

Optimal paid parental leave policy*

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Abstract

This study characterizes an optimal paid parental leave policy using a model in which a worker leaves a job with a certain probability and chooses whether to return to work after the leave period ends. An optimal policy, consisting of a lump-sum tax levied on a worker, and the length of the leave, maximizes social welfare subject to the resource feasibility and incentive constraints under which a worker on leave voluntarily chooses to return to work after the leave period ends. This study finds that when the incentive constraint binds, the income risk caused by the leave is not perfectly shared among workers and workers on leave, and workers consume more than those on leave, which is observed in most OECD countries. In addition, by lengthening the leave period, another feasible allocation improves social welfare, implying that the length of the leave at the constrained-optimal allocation is too short. Moreover, using a numerical simulation, I conclude that the negative relationship between the ratio of cash benefits during the leave to wages while working, and the length of the leave period, could result from a constrained-optimal paid parental leave policy.

Keywords: Paid parental leave policy, limited commitment, incentive constraint, constrained-optimal allocation

JEL Classification: H21, E24, J18

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