

# PRENUPTIAL CONTRACTS, LABOR SUPPLY AND HOUSEHOLD INVESTMENTS\*

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March 12, 2014

## Abstract

This paper examines prenuptial contracts that allow couples in Italy to choose, at virtually no cost, how their assets will be divided in case of divorce. Unique administrative data on marriages and divorces from 1995 to 2011 indicate that the majority of newlyweds (67% in 2011) choose to forgo the default community property regime and to maintain separate property, which in other countries would require signing a costly prenuptial contract. In addition, the data suggest that couples choose community property to provide insurance to wives who forgo labor market opportunities and undertake household-specific investments. We estimate a dynamic model of marriage, female labor supply, savings and divorce to match the patterns of regime choice and outcomes observed in the administrative data. The estimates suggest that, as the rate of female labor participation increases and the gender wage gap decreases, there are increasing gains from separate property. Hence, lower costs of prenuptial contracting, as occurs in Italy and other civil law countries, might lead to substantial welfare gains for both husbands and wives, greater rates of female labor participation, lower probability of divorce and higher rates of household savings.

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\*Corresponding author's email: avoena@uchicago.edu. We thank Manuel Amador, Pierre-André Chiappori, Marco Cosconati, Alex Frankel, Tullio Jappelli, Emir Kamenica, Neale Mahoney, Luigi Pistaferri, Aloysius Siow and participants in presentations at Collegio Carlo Alberto, CSEF, EIEF, WashU/Saint Louis Fed, the Minneapolis Fed, the FINET conference at UChicago, Yale, UVA, UChicago Harris, Ohio State, the Chicago Fed, UCL, Chicago Booth, Collegio Carlo Alberto and the AEA meetings for helpful comments. Maria Cristina Bruno provided invaluable insights on the Italian family law. A part of the data used in this paper has been examined at the Laboratorio per l'Analisi dei Dati ELEMENTARI at ISTAT, in compliance to the laws on the protection of statistical confidentiality and of personal data. We are exclusively responsible for the results and the opinions expressed in this paper, which do not constitute any official statistic. We are grateful to Marco Caputo, Maurizio Gatti, Giancarlo Gualtieri and Maurizio Lucarelli at ISTAT for their support in accessing the restricted data. Simone Lenzu provided outstanding research assistance. The financial support of an NBER Household Finance research grant is gratefully acknowledged.

Supporting the specialization of household members between market and home production activities is one of the fundamental purposes of family life (Becker, 1991). When women have a comparative advantage in home production, it is often optimal for the household to have them undertake substantial household-specific investments and forgo labor market opportunities. As a result of these investments, women’s human capital typically depreciates, hindering their ability to support themselves in case of divorce. Hence, if the risk of divorce is high, specializing in home production can be costly for women if husbands cannot commit to income transfers after the end of the marriage.

This paper studies whether couples use prenuptial contracts that establish property rights over household resources to promote efficient intra-household specialization and wives’ labor market participation. We examine an environment in which the financial and effort cost of signing a particular kind of prenuptial contract are very low: by marking their choice on the marriage license application, Italian couples can choose at the time of marriage how their marital property will be divided in case of divorce. Such a choice can be done at no upfront cost, and is regularly enforced by courts.

In the Italian context, similarly to other civil law countries, two regimes can be chosen, which are the most prevalent systems of property allocation around the world (The World Bank, 2012). The default regime is *community property*, which presumes that the assets accumulated during the marriage belong to both spouses and are divided equally in case of divorce, irrespectively of who financially contributed to the purchase. The alternative regime is *separation of property*, in which spouses hold separate assets that they keep in case of divorce. As a comparison, community property is the legal regime in place in several U.S. states and it is broadly comparable to the nationwide default, while obtaining separation of property requires signing a prenuptial agreement in the United States.<sup>1</sup>

Data from the national statistical institute (ISTAT) indicate that separation of property is a popular choice among Italian couples: in 2011, 67% of newlyweds agreed to a separation of property regime, forgoing the default community property.<sup>2</sup> Such a rate is relatively high compared to estimates of the take up of prenuptial agreements in the United States, which is often indicated to be approximately 5 to 10% (Rainer, 2007; Mahar, 2003). These numbers suggest that the high upfront costs might partly explain the low take up of prenuptial agreements in the United States, although the regime choice examined in this paper captures only a subset of the type of contracts that can be obtained through an actual prenuptial agreement.

It is worth noticing that a sizable fraction of couples (33% in 2011) chooses to keep their assets

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<sup>1</sup>During the 1970s and ’80s, the legal division of property upon divorce changed radically in most U.S. states. Traditionally, spouses held separate property that they would keep in case of divorce. Today, property is usually divided by courts irrespectively of who holds the formal title of ownership (Turner, 2005) and in many states marital assets are assumed to be community property that belong in equal shares to both spouses.

<sup>2</sup>If community property were not the default option, its prevalence could potentially be even lower, as default options appear to have a large impact on household financial decision (Madrian and Shea, 2001).

in community property. The fraction of households choosing to maintain the default regime of community property was as high as 60% in 1995, and has been steadily declining ever since. Choosing this regime greatly restricts the set of property allocations compared to separation of property: households in community property commit to dividing assets exactly equally in case of divorce, irrespectively of spouses' relative contribution to household income. On the contrary, separation of property grants greater flexibility to spouses' assets accumulation, but does not allow for *ex ante* commitment over asset allocation, because throughout the marriage, whenever they purchase an asset, spouses will have to specify who owns it and in what proportion.

We use unique administrative data on the universe of marriages, divorces and separations to examine the choices of property regime by Italian couples from 1995 to 2011 and how household characteristics and outcomes are correlated with the regime chosen. We document that marriages in which the wife does not participate in the labor market and which have more children are also more likely to have chosen community property, while households in which the wife works and contributes to a greater fraction of household income are more likely to choose a regime of separation of property. Marriages in which the wife is more educated, and hence has a greater opportunity cost of specialization, are more likely to choose separation of property, even controlling for the educational achievement of the husband.

We also show that geographic variation in the cost of childcare due to changes in the resources of local governments, which provide public childcare, are associated with corresponding changes in regime choice: when local governments reduce the supply of public childcare, women are less likely to participate in the labor market and couples are more likely to opt for community property.

These patterns in the data are consistent with the hypothesis that community property might serve as a way to provide insurance in case of divorce to the spouse who makes household-specific investments, which is typically the wife. Such a commitment comes at the cost of lower flexibility compared to separation of property, as property can only be divided equally in community property, while any sharing rule can be achieved in separation of property.

To capture this mechanism and the tradeoff in regime choice, we build a stochastic dynamic model of marriage, savings, labor supply and divorce. The basic formulation of this model, which follows from the literature on risk sharing with limited commitment (Kocherlakota, 1996) and has been often applied to household decision making, cannot explain why some couples might prefer restricting their future choices by electing community property: we show that, as long as households make *ex post* efficient decisions, separation of property is the constrained efficient property division regime even under limited commitment. The proof relies on the time consistency of the household planning problem, up to a change in the intra-household allocation parameters (Marcet and Marimon 2011).

To capture the fact that a sizable fraction of couples elects community property, and in

particular couples in which the wife undertakes a substantial household-specific investment, we modify the basic limited commitment model to accommodate an endogenous non-cooperative phase that (possibly) precedes divorce. Spouses anticipate that they may choose not to cooperate in the periods preceding divorce, and that such non-cooperative behavior will cause the allocation of property at divorce to depart from the efficient one, i.e. the allocation that allows both spouses to smooth the marginal utility of consumption when transitioning into a divorce. If this is the case, spouses might prefer at the time of marriage to constrain their property allocation options and guarantee that, if the wife intends to make a household-specific investment, she can receive a fixed and sizable share of household assets, as ensured by community property.

We estimate the model by the method of simulated moments (calibrate at this stage), targeting, among other moments, the take up rates of separation of property and its change following exogenous changes in childcare costs. We then use the estimated model to perform welfare and counterfactual analysis. The estimates indicate that the gains from separation of property increase as women’s contribution to household income increases, and that allowing households to opt out of community property might lead to higher rates of female labor market participation, lower divorce rates and higher saving rates.

## 1 Prenuptial contracts and property division

Divorce was introduced in Italy in 1970, and confirmed with a referendum on May 11th 1974.<sup>3</sup> In the following year, a reform of the family law code introduced *community property*, a regime that presumes that all assets accumulated during the marriage are jointly owned by the spouses, irrespectively of the relative financial contributions, as long as these assets are not the result of bequests or gifts.<sup>4</sup> Previously, couples held their assets separately, in a regime called *separation of property*. The reform allowed couples to choose between community property and separation of property, with community property as the default option.<sup>5</sup> This system is still in place today, and the choice between the two regimes can be done at the time of marriage at no cost. After marriage, any change to a marital property regime chosen at the time of marriage requires a bilateral contract in the presence of a notary.

The primary difference between the two regimes arises in case of divorce. In community property, assets that are acquired after marriage are divided equally between husband and wife, irrespectively of spouses’ individual financial contributions. Both spouses’ names appear on the titles to all household assets, which cannot be sold or liquidated without the authorization of both spouses. In separation of property, each asset is assigned to the spouse who holds the

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<sup>3</sup>Law no.898 of December 1st 1970, *Disciplina dei casi di scioglimento del matrimonio*.

<sup>4</sup>Law no.151 of May 19th 1975.

