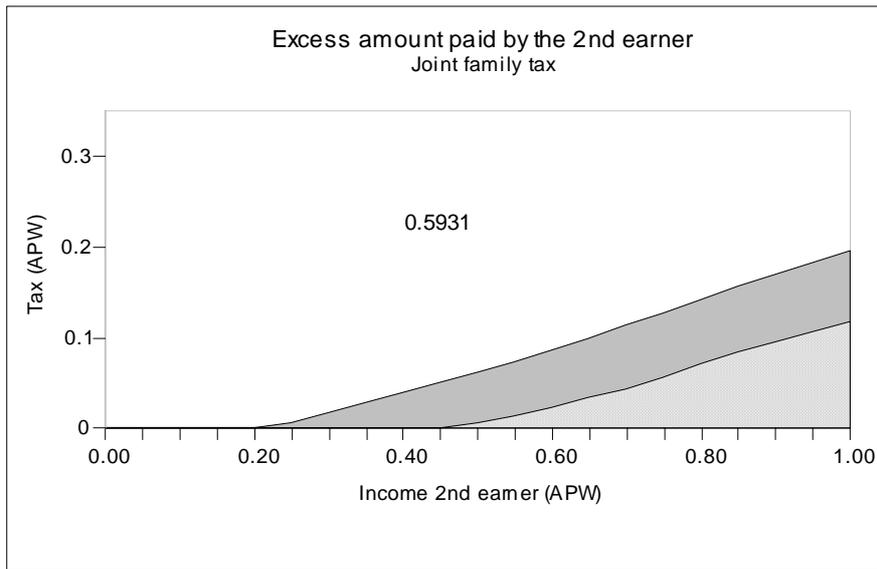
Accumulated taxation

We have taken the Spanish Personal Income Tax system as an example of accumulated taxation, where joint tax statement is made. The excess taxation suffered by the second recipient is due to the fact that, as previously shown, his or her income is taxed, at the very least, at the marginal rate of the main recipient, without any reduction, since the reduction applicable (personal minimum) is availed of by the spouse. Where an

individual taxation statement is applied the recipient could apply the amount corresponding to the personal minimum and the lower marginal rate on the tax scale (18% or 15% since 2003).

The diagram below depicts the areas S_e (grey) and S_2 (dots) and the value of the index calculated by the expression $I = S_e / S_2$ rises to 0.5931, the second highest of the twelve European countries surveyed in this document, although due to lack of space we only include diagrams of a very small number of them. It must be stressed that, in the case of Spain, the greater the income of the main recipient the greater the discrimination, a result of being subject to a higher marginal rate (chart 5).

Chart 5

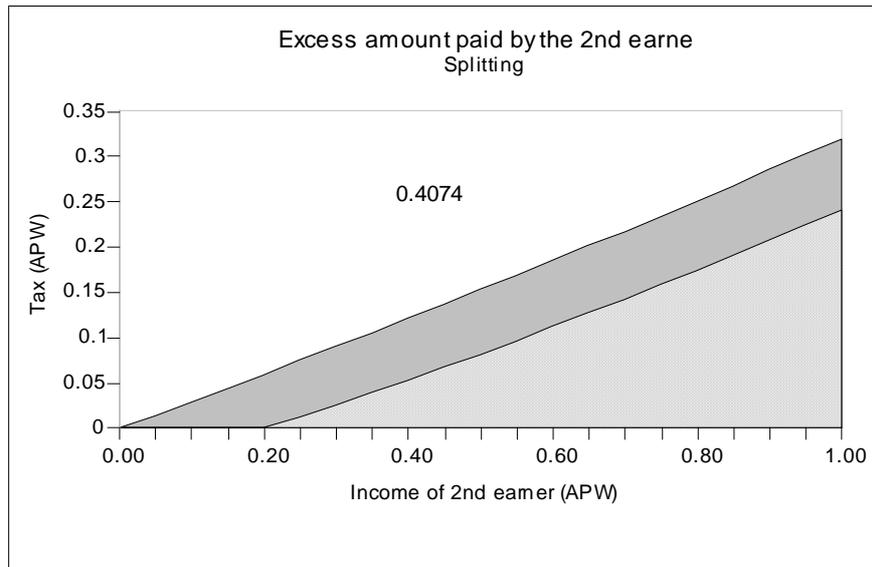


(Source: Author)