<sup>5</sup>Until 1978, couples that were already married before 1975 could opt out of community property through a *unilateral* notary act (i.e. even in the absence of the consent of one spouse).

formal title to the property (i.e., has his or her name on a bank account or on a vehicle or on a house and so on). Couples who have chosen separation of property can easily replicate community property by ensuring that each spouse’s name appears on the formal title of every asset and account owned by the household.

While the central distinction between the two regimes arises in case of divorce, separation of property and community property might also have different implications for bequests in case of death of one of the spouses: in community property, one half of the household assets will be inherited by the members of the household (including the surviving spouses), while in separation of property, it is only the fraction of assets formally owned by the deceased which is divided between the heirs.

One difference between the two regimes is independent of divorce or widowhood. While there is no personal bankruptcy in Italy, there exists bankruptcy of non-incorporated businesses, which hence only involves self-employed workers who own non-incorporated businesses. In such case, the spouse’s assets cannot be seized if the couple has chosen separation of property, but are seized in community property. Hence, separation of property provides a way of sheltering a fraction of household assets from the risk of bankruptcy. For this reason, whenever possible, we will confirm that our findings are robust to excluding couples in which at least one spouse is self employed.

## 2 Administrative data on property division regimes

This paper utilizes administrative data collected by the Italian National Institute of Statistics (ISTAT) between 1995 and 2011. The institute collects information on the characteristics of *every* marriage, separation and divorce occurred in Italy. Since 1995, information about the marital property regime chosen by the couple is available for all marriages. This leads to over 4 million of observation, on average 250,000 per year. Since 2000, the same type of information is also available for every divorce (over 400,000 observations) and separation (over 800,000 observations) records. Table 2 reports the number of observations included in the datasets.

### 2.1 Data on marriages

The administrative ISTAT data on choices at the time of marriage indicate that, over the past decade, separation of property has been the most common regime choice of Italian newlyweds: 67% in 2011, 66% in 2010 and 64% in 2009 of newlyweds have elected to hold their assets in a separation of property regime. Since the year 2000, more than half of Italians have made such a choice (Figure 1, panel a). The rates of separation of property are only slightly lower among first marriages and among couples with no self-employed spouse (Figure 1, panel b and c).

Family law experts indicate that community property is the most suitable regime for couples

Table 1: **Number of observations in the administrative data**

year	separations	divorces	marriages
1995	-	-	290,009
1996	-	-	278,611
1997	-	-	277,738
1998	-	-	280,034
1999	-	-	280,330
2000	71,969	37,573	284,410
2001	75,890	40,051	264,026
2002	79,642	41,835	270,013
2003	81,744	43,856	264,097
2004	83,179	45,097	248,969
2005	82,291	47,036	247,740
2006	80,407	49,534	245,992
2007	81,359	50,669	250,360
2008	84,165	54,351	246,613
2009	85,945	54,456	230,613
2010	88,191	54,160	217,700
2011	-	-	204,830

*Note:* Observations from the *Rilevazione dei matrimoni* (1995-2011), the *Rilevazione delle cessazioni degli effetti civili del matrimonio (divorzi)* (2000-2009) and the *Rilevazione delle separazioni* (2000-2009). The data provides information on the universe of couples marrying in each calendar year between 1995 and 2011 and divorcing or separating in each year between 2000 and 2009.

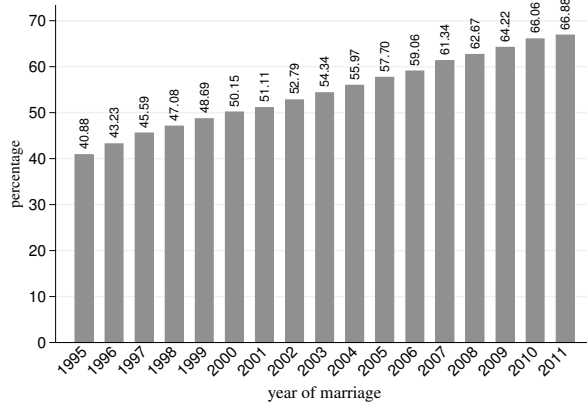
in which one spouse specializes in home production activities, while separation of property grants greater flexibility to couples in which both spouses are able to invest in their careers. As suggested by a Professor of Private Law at the University of Milan on a major newspaper:

“[...]separation of property can be recommended to those couples in which the burden of the family needs is equally distributed between the spouses. If instead the spouses plan to organize their life so that one of the two will be primarily dedicated to housework, leaving the other one free to devote itself to its career, then community property is a choice that should be carefully considered.” (Rimini 2012, translated from Italian).

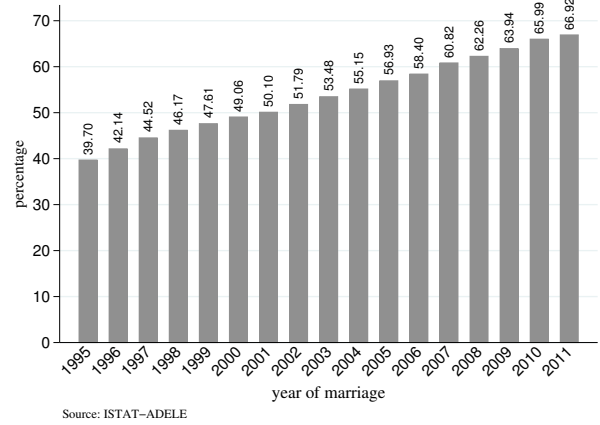
The administrative data reveal that separation of property is systematically correlated with predictors of intra-household specialization. Households in which the wife reports to be a housewife tend to have chosen a community property regime, while households with a wife employed in the formal labor market are more likely to choose a separate property regime. We observe this relation across all years in the sample (Figure 2).<sup>6</sup>

<sup>6</sup>The probability that such a pattern would be generated randomly if there was no relation between employment

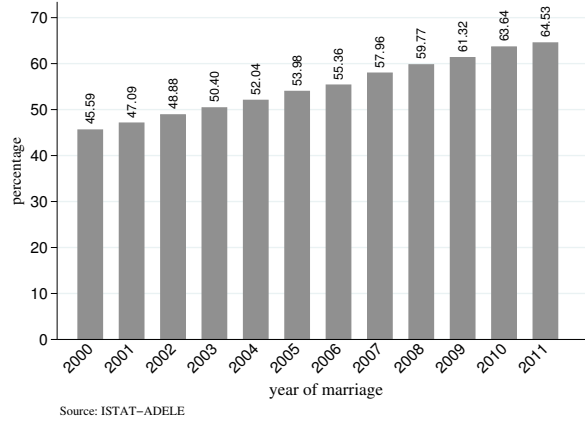
Figure 1: Percentage of newlyweds that choose a separation of property regime



(a) All marriages



(b) First marriages



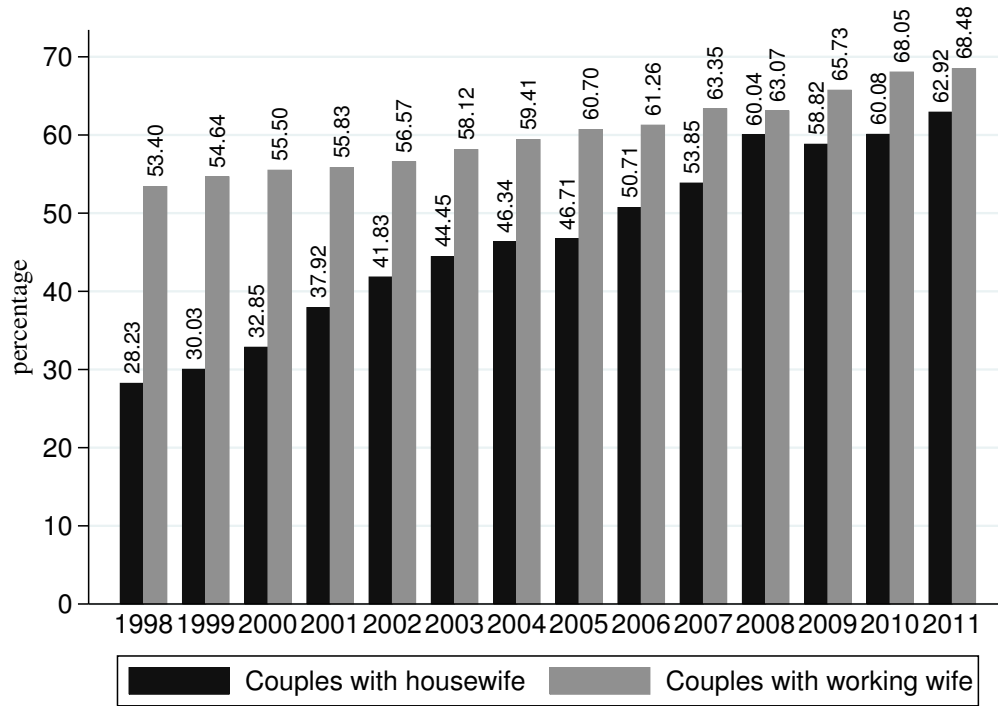
(c) No self-employed spouse

Data source: ISTAT. 1995-2011. *Rilevazione dei matrimoni*.

We examine annual regime choice data aggregated at the provincial level. Provinces represent a relatively small geographic unit, corresponding to a labor market. Examining data on the choice of regime at the provincial level over time indicates that changes in employment rates of women of marriage age are associated with changes in regime choice: higher rates of female employment among young women (25-34) are correlated with higher rates of separation of property (table 3, columns 1 and 2), while the correlation fades away for older women (35-44, see columns 3 and 4). The variable *% women employed 25-34* represents the annual employment rate among women aged 25-34 years residing in the province. The data for these variables comes from the *Labor Force Survey* (LFS) conducted quarterly by ISTAT. The estimates do not include households usually living abroad and permanent members of communities (religious institutes, army etc.).

status and regime choice is equal to  $\frac{1}{2\pi} < 0.001$ .