Germany: *splitting*

The German *splitting* shows a discrimination rate of 0.4074, which could be called average compared with other EU countries. It is not as high as that of accumulated taxation, but it highlights the fact that the transfer of tax burden from the main earner to the second is significant for work yields of approximately 1 APW, because the second earner's income is added to the spouse's income (that is, 50% of his or her own) and is subject to a higher marginal rate than would be applied if filing an individual tax statement (chart 6).

Chart 6

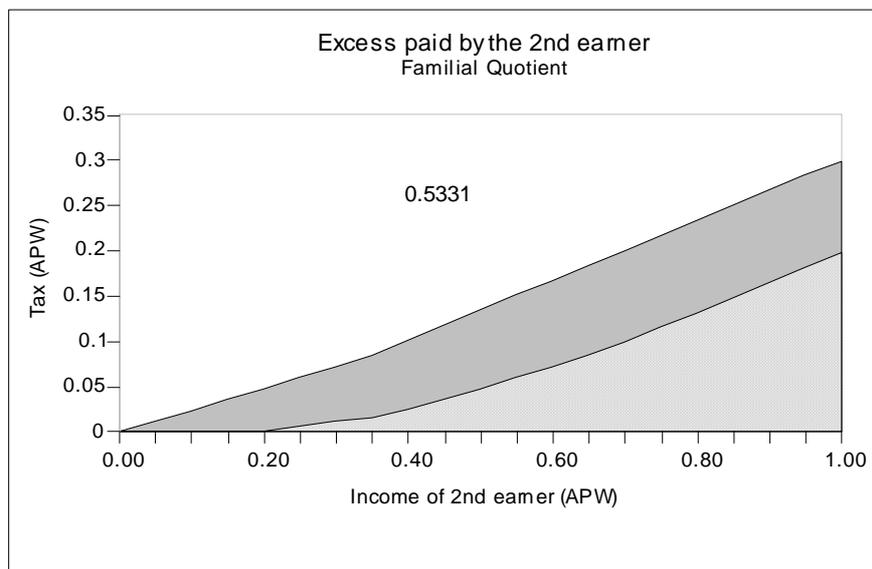


(Source: Author)

France: familial quotient

The French familial quotient is a *splitting* in which the quotient depends on the family type and the number of dependent persons. As regards married couples without children, the quotient is 2, which would lead one to expect that the French tax discrimination rate would be identical to the German. However, that is not the case because, as has been shown above, the degree of discrimination of a tax depends not only on the taxpayer unit adopted but also on the other parameters of which it is made up (chart 7).

Chart 7



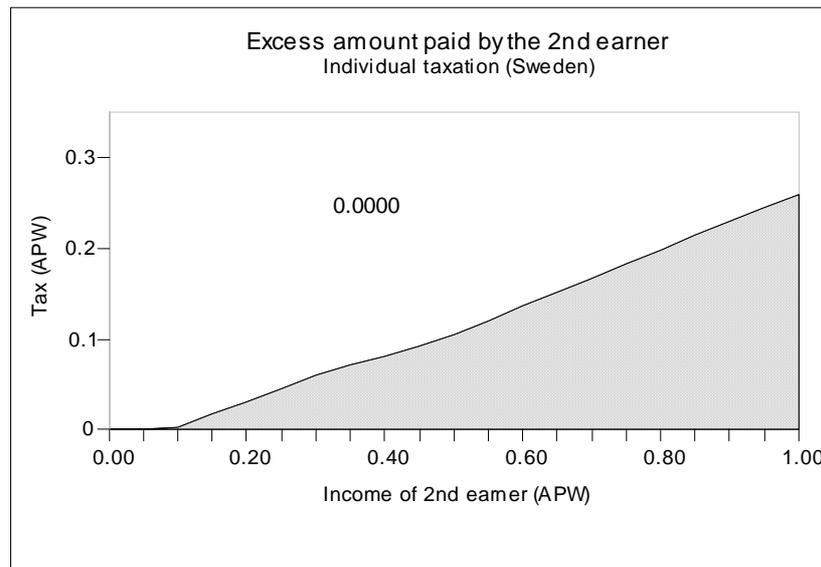
(Source: Author)