Figure 2: Percentage of newlyweds that choose a separation of property regime by the wife's employment status



Source: ISTAT-ADELE

Data source: ISTAT. 1995-2011. *Rilevazione dei matrimoni.*

The choice of separation of property is also correlated with spouses' education achievement, particularly the one of wives. Conditioning on the husband's education, the likelihood that a couple chooses separation of property is increasing in the wife's education for all years from 1995 to 2011 (see Figure 3). In a regression that controls for both spouses' educational attainment, geographic location of the household, spouse's age at marriage and spouses' self-employment status, the level of education of the wife is a statistically significant determinant of the regime chosen for every year, while the one of the husband is not statistically significant in some years, and especially in the more recent ones.

Such a pattern is consistent with the one of intra-household specialization because, in Italy, the educational attainment of a woman is highly correlated with the likelihood of employment: the average rate of labor market participation is 82% among married women under the age of 60 with a college degree, 64% among women with a high school degree and 39% among women with a middle school degree in the Survey of Household Income and Wealth (1998-2010).

While the highest spousal educational attainment in a household might capture a better understanding of the institutional framework, the fact that a woman's educational attainment



Table 2: **Summary statistics**

	observations	mean	std.dev.	min	max
% employed age 25-34 female	820	58.8	16.9	20.5	85.1
% employed age 35-44 female	820	62.3	15.8	24.8	89.7
% childcare coverage	939	70.2	21.6	9.5	100
$\ln(\text{municipal tax revenue})$	911	10.4	0.8	3.1	12.9
unemployment rate	821	7.8	4.2	1.9	21.6
regional college education rate	841	13.2	2.4	9.1	19.6

*Note:* The variable *% childcare coverage* represents the percentage of children aged 0-2 years that reside in the province attending public infancy day-care services. This variable is part of the *Indagine sugli interventi e i servizi sociali dei comuni singoli o associati* collected every year by ISTAT since 2003. The variable *% women employed 25-34* represents the annual employment rate among women aged 25-34 years residing in the province. The data for these variables comes from the Labor Force Survey (LFS) conducted quarterly by ISTAT. The estimates do not include households usually living abroad and permanent members of communities (religious institutes, army etc.). The variable *% college graduates* represents the percentage of residents in the region between age 25 and 64 with tertiary education (college and above) attainment, part of the EUROSTAT Regional Statistics Database collected annually since 2000 for each region of the countries in the EU. The variable  $\ln(\text{municipal tax revenue})$  is the natural logarithm total revenues of the province accrued during the year through local property and income taxes. The data is collected yearly since 2003 by the local finance division of the Italian Ministry of Interior.

*conditional* on the one of the husband is positively correlated with the likelihood of choosing separation of property is harder to justify without accounting for patterns of labor supply. Moreover, lack of information is less of a concern in this context as couples typically learn about these regimes when taking pre-marital courses in their churches, required for couple who marry in a Catholic ceremony, which are approximately 60% of all ceremonies.

Variation in childcare costs is also associated with regime choice. Rationing of publicly-funded childcare is believed to greatly influence women's likelihood of timely re-entry in the labor market after pregnancy in Italy (Del Boca and Vuri, 2007). We examine province-level data on publicly-provided childcare: on average, only 32% of children aged 0 to 2 in a province have access to such services, for which often long queues and elaborate allocation mechanisms are devised (Table 2). There exists also a substantial amount of variation in the offer of these services, which is correlated with the resources of the local government (i.e. municipalities, provinces and regions, which are the three unites of local governments). Even within a province, the supply of public childcare fluctuates over time as a result of changes in the resources of local governments. We examine the correlation between changes in public childcare coverage in a province, measured as the percentage of children under the age of 2 who have access to publicly-provided childcare, and the percentage of newlyweds choosing separation of property in each year and province. We use the natural logarithm of local tax revenue as an instrument for childcare coverage in each

Table 3: Separation of property and female employment

	(1)	(2)	(3)	(4)
	% separation of property	% separation of property	% separation of property	% separation of property
% employed women 25-34	0.223 (0.098)	0.080 (0.030)		
% employed women 35-44			0.111 (0.102)	-0.029 (0.061)
Year fe.	Yes	Yes	Yes	Yes
Region f.e.	Yes	No	Yes	No
Province f.e.	No	Yes	No	Yes
Observations	829	821	861	745
R-squared	0.884	0.942	0.902	0.905
Clustered standard errors in parentheses				

Notes: Estimation equation is:

$$\text{Percentage choosing separation of property}_{p,r,t} = \text{Percentage employed}_{p,r,t} + \delta_t + \gamma_r + \epsilon_{p,r,t}$$

The variable *% separation of property* is based on ISTAT administrative data between 1995 and 2011 and represents the percentage of newlyweds who have chosen separation of property in a give year and province. The variable *% women employed 25-34* represents the annual employment rate among women aged 25-34 years residing in the province. The data for these variables comes from the Labor force survey (LFS) conducted quarterly by ISTAT. The estimates do not include households usually living abroad and permanent members of communities (religious institutes, army etc..).

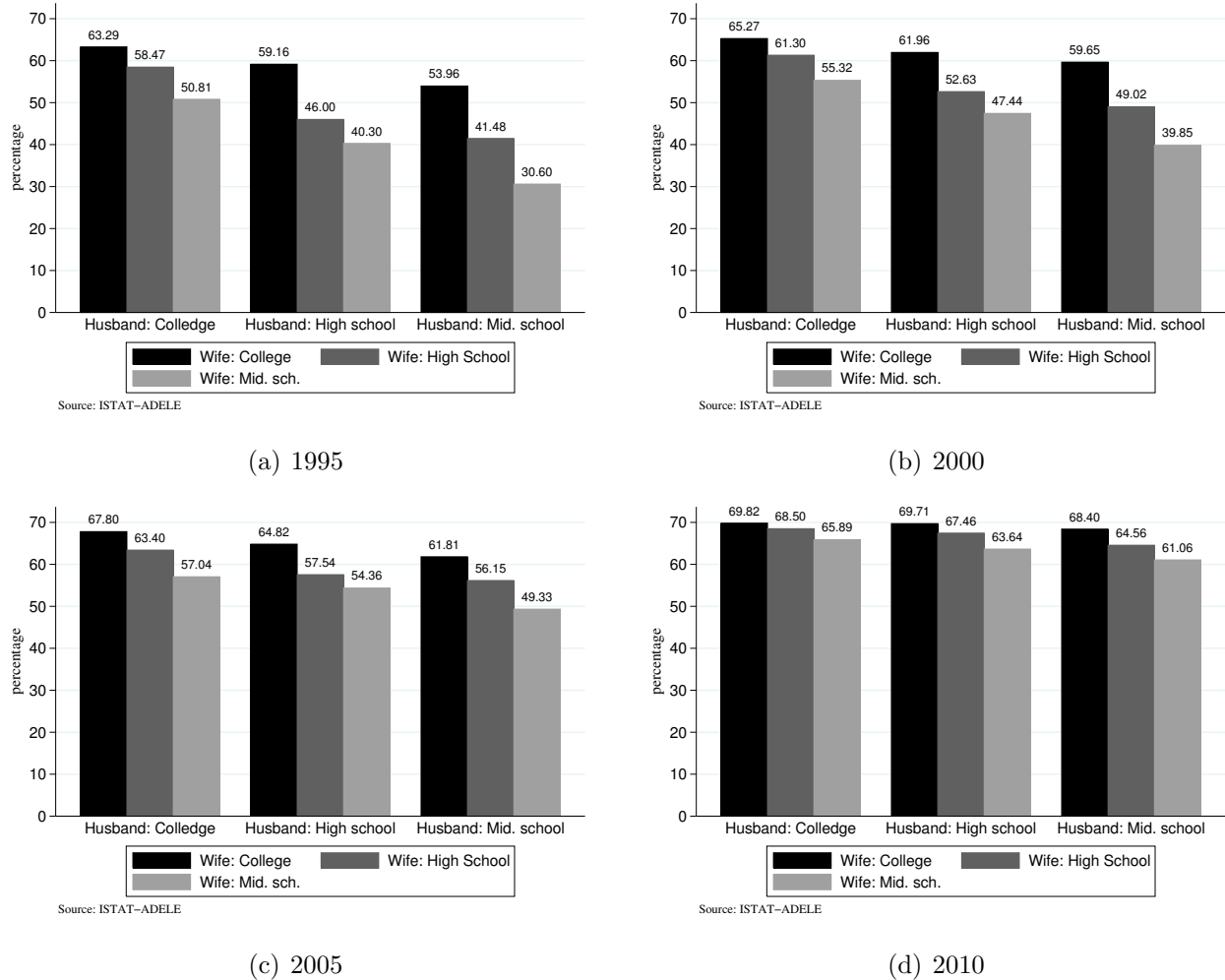
province and year, estimating the following system:

$$\% \text{ childcare coverage}_{p,r,t} = \lambda \cdot \ln(\text{municipal tax revenue})_{p,r,t} + \mu' X_{p,r,t} + \nu_r + \pi_t + \epsilon_{p,r,t}$$

$$\% \text{ separation of property}_{p,r,t} = \alpha \cdot \% \text{ childcare coverage}_{p,r,t} + \beta' X_{p,r,t} + \gamma_r + \delta_t + \upsilon_{p,r,t}$$

The variable *% childcare coverage* represents the percentage of children aged 0-2 years that reside in the province attending public infancy day-care services. This variable is part of the *Indagine sugli interventi e i servizi sociali dei comuni singoli o associati* collected every year by ISTAT starting in 2003. The variable *% college graduates* represents the percentage of residents in the region between age 25 and 64 with tertiary education (college and above) attainment, part of the EUROSTAT Regional Statistics Database collected annually since 2000 for each region of the countries in the EU. The variable  $\ln(\text{municipal tax revenue})$  is the natural logarithm total revenues of the province accrued during the year through local property and income taxes.

Figure 3: Percentage of newlyweds choosing a separation of property regime, by level of education of each spouse (Italy, 1995-2011)



Source: ISTAT. 1995-2011. "Rilevazione dei matrimoni." The data provides information on the universe of couples marrying in each calendar year between 1995 and 2010. Sample of first marriages.

The data is collected yearly since 2003 by the local finance division of the Italian Ministry of Interior.<sup>7</sup> The regressions control for year ( $\delta_t$ ) and region ( $\gamma_r$ ) fixed effects, but not for province fixed effects. Hence, the regression also exploit time-invariant differences in provincial level characteristics *within* a given region.

The regressions indicate that a 1 percentage point increase in childcare coverage is associated with a 0.3 percentage points increase in the take-up of separation of property among newlyweds (table 5, column 7). This association is robust to controlling for socio-economic variables at the provincial and regional level (column 8): the variable *% college graduates* represents the

<sup>7</sup>Available online at <http://finanzalocale.interno.it/docum/index.html>.

percentage of residents in the region between age 25 and 64 with tertiary education (college and above) attainment, part of the EUROSTAT Regional Statistics Database collected annually since 2000 for each region of the countries in the EU, while the variable *Total unemployment rate* is also based on the Labor Force Survey provincial data.

Table 4: Separation of property and childcare costs - All marriages

	(1) OLS	(2) OLS	(3) 1st stage	(4) 1st stage	(5) RF	(6) RF	(7) IV	(8) IV
	% separation of property	% separation of property	% childcare coverage	% childcare coverage	% separation of property	% separation of property	% separation of property	% separation of property
% childcare coverage	0.106 (0.0501)	0.108 (0.0492)					0.323 (0.0987)	0.291 (0.0890)
ln(local tax rev)			6.721 (1.260)	7.666 (1.001)	2.521 (0.646)	2.235 (0.620)		
Year fe.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Region f.e.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Total unempl. rate	No	Yes	No	Yes	No	Yes	No	Yes
% college graduates	No	Yes	No	Yes	No	Yes	No	Yes
Observations	937	756	921	754	1,319	753	920	753
R-squared	0.571	0.584	0.729	0.739	0.648	0.589	0.477	0.526

Standard errors in parentheses, clustered at the region level

*Notes:* The variable *% childcare coverage* represents the percentage of children aged 0-2 years that reside in the province attending public infancy day-care services. This variable is part of the *Indagine sugli interventi e i servizi sociali dei comuni singoli o associati* collected every year by ISTAT since 2003. The variable *% women employed 25-34 (35-44)* represents the annual employment rate among women aged 25-34 (35-44) years residing in the province. The data for these variables comes from the Labor Force Survey (LFS) conducted quarterly by ISTAT. The estimates do not include households usually living abroad and permanent members of communities (religious institutes, army etc.). The variable *% college graduates* represents the percentage of residents in the region between age 25 and 64 with tertiary education (college and above) attainment, part of the EUROSTAT Regional Statistics Database collected annually since 2000 for each region of the countries in the EU. The variable *ln(municipal tax revenue)* is the natural logarithm total revenues of the province accrued during the year through local property and income taxes. The data is collected yearly since 2003 by the local finance division of the Italian Ministry of Interior, available online at <http://finanzalocale.interno.it/docum/index.html>.

Table 5: Separation of property and childcare costs - Excluding self-employed

	(1) OLS	(2) OLS	(3) 1st stage	(4) 1st stage	(5) RF	(6) RF	(7) IV	(8) IV
	% separation of property	% separation of property	% childcare coverage	% childcare coverage	% separation of property	% separation of property	% separation of property	% separation of property
% childcare coverage	0.094 (0.0507)	0.094 (0.0490)					0.292 (0.101)	0.260 (0.0933)
ln(local tax rev)			6.721 (1.260)	7.666 (1.001)	2.320 (0.663)	1.997 (0.652)		
Year fe.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Region f.e.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Total unempl. rate	No	Yes	No	Yes	No	Yes	No	Yes
% college graduates	No	Yes	No	Yes	No	Yes	No	Yes
Observations	937	756	921	754	1,219	753	920	753
R-squared	0.557	0.571	0.729	0.739	0.611	0.575	0.478	0.525
Standard errors in parentheses, clustered at the region level								

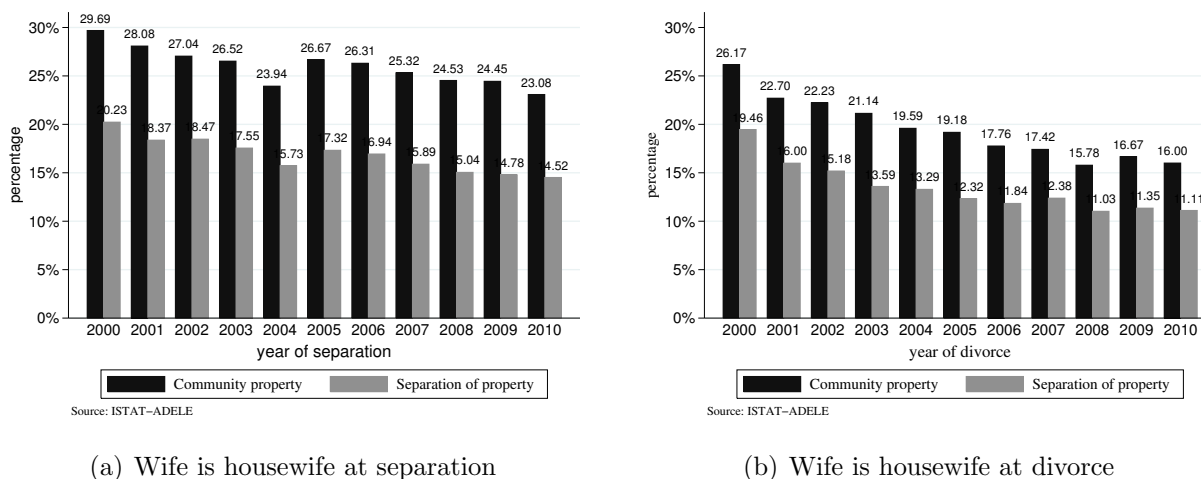
*Notes:* The variable *% childcare coverage* represents the percentage of children aged 0-2 years that reside in the province attending public infancy day-care services. This variable is part of the *Indagine sugli interventi e i servizi sociali dei comuni singoli o associati* collected every year by ISTAT since 2003. The variable *% women employed 25-34 (35-44)* represents the annual employment rate among women aged 25-34 (35-44) years residing in the province. The data for these variables comes from the Labor Force Survey (LFS) conducted quarterly by ISTAT. The estimates do not include households usually living abroad and permanent members of communities (religious institutes, army etc.). The variable *% college graduates* represents the percentage of residents in the region between age 25 and 64 with tertiary education (college and above) attainment, part of the EUROSTAT Regional Statistics Database collected annually since 2000 for each region of the countries in the EU. The variable *ln(municipal tax revenue)* is the natural logarithm total revenues of the province accrued during the year through local property and income taxes. The data is collected yearly since 2003 by the local finance division of the Italian Ministry of Interior, available online at <http://finanzalocale.interno.it/docum/index.html>.

## 2.2 Data on separations and divorces

The data on separations and divorces provides additional evidence that the choice between community property and separation of property is related to spouses' expected household-specific investments.

First, we observe that women in community property households are between 7 and 5 percentage points more likely report being housewives at the time of separation and at the time of divorce (figure 4, panel a and b).

Figure 4: Property regimes and female employment (Italy, 2000-2010)



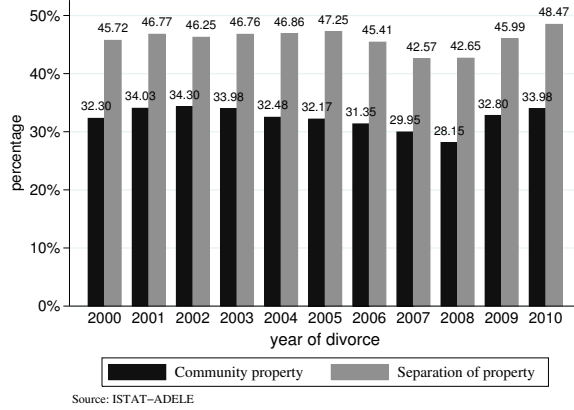
Data source: ISTAT. 2000-2010. *Rilevazione delle separazioni. Rilevazione dei divorzi.*

Household fertility outcomes are also consistently correlated with regime choice: household that had chosen separation of property are over 10 percentage points more likely to not have children at the time of divorce. Conditional on having children at the time of divorce, they have a lower number on average: approximately 1.5 in community property and 1.6 children in separation of property (figure 5, panel a and b).

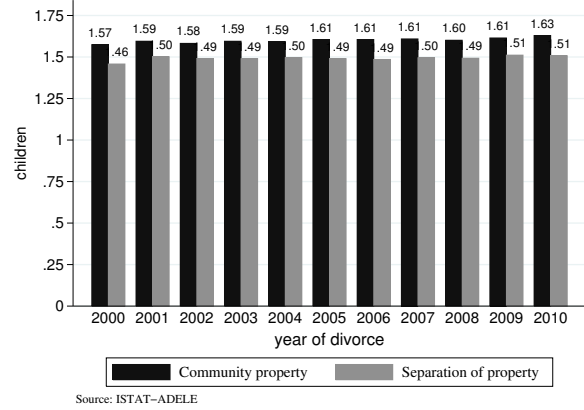
The different extent of specialization is reflected in divorce settlements data: mothers in community of property are also 2 percentage points more likely to be assigned sole custody of children, as an alternative to joint custody (father custody is rare). Such an outcome might be more common among mothers working longer hours (figure 6, panel a). Also, women in community property households are 3 to 5 percentage points more likely to also be granted alimony as they transition into the labor market.

In sum, descriptive evidence from both the data about marriages, separations and divorces suggests that community property is more prevalent along households that have higher degrees of Beckerian specialization, i.e. households in which the wife makes a substantial household specific-investment, in particular towards the childrearing.

Figure 5: Property regimes and fertility outcomes at divorce (Italy, 2000-2010)



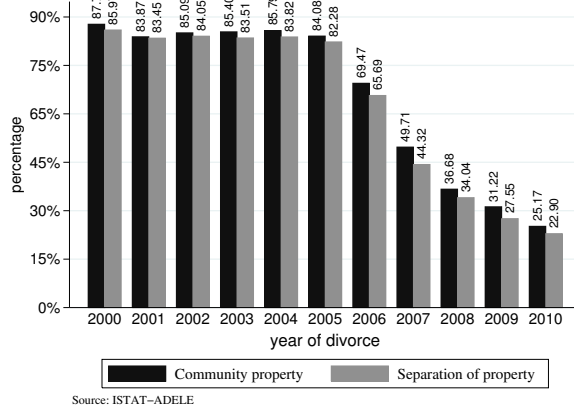
(a) Probability of having no children



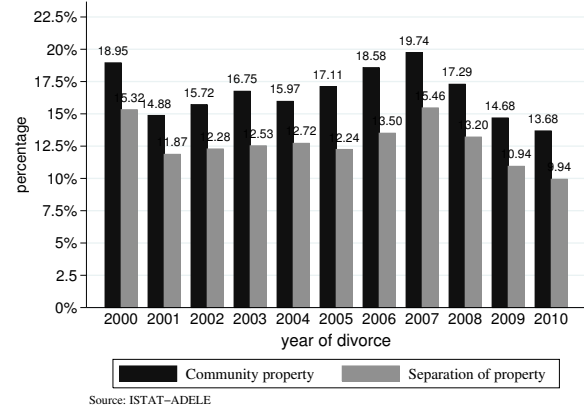
(b) Number of children, if any

Data source: ISTAT, 2000-2010. *Rilevazione dei divorzi*.

Figure 6: Property regimes and household-specific investment (Italy, 2000-2010)



(a) Mother is assigned primary custody



(b) Wife is granted alimony

Data source: ISTAT, 2000-2010. *Rilevazione dei divorzi*.

### 3 The model

In this section, we present a simple model of intra-household decision making that illustrates the trade-off that spouses face when choosing between separation of property and community property. In an idealized Coasean environment where both spouses can perfectly contract on all marital outcomes at the time of marriage, the regime choice would be irrelevant: couples in this ex-ante Pareto-optimal environment would simply construct an (enforceable) prenuptial contract, one that ensures efficient outcomes during marriage. Our model closely adheres to the Coasean environment but departs from the standard setting in a few ways. We consider the more tenable



assumption of *ex-post* efficiency – that is, the household optimally allocates its resources over time rather than draft a complex contract of history-dependent allocation choices. Cooperation ensues so long as both parties benefit from an agreement, but a spouse can at anytime choose to cease cooperating when no such agreement matches the value of her outside alternative.

Our model closely follows the approach used in the literature on risk sharing under limited commitment (Kocherlakota, 1996; Ligon, Thomas, and Worrall, 2002), which has been previously applied to household behavior (Mazzocco, 2007; Mazzocco, Yamaguchi, and Ruiz, 2007; Ligon, 2011; Voena, 2013). Unlike the existing models of intra-household allocation with two-sided limited commitment, we allow households to default to an outside option that is less stark than fully divorcing (*divorce phase*). Households in our model have the option of interacting in a limited fashion for the sake of raising a child, which we call the *autarky phase*. We begin by discussing the behavior of the household during periods of full cooperation.

### 3.1 The ex-post efficient household

Households behave ex-post efficiently at the time of marriage. In each period spouses choose a consumption allocation, savings and labor force participation decision efficiently until cooperation ceases. The household cooperative decision is based on each spouse’s bargaining position. At the time of marriage, a spouse’s bargaining position is summarized by the Pareto weights,  $\theta^j$  for each  $j \in H, W$ . These weights evolve over time, and their evolution depends on both spouses’ outside option: weights are adjusted so that both spouses prefer an allocation that lie on the Pareto frontier. When no adjustments that ensures both outside option valuations are met can be made, cooperation ends and couples default to their outside option.

The state space comprises of spouses’ individual incomes ( $y_t^j$ ) and assets ( $A_t^j$ ) and of match quality ( $\xi_t$ ). We call this collection of states the primitive state space and denote it by  $\omega_t \in \Omega_t$ . In addition, we include a state variable that captures any past renegotiation of intra-household allocations made by the spouses in order to sustain the cooperative state ( $M_t^j$  for  $j \in H, W$ ).  $M_t^j$  captures the deviation from the original bargaining stance  $\theta^j$ ; hence, both spouses enter the period with a new status quo Pareto weight  $M_t^j + \theta^j$ .

We define each spouses value function in period  $t$  when the preceding period resulted in cooperation and call this  $V^{jM}(\omega_t, M_t)$  for each  $j \in \{H, W\}$ . At the beginning of this period, both spouses reflect on their outside options  $V_t^{jO}(\omega_t)$ . The planner internalizes these outside option and offers an optimal allocation of current-period consumption ( $c_t^j$ ), individual savings ( $A_{t+1}^j$ ) each spouses carry on to the next period and the wife’s labor-force participation decision

$(P_t^W)$  that solves the following constrained Pareto problem:

$$\max_{a_t = \{A_{t+1}^j, c_t^j, P_t^W\}} \sum_{j \in \{H, W\}} (\theta^j + M_t^j) [u(c_t^j, P_t^j; \xi_t) + \beta E[V_{t+1}^j(\omega_{t+1}, M_{t+1}) | a_t, \omega_t]]$$

s.t. budget constraint in cooperative state

$$[\lambda_t^j] : u(c_t^j, P_t^j; \xi_t) + \beta E[V_{t+1}^j(\omega_{t+1}, M_{t+1}) | a_t, \omega_t] \geq V_t^{jO}(\omega_t) \text{ and} \\ M_{t+1}^j = M_t^j + \lambda_t^j \text{ for } j = H, W$$

During this cooperative phase, each spouse's felicity function takes the form

$$u(c_t^j, P_t^j; \xi_t) = u(c_t^j, P_t^j) + \xi_t + \Xi(k_t).$$

The function  $u(c_t^j, P_t^j)$  is a standard felicity function over each spouse's consumption  $c_t^j$  and labor force participation  $P_t^j$ . An additive component  $\xi_t$ , the match quality process, captures the spouses' benefits and costs of being in the current marriage, while  $\Xi(k_t)$  reflects the gains of raising a child in an intact marriage as a function of the number of children  $k_t$ .

The symbol  $\lambda_t^j$  denotes the Lagrange multiplier of the constraint governing each spouse's outside option so that the first order condition with respect to the consumption allocation admits the following familiar expression:

$$\frac{u_c(c_t^H, P_t^H)}{u_c(c_t^W, P_t^W)} = \frac{\theta^W + M_t^W + \lambda_t^W}{\theta^H + M_t^H + \lambda_t^H}$$

This expression highlights the role of the Lagrange multipliers  $\lambda_t^j$  on the evolution of the Pareto weights. If at the beginning of the period, the "status-quo" bargaining positions  $\theta_t^j + M_t^j$  leads to one spouse preferring her outside option then the planner increases her bargaining weight in period  $t$  and in subsequent periods. If a solution to the problem above exists, then cooperation is sustainable. In this case, the solution to the problem above yields the following value function for the spouse at the beginning of period  $t$  when the preceding period resulted in full cooperation:

$$V_t^{jM}(\omega_t, \mathbf{M}_t) = u(\hat{c}_t^j, \hat{P}_t^j; \xi_t) + \beta E[V_{t+1}^j(\omega_{t+1}, \mathbf{M}_{t+1}) | \hat{a}_t, M_{t+1}^j = M_t + \lambda_t^j, \omega_t],$$

where  $\hat{a}_t$  denotes the optimal solution to the problem above.

Note that, if cooperation is sustainable, then it is always optimal for couples to continue cooperating. On the contrary, if cooperative state is not sustainable, that is, if there exists no feasible allocation that satisfies both spouses' participation constraints, then the state defaults to the outside option and  $V_t^{jM}(\mathbf{M}_t, \omega_t) = V_t^{jO}(\omega_t)$ . We further assume that when cooperation ceases it continues to do so indefinitely.