In this way, the French familial quotient applied to a married couple without children shows a discrimination rate of 0.5331, higher than the German rate, or, what amounts to the same thing, French taxation discriminates more than German taxation against the second earner, in the case examined here.

Sweden: individual

Sweden is the clearest example of individual taxation. Personal taxation is completely individualized and there is no provision for movement of income between members of the family unit, nor for reductions and deductions, which makes it a system where there is no discrimination whatsoever. Another feature of the Swedish system is the zero effect of personal and family circumstances when calculating taxation: direct spending, implemented by social policy through an ample provision of people-care services during the whole life cycle, substitutes tax spending (chart 8).

Chart 8



(Source: Author)

As may be seen in the above diagram, the penalization rate on the second earner in the Swedish case is zero.

Values of index of tax discrimination in the twelve countries of the European Union

In the countries analyzed so far, it may be observed that those showing a lower discrimination rate against the income of the second earner are those which have adopted individual taxation, and those showing a higher rate are based on family taxation. This fact reveals that any kind of taxation different from the individual kind works in detriment to the second recipient of income in the family and is an impediment as regards entering the labor market or increasing work activity.

If we exchange the variable corresponding to the different tax discrimination rates obtained for twelve countries of the European Union with the variable "activity index of married women", as chart 9 shows, we obtain the listing in table 3.

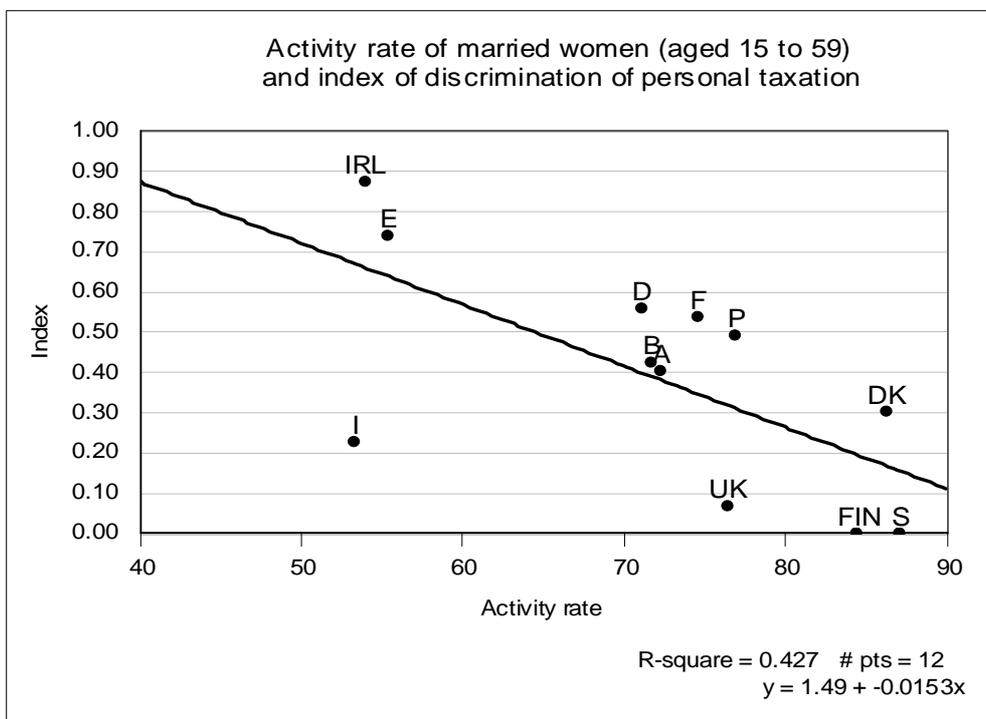
Table 3

<u>Country</u>	<u>Activity rate of Married women</u>	<u>Fiscal Index</u>
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Finland	84.4	0.0000
Sweden	87.0	0.0000
U Kingdom	76.4	0.0698
Italy	53.2	0.2289
Denmark	86.2	0.3039
Austria	72.2	0.4041
Belgium	71.6	0.4282
Portugal	76.9	0.4945
France	74.5	0.5396
Germany	71.1	0.5620
Spain	55.3	0.7425
Ireland	54.0	0.8777

Correlation -0.6535

Chart 9



FIN	Finland	B	Belgium
S	Sweden	P	Portugal
UK	United Kingdom	F	France
I	Italy	D	Germany
DK	Denmark	E	Spain
A	Austria	IRL	Ireland

(Source: Author's elaboration with data from Eurostat for women activity rate: *EU Labour Force Survey, 2001*)

Each point on chart 9 represents a country and its situation is reflected in the rate of activity of married women (horizontal axis) and the discrimination rate of personal income tax (vertical axis). The greater the rate of activity, the further to the right the country is situated in the diagram, and as the degree of tax discrimination increases, the

higher up the country is situated. In this way, a country with a high rate of activity of married women and a low tax discrimination rate, as in Sweden's case, will be found in the lower right part of the diagram.

This way, three different zones can be distinguished. Countries where the rate of employment of married women is lower than 60% appear in the first zone. A second zone shows those with rates between 60% and 80%, and a third includes those countries with values over 80%. Careful observation of the zone in which each country is found reveals that countries having tax systems that discriminate against women (where the level of discrimination is high), such as Ireland and Spain, have low rates of married women in employment, while, in contrast, those with less tax discrimination, such as Sweden, Finland and Denmark, have high rates of female employment, in the region of 85%. Countries with an intermediate rate of tax discrimination have employment rates of between 65% and 77%.

The correlation coefficient between the two variables is -0.6896, which seems to indicate the existence of a certain relationship between them. Nevertheless, it should be taken into account that taxation is not the only factor that determines a greater rate of female participation in the labor market; other factors, related to the availability of social services and community care, also affect the decisions of married women as to whether or not to continue in the labor market, and have a bearing on the degree to which men and women can successfully combine professional and family life.

Variation of the index of discrimination according to number of children

In tax systems that offer reductions and deductions for children there is always an increase in discrimination against the 2nd earner, as seen in the following chart:

	<u>No children</u>	<u>1 child</u>	<u>2 children</u>	<u>3 children</u>
Germany	0.5620	0.7622	0.8345	0.8941
Austria	0.4041	0.5046	0.5730	0.6716
Belgium	0.4282	0.4508	0.5066	0.5519
Denmark	0.3039	0.3039	0.3039	0.3039
Spain	0.7425	0.7847	0.8142	0.8550
Finland	0.0000	0.0000	0.0000	0.0000
France ³	0.5396	0.5804	0.5816	0.5502
Ireland	0.8777	0.8777	0.8777	0.8777
Italy	0.2289	0.2370	0.3122	0.3521
Portugal	0.4945	0.6826	0.8265	0.9262
United Kingdom	0.0698	0.0698	0.0698	0.0698
Sweden	0.0000	0.0000	0.0000	0.0000

In countries in which the index does not vary (Denmark, Sweden, Finland, United Kingdom and Italy) this is the result of deductions or reductions for children in the individual income tax being substituted with a universal set of economic social benefits.

In those systems that offer deductions of the quota (Denmark, Austria...), the increase in the index comes from the lower income tax liability due to the applicable deduction per child, since the excess taxation remains constant. In the other cases, like Spain, where a reduction is applied to taxable income, the effect is more complex as it alters both the excess taxation and the reduction of individual taxation.

Conclusions

The statistics clearly confirm that participation of women in the labor market is very different from that of men in all European countries, with the exception of the Nordic ones. The incorporation of women into the work force is influenced by their life cycle; while men enter the labor market when they reach the age they can legally do so, or on finishing their studies, to stay in it all their working lives, women frequently give up work to get married or to have and look after children, sometimes returning to work once this stage in their lives is over.

Therefore, it is possible to differentiate the incorporation of women into the work force according to their marital status and the number of young children they have, factors which practically do not exist for men in decisions concerning employment. Thus, the rate of employment for married European women is less than 60% (in Spain 47%), compared to 84.4% for married men (87.7% in Spain); moreover, 39% of these women work part time, while only 3.7% of married men are in part time work. The rate of employment for women between the ages of 20 and 34 with children younger than two years old is 57.2%, whereas that of men in the same age bracket is 96.4%.

The principle of tax equity implies that each person should contribute according to his or her economic capacity. If this does not happen within the family it means that tax discrimination exists against some member of the family unit. From a quantitative point of view, the taxation penalization - or excess tax - supported by the second earner gives us some idea of the degree of tax discrimination against women in each country where personal income tax is concerned. This disadvantage can be determined from the difference between tax liability as second earner, and that which would be paid if that person were taxed individually.

From this perspective, an analysis of the tax systems in force in the European Union shows that joint taxation, in whichever of its many forms (splitting, familial quotient, accumulation etc.) has a detrimental effect on second income earners within the family. This influences decisions, such as to whether or not to remain in the labor market or whether to work longer, and flagrantly compromises the principle of efficiency. In the same way, the choice of this type of taxation compromises the principle of equity because it clearly leads to indirect discrimination against married women (second earners), as already denounced by the European Commission in 1981.

The graphs on these pages show the excess in the amount of tax paid by the second earner (measured in relation to the amount paid with individual taxation), and clearly show that the system that puts the second earner at most disadvantage is that of joint taxation, followed by the German model of splitting, and lastly, to a lesser extent, the French familial quotient, which is a consequence of the greater tax levy borne by unmarried taxpayers or those without family responsibilities.

Likewise, these pages highlight the fact that the disadvantage to the second earner depends at times on the way the family unit is made up and may vary with the number of children. This effect is very noticeable in joint taxation and is a result of disparities in the treatment of family descendants. The French quotient uses a joint income factor, determined by the type and make up of the family unit; the German system of splitting applies deductions to contributions (at present an option exists between deductions in contributions and direct transfer), and in Spain the tax base is lowered by accumulated taxation.

Among those countries that have opted for obligatory individual taxation Sweden and Finland stand out. Both have strictly individualized systems with no transfer whatsoever between spouses so that there is no interference at all with the disposable income of the second earner. With the other systems, however, this is changed, to a greater or lesser extent, because such systems permit the transfer of deductions and allowances between both spouses, that is, they make use of derived fiscal rights.

The rate of tax disadvantage to the second earner shown here (based on the quantification of excess tax paid by this taxpayer compared to that paid through individual taxation) permits the comparison of discrimination in different personal taxes. Its application to different European Union countries confirms the previous conclusions, as the highest figures correspond to Ireland with 0.8777 (optional between accumulation, splitting and individual) and Spain, with 0.5475 (optional between accumulation and individual), followed by France, with 0.5331 (familial quotient). In contrast, the countries with the lowest rates are Sweden (individual) and France (individual).

When the data on numbers of married women in employment is compared, it can be seen that the countries with the highest rates of tax discrimination against women (Ireland and Spain) are those which at the same time have the lowest rates of married women in employment. Conversely, those with lower rates of discrimination (Finland, Sweden and Denmark) have higher employment rates, approximately 85%, with a correlation coefficient between the two variables of -0.6896.

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Notes

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² The salary unit used is the average salary of a full-time Average Production Worker, APW, in accordance with the definition given by the OECD, considered as a standard collective which allows the simultaneous study of several countries in a standardized

fashion. The amount is determined by the OECD and its values have been used in this study. In the year 2002 in Spain the APW earned €16,219 a year.

³ In France, the familial coefficient used is the same for married couples and widowed persons with the same number of children. Hence, the variation of the index with the number of children is compiled comparing married couples with children and single or divorced people with children.