### 3.2 Property division regime

The two property regimes, separation of property and community property, affect the environment under which the *ex-post* efficient household operates in. Asset accumulation and allocation depend on the property division regime. The general form of the budget constraint is:

$$A_{t+1} - (1 + r) \cdot A_t + x_t = y_t^H + (y_t^W - g_t^k) \cdot P_t^W. \quad (3.1)$$

where  $A_t$  is a risk-free asset that bears a risk-free return  $r$  in the following period,  $y_t^H$  is the husband's income,  $P_t^W = 1$  if the woman works, earning income  $y_t^W$  and paying child-care expenses ( $g_t^k$ ) and  $x_t$  is the total monetary expense allocated in period  $t$ .

In separation of property, assets can be flexibly allocated between each spouse's "accounts"  $A^H$  and  $A^W$ , leading to the following formulation of the budget constraint:

$$(A_{t+1}^H + A_{t+1}^W) - (1 + r) \cdot (A_t^H + A_t^W) + x_t = y_t^H + (y_t^W - g_t^k) \cdot P_t^W. \quad (3.2)$$

In community property, there is only one asset  $A_t$ , which corresponds to imposing that  $A_t^H = A_t^W$  so that  $A_t = A_t^H + A_t^W = 2 \cdot A_t^H = 2 \cdot A_t^W$ .

It is natural to ask whether the *ex-post* efficient household would always choose the more flexible property division regime. On one hand, separation of property affords greater flexibility in the allocation of assets in each period. The relative importance of each spouses in the marriage, however, as summarized by  $\theta^j$ , changes as the households enter periods in which a spouse prefers her outside option relative to the existing status quo in the relationship. This might lead one to believe that the *ex-ante* planner (at the time of marriage) may choose to restrict the property division regime as it anticipates "future" planners to shift the spouses' relative bargaining positions. The following result answers question.

**Proposition 3.1.** *If outside option value functions  $V_t^{jO}$  for  $j \in \{H, W\}$  are invariant to the property division regime chosen at the time of marriage, then separation of property is the optimal regime for the household in each period  $t$ .*

*Proof.* See Appendix. □

Details of this proof is provided in the appendix, but the main idea takes insight from the analysis by Marcat and Marimon (2011). Marcat and Marimon show that, despite introducing limited commitment in an *ex-post* efficient environment, the outcome of an *ex-post* efficient household is equivalent to an outcome that is based on an optimal contracting problem at time zero. In such contracting problem, households form a *prenuptial contract* that specifies, for each date  $t$  and every history of states up to and including date  $t$  ( $h_t$ ), a consumption allocation ( $\{c_t^j(h_t)\}_{t=0}^T$ ), individual savings account each spouses carry on ( $\{A_t^j(h_t)\}_{t=0}^T$ ) and

female labor force participation ( $\{P_t^W(h_t)\}_{t=0}^T$ ). Contracts are chosen so as to optimize the time-zero households lifetime weighted utility, where the weights respect the bargaining stance given at the time of marriage. A spouse can at anytime deviate from the contract if she finds her outside option more enticing than the plan specified by the contract, and the optimal contract takes into account each spouses' limited commitment.

We use this result to analyze the regime from the perspective of the household at the time of marriage. Given this equivalence, a household that behaves *ex post* efficiently is weakly better off if the corresponding sequential problem affords a more flexible set of contracts in each period. In a community property regime, spouses divide assets equally, which adds an additional constraint on the law of motion governing each spouses' feasible asset accumulation. The set of feasible contracts that reflect this additional constraint must then be a subset of the initial set of feasible contracts discussed above, if outside options do not differ across the two regimes. Consequently, contracts maximized over this more restrictive set of contracts (community property) can never be strictly preferred by the household, and separation of property is weakly preferred by the *ex post* constrained-efficient household in each period.

Previous models of intra-household allocations with two-sided limited commitment assume that the default outside option to intra-household cooperation is divorce (Mazzocco (2007), Mazzocco, Yamaguchi, and Ruiz (2007), and Voena (2013)). The divorce state and its associated value functions typically depend on the property division regime *only* through its ultimate effect on each spouse's assets at the time of divorce, proposition 3.1 states that in all these models we would observe full participation in a separate property regime. We build on these existing models by relaxing this assumption. In particular, we introduce an additional outside option beyond divorce and allow couples to cohabit but interact in a limited, non-cooperative fashion. The next section discusses these two outside options.

### 3.3 The outside options to marital cooperation

Depending on the realization of their match quality shocks, spouses may revert to non-cooperation as an outside option to marital cooperation, or might decide to divorce. In the below subsections, we describe these models of interaction and their implications for property regime choice.

#### 3.3.1 Non-cooperation within marriage

When cooperation ceases to be feasible, couples select their outside option, which needs not to be equal to a divorce (Lundberg and Pollak, 1993; Del Boca and Flinn, 2012). We introduce an alternative phase, which may precede divorce, in which spouses do not cooperate and behave in autarky. During the autarky phase, couples continue living in the same household but do not

cooperate on intertemporal asset allocation and labor force participation decision; each spouse makes her own consumption, savings and work decision, similar to the divorce phase. Unlike the divorce phase, the period utility takes the form:

$$u^{j,aut} = u(c_t^j, P_t^j) + \kappa \xi_t + \Xi(k_t) \text{ for } \kappa \in (0, 1)$$

The period utility includes a scaled version of the marital taste shock  $\kappa \xi_t$ , which reflects the limited interaction that the autarkic behavior allows. By still living together, spouses gain  $\Xi(k_t) \geq 0$ , which depends also on the presence and on the number of children in the household.

During autarky phase, couples face the budget constraint described in equation 3.4. In particular, couples maintain separate financial accounts and live off individual income and assets. In each period, either spouse can unilaterally divorce. When the autarky phases ceases, assets are divided according to the regime chosen by the couple at the time of marriage. In a separation of property regime, each spouse keeps the assets from their individual account  $A_t^{j,divorce} = A_t^{j,aut}$ . In a community property regime, courts pool spouses' assets from their own individual account and divide them equally at the time of divorce:  $A_t^{j,divorce} = \frac{A_t^{H,aut} + A_t^{W,aut}}{2}$  for  $j = H, W$ .

During periods of autarky, each spouse accounts for the other spouse's state space and current-period action when choosing optimal savings and labor force participation. In both regimes, each spouse's assets affect the divorce state since both spouses can unilaterally end the autarky phase. Moreover, in a community property regime a spouse's asset at divorce depends on the other spouse's savings decision in the previous periods. Hence, the autarkic phase forms a non-cooperative game between the two spouses.

We restrict our attention to Markov Perfect Equilibria and formulate the game in a sequential fashion. However, the formulation here can be naturally described as a game of history-dependent asset allocation and labor force participation decision that is sub-game perfect and specified on pay-off relevant states.

Let  $\omega_t = \{A_t^H, A_t^W, z_t^H, z_t^W, \xi_t, h_t^W\}$ . We begin by recursively defining the value of being in an autarkic state in equilibrium (i.e., a value function defined by the equilibrium path of the game) and suppose that such valuation has been defined in period  $t+1$  for both spouses, say  $V_{t+1}^{j,aut}(\omega_{t+1})$  (i.e., the equilibrium path has been defined in period  $t+1$ ). Divorce occurs when one spouse unilaterally decides to dissolve the marriage and to remain single. In particular,  $D_{t+1}(\omega_{t+1}) = 1$  if and only if  $V_{t+1}^{jD}(\omega_{t+1}^D) \geq V_{t+1}^{j,aut}(\omega_{t+1})$  for both spouses  $j \in \{H, W\}$ . Here  $\omega_{t+1}^D$  is the state-space each spouse inherits at divorce. This state space depends on the marital-regime choice as follows:

$$\omega_{t+1}^D = \begin{cases} \left\{ \frac{A_{t+1}^H + A_{t+1}^W}{2}, \frac{A_{t+1}^H + A_{t+1}^W}{2}, z_{t+1}^H, z_{t+1}^W, \xi_t, h_{t+1}^W \right\} & \text{in community property} \\ \{A_{t+1}^H, A_{t+1}^W, z_{t+1}^H, z_{t+1}^W, \xi_t, h_{t+1}^W\} & \text{in separate property} \end{cases}$$

Let  $V_t^{j,aut}(\omega_t | \sigma_t^{-j})$  be the current-period valuation during the autarkic phase contingent on

the other spouse's strategy  $\sigma_t^{-j}$ , which specifies the intertemporal allocation and work decision (for the wife):

$$V_t^{j,aut}(\omega_t|\sigma_t^{-j}) \equiv \max_{\sigma_t^j} u(c_t^j, P_t^j) + \kappa\xi_t + \Xi(k_t) + \beta \left\{ E \left[ D_{t+1}(\omega_{t+1}) V_t^{jD}(\tilde{\omega}_{t+1}) \right. \right. \\ \left. \left. + (1 - D_{t+1}(\omega_{t+1})) V_{t+1}^{j,aut}(\omega_{t+1}) | \sigma_t^{-j}, \sigma_t^j, \omega_t \right] \right\}$$

subject to each spouses budget constraint during autarky.

We are now ready to define the value function in the current period  $V_t^{j,aut}(\omega_t)$ . As mentioned earlier, we restrict our attention to Markov Perfect Equilibrium so that one may define the equilibrium via backward induction. In particular, having defined  $V_{t+1}^{j,aut}(\omega_{t+1})$  the equilibrium outcome in period  $t$ ,  $(\sigma_t^{H*}(\omega_t), \sigma_t^{W*}(\omega_t))$ , can be aptly described as follows:

$$\sigma_t^{j*}(\omega_t) = \arg \max_{\sigma_t^j} u(c_t^j, P_t^j) + \kappa\xi_t + \Xi(k_t) + \beta \left\{ E \left[ D_{t+1}(\omega_{t+1}) V_t^{jD}(\omega_{t+1}^D) \right. \right. \\ \left. \left. + (1 - D_{t+1}(\omega_{t+1})) V_{t+1}^{j,aut}(\omega_{t+1}) | \sigma_t^{-j*}(\omega_t), \sigma_t^{j*}(\omega_t), \omega_t \right] \right\}$$

Consequently,  $V_t^{j,aut}(\omega_t) = V_t^{j,aut}(\omega_t|\sigma_t^{-j*})$  for both  $j \in \{H, W\}$ .

### 3.3.2 Divorce

When spouses' joint value of divorce exceeds their joint value of autarky, spouses divorce. We characterize the value of being divorced, given state variables  $\omega_t^D$ , as  $V_t^{jD}(\omega_t^D)$ . In this problem,  $\omega_t^D = \{A_t^H, A_t^W, z_t^H, z_t^W, h_t^W\}$ , where  $A_t^H$  and  $A_t^W$  denote each spouses assets. After divorce, spouses live off their individual income and assets. They both contribute to the consumption of their children as a fraction of their own consumption (which is meant to capture the cost of child custody and of child support) according to the equivalence scale  $e(k)$  and they share childcare expenses. The budget constraint becomes:

$$A_{t+1}^j - (1 + r) \cdot A_t^j + c_t^j \cdot e(k_t) = (y_t^j - \frac{g_t^k}{2}) \cdot P_t^j. \quad j = H, W \quad (3.3)$$

In each period  $t$ , a divorcee has an exogenous probability  $\pi_t^{j\Omega}$  of remarrying another person. The probability of remarriage depends on gender, age and the divorce law regime. If remarriage occurs, it is an absorbing state and the problem is analogous to the one of a married couple during a full cooperative state (see below) with no possibility of divorce. We denote each spouse's value function during remarriage by  $V_t^{jR}(\omega_t)$ .<sup>8</sup>

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<sup>8</sup>The value of being remarried is

$$V_t^{jR}(\omega_t) = u(c^{j*R}, P^{j*R}) + \beta E[V_{t+1}^{jR}(\omega_{t+1}|\omega_t)]$$

In each period, the divorcee chooses consumption, savings and whether or not to work (if she is a woman). Thus, the value of being divorced at time  $t$  is:

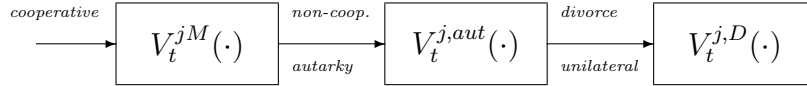
$$V_t^{jD}(\omega_t) = \max_{c_t^{jD}, P_t^{jD}, A_{t+1}^{jD}} u(c_t^{jD}, P_t^{jD}) + \beta \left\{ \pi_{t+1}^{j\Omega} E[V_{t+1}^{jR}(\omega_{t+1}|\omega_t)] + (1 - \pi_{t+1}^{j\Omega}) E[V_{t+1}^{jD}(\omega_{t+1}|\omega_t)] \right\}$$

s.t. budget constraint in divorce (3.3), for  $j = H, W$ .

### 3.3.3 Transitions between models of interaction

Our model relaxes the common assumption placed on each spouse's outside option, i.e. that only one outside option, typically divorce, is available to spouses. Figure 7 summarizes the various marital states leading to a divorce. Couples start by acting in a cooperative manner until it is no longer feasible to do so, i.e. until there exists no feasible allocation that satisfies each spouse's participation constraint, and they shifting into an autarkic state. In particular, we let the outside option  $V_t^{jO}(\cdot) = V_t^{j,aut}(\cdot)$ . During an autarky phase, either spouse can unilaterally deviate from such state and file for divorce. If either one of the spouse immediately finds divorcing optimal upon after ceasing the cooperative state then we have the specific case of  $V_t^{jO}(\cdot) = V_t^{jD}(\cdot)$ . We emphasize that the value function during an autarky phase,  $V_t^{j,aut}(\cdot)$ , depend on the marital regime choice.

Figure 7: Summary of marital status



### 3.3.4 Discussion

Proposition 3.1 states that if spouses revert from marital cooperation directly to divorce, i.e. if assets get divided upon divorce following spousal cooperation, then separation of property is

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for  $j = H, W$ , from the solution to the problem

$$V_t^R(\omega_t) = \max_{c_t^{HR}, c_t^{WR}, P_t^{WR}, A_{t+1}^R} \theta u(c_t^{HR}, P_t^{HR}) + (1 - \theta) u(c_t^{WR}, P_t^{WR}) + \beta E[V_{t+1}^R(\omega_{t+1}|\omega_t)]$$

subject to the couple's budget constraints:

$$A_{t+1}^R - (1 + r) \cdot A_t^R + x_t = y_t^H + (y_t^W - g_t^k) \cdot P_t^W. \quad (3.4)$$

the constrained-efficient property division regime, and hence optimizing households might never choose community property.

Introducing the non-cooperative option within marriage makes proposition 3.1 fail, because the outside option to marital cooperation is no longer invariant with respect to the property allocation regime chosen at the time of marriage. In particular, in separation of property spouses can save separately in this phase and their savings choice does not affect these spouse's future assets in case of divorce. This is not true in community property, where a spouse's assets will affect the amount of assets available to the other spouse in the event of a divorce.

Intuitively, such a modification to the most basic model allows explaining why some couples might prefer community property: from the point of view of the (constrained-)efficient planning problem at the time of marriage, it might be preferable to limit the ability of spouses to depart from the efficient allocation of assets during such the non-cooperative phase, which precedes the time in which assets are divided upon divorce.

Introducing a non-cooperative phase that might precede divorce also has the desirable feature of allowing spouses to not cooperate on assets allocation when the probability of divorce becomes high. It appears unlikely, in fact, that a high-earning spouse would comply to the constrained-efficient household planning problem solution by transferring large amounts of money in the other spouse's bank account in the period that precedes divorce. It is indeed more likely that, as the risk of divorce increases, spouses in a separation of property regime might decide to keep their own earnings in their own bank accounts.

Other candidate theories, which are not explored in this model, might explain why couples choose community property. For instance, even when spouses always *ex post* cooperate, the presence of transaction costs may prevent couples from electing the constrained efficient regime at the time of marriage. Yet, there is a substantial evidence supporting the hypothesis that couples' consumption and labor supply choices are Pareto efficient (Chiappori, Fortin, and Lacroix, 2002; Bobonis, 2009; Attanasio and Lechene, 2011), so it is harder to postulate that they may be making inefficient choices when electing a property division regime right at the time of marriage.

On the contrary, our model takes the view that couples cooperate whenever possible, and that cooperation might break down as divorce becomes more likely. Such a framework imposes that spouses transfer assets to one another, following the prescription of the *ex post* efficient household planning problem, under most circumstances. However, as the match quality deteriorates, the benefits of cooperating decrease and divorce becomes more likely, spouses may be more likely to save individually, in a non-cooperative fashion. In fact, in the estimation (for now, calibration) exercise, the parameters that govern the likelihood of an autarkic phase are estimated to match the take up of community property: in the absence of autarky (i.e. when  $\kappa = 1$  and  $\Xi = 0$ ), all couples choose separation of property, as postulated by Proposition 3.1.



### 3.4 The marriage market

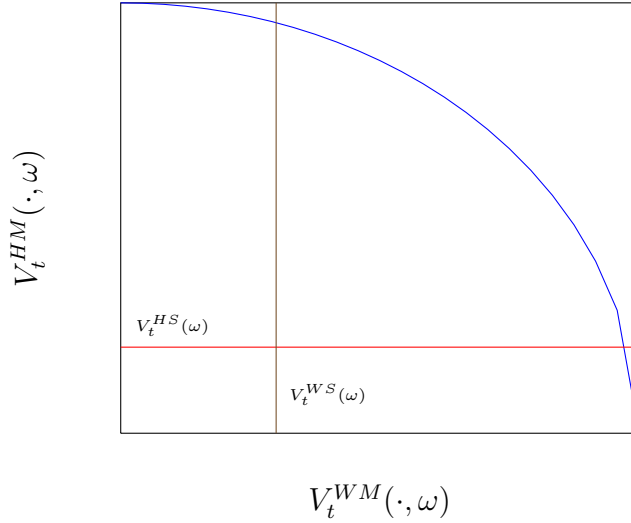
Agents were never married before search for partners of their same age group in a marriage market with frictions, meeting one potential spouse with probability  $\nu_t$  in each period  $t$ , drawn for a distribution of assets, human capital and permanent income. Upon meeting, the two singles can decide to marry one another or continue searching.

We consider each spouse's outside option at the time of marriage, i.e. the value of remaining single at the time of marriage  $V_t^{jS}(\cdot)$ . A couple that meets forms a match  $(\theta, \omega_t)$  and marriage occurs if and only if

$$V_t^{HM}(\theta, \omega_t) \geq V_t^{HS}(\omega_t) \quad \text{and} \quad V_t^{WM}(\theta, \omega_t) \geq V_t^{WS}(\omega_t).$$

Figure 2 depicts the trace of the Pareto frontier with respect to  $\theta$  and the bounds provided by the marriage market. We assume that spouses pick a  $\theta$  that equates the gains from marriage for each spouse. Details of the marriage market and the recursive construction of value functions  $V_t^{jS}$  can be found in Appendix B.

Figure 2: Bounds on the Pareto Frontier



### 3.5 Parametric forms and computational implementation

We describe below the parametric forms that we used for the numerical implementation of the model described above.

#### 3.5.1 Preferences and match quality process

Both husband and wife derive utility from own consumption  $c^j$  and disutility from own labor force participation  $P^j$  for  $j = H, W$ . The per-period utility from consumption follows Constant

Relative Risk Aversion (CRRA) form and is separable in the disutility for participating in the labor market:

$$u(c, P) = \frac{c^{1-\gamma}}{1-\gamma} - \psi P, \quad \text{with } \gamma \geq 0 \text{ and } \psi > 0.$$

Preferences are separable across periods of time and states of the world.

The match quality process evolves over time following an AR(1) process to reflect the persistence in the taste:

$$\xi_t = \phi \xi_{t-1} + \epsilon_t, \quad \xi_1 = \epsilon_1 \quad \text{where } \epsilon_t \text{ is distributed as } N(0, \sigma^2) \text{ and } \phi < 1.$$

### 3.5.2 Economies of scale and children

Spouses benefit from economies of scale in consumption: for a given level of household expenditure  $x$ , spouses' consumption depends on the household inverse production function

$$x = F(c^H, c^W) e(k) = [(c^H)^\rho + (c^W)^\rho]^{\frac{1}{\rho}} e(k).$$

With  $\rho \geq 1$ , this functional form implies that, for a given level of expenditure, a couple is able to consume more than what it could consume if spouses were living separately. The magnitude of economies of scale in the household depends on the consumption gap between spouses: if one spouse does not consume anything, there are no economies of scale. Economies of scale are maximized when spouses consume the same amount. Children affect household consumption according to an equivalence scale, denoted as  $e(k)$  (where  $k$  stands for “kids”).

Childbirth occurs at predetermined ages of the parents and fertility is exogenous.

### 3.5.3 Income over the life-cycle

Each spouse's labor income ( $y^j$  for  $j = H, W$ ) depends on her human capital ( $h^j$ ) and on her permanent income ( $z^j$ ):

$$\ln(y_t^j) = \ln(h_t^j) + z_t^j.$$

Spouses experience permanent income shocks, which follow a random walk process:

$$z_t^j = z_{t-1}^j + \zeta_t^j \quad \text{and} \quad z_1^j = \zeta_1^j \tag{3.5}$$

in which  $\zeta_t^j$  is i.i.d. as  $N(0, \sigma_{\zeta^j}^2)$  and is correlated between spouses.

Human capital is accumulated through labor force participation. The law of motion for each

spouse's human capital  $h^j$  is:

$$\ln(h_t^j) = \ln(h_{t-1}^j) + (\lambda_0^j + \lambda_1^j \cdot t) \cdot P_{t-1}^j.$$

If a woman worked in the previous period, her human capital increases at a rate  $\lambda_0^W + \lambda_1^W t$ . Since men always work until they retire,  $P_{t-1}^H = 1, \forall t$ . At the end of period  $T - R$ , spouses retire and receive a share of their pre-retirement income in every subsequent period. If a woman works, the household faces childcare expenses  $g_t^k$ , which are a function of the number of children and of their age.

## 4 Model calibration

We calibrate the model using parameters from the literature and other parameters calibrated to match a number of empirical moments in the administrative data and in the data from the *Survey of Households Income and Wealth* for the 2000 marriage cohort of college graduates, as described in table 6. The ultimate goal of this exercise is in fact to structurally estimate the model by explicitly targeting these moments using the method of simulated moments.

Table 6: **Parameters of the model**

Parameter	Value	Reference
Initial age	24-27	ISTAT
Years in each period	2	
Age at terminal period	75-78	
Retirement age	60-63	
Economies of scale in marriage ( $\rho$ )	1.4023	McClements scale
Relative risk aversion ( $\gamma$ )	1.5	Attanasio <i>et al.</i> (2008)
Utility cost of working ( $\psi$ )	0.0030	match childcare response
Gender offer wage ratio	0.7	match FLP
Match quality ( $\sigma, \phi$ )	0.002, 0.95	match divorce rate over the life cycle
Scale of marriage preferences in autarky ( $\kappa$ )	0.1	match regime choice
Meeting probability ( $\nu_t$ )		match age at marriage
Gain from marriage ( $\Xi(\cdot)$ )		match marriage rates
Market returns on assets ( $r$ )	0.02	
Discount factor ( $\beta$ )	0.98	Attanasio <i>et al.</i> (2008)
W's age at childbearing	30 and 34	ISTAT
Childcare costs ( $g^k$ )	3,500	ISTAT
Retirement income	70%	replacement rate
Income process ( $\lambda_0, \lambda_1, \sigma_z^2$ )		SHIW data

Table 7: **Simulation: regime choice at marriage by couple characteristics**

Panel A	
Wife's education	% separation of property
College graduate	57.9%
High school graduate	46.2%
High school dropout or below	40.7%
Panel B	
Number of children	% separation of property
No children	61.2%
Two children	57.9%
Panel C	
Childcare costs	% separation of property
Half the average	61.1%
Average	57.9%

*Notes:* In the simulation, the husband is a college graduate. Unless otherwise specified, the wife is a college graduate, the couple has two children and childcare cost are average.

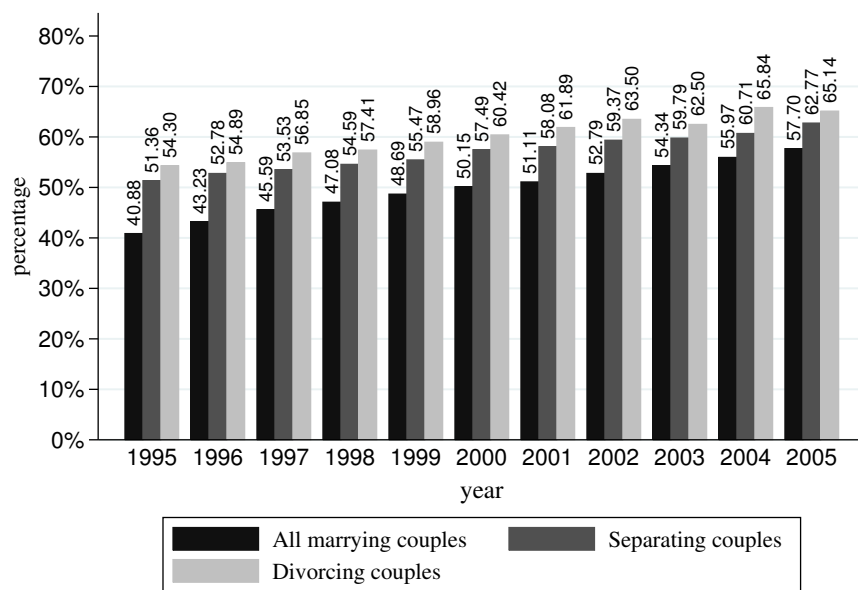
## 4.1 Simulations

We simulated the model for a random sample of 1,000 households, according to the parametrization described above. The simulations replicate a number of basic facts from the administrative data. First, the take up of separation of property increase with the wife's educational attainment (table 7, Panel A), as seen in the administrative data. Moreover, low (exogenous) fertility or lower cost of childcare both raise the take up of separation of property (table 7, panels B and C).

The simulations can also replicate some interesting facts in the data that were not explicitly targeted in the calibration. For the parameter values described above and among college graduates (for which the simulations have been computed), the simulated data indicates that the prevalence of separation of property is higher among couple that end up divorcing (58%) compared to couple that remain together (54%). In the overall actual administrative sample, 50% of all couples married in the year 2000 chose separation of property, while the rate of separation of property is 60% for those couples that ended up divorcing (at least before 2010, see figure 8).

We are able to replicate this empirical regularity because community property, for the couple who choose it, allows for efficient intra-household specialization that is not available to the other couples, who did not find a fifty-fifty sharing rule to be optimal compared to a flexible, but uncommitted, arrangement. This outcome is not ensured for all parameter values, because couples with higher match quality will self-select into separation of property, leading to a selection mechanism of the opposite sign.

Figure 8: Property regimes and marital stability: percentage in separation of property by year of marriage (Italy, 2000-2010)



Source: ISTAT-ADELE

Data source: ISTAT. 2000-2010. *Rilevazione dei divorzi. Rilevazione delle separazioni.*

## 4.2 Counterfactual exercise

To examine the welfare implications of the opportunity to choose separation of property at no cost, we simulate the model for 1,000 households both under the current Italian system and after eliminating regime choice, forcing couples into community property. This exercise suggests that the possibility of choosing a property regime in a costless fashion, like in Italy, promotes higher household savings, lower divorce rates and higher rates of female labor participation (table 8).

Table 8: **Counterfactual exercise: eliminate separation of property**

Outcome	$\Delta$ with no regime choice
Change in female employment	-1pcpt
Change in divorce probability	6pcpt
Change in household savings	-30%

## 5 Final remarks

This paper examines whether prenuptial contracts are used to support efficient intra-household specialization and female labor market participation. To this end, we examine an environment in which a particular kind of prenuptial contract is available at no financial cost and at limited effort cost. We develop and calibrate a dynamic model of intra-household allocation that captures the effect of prenuptial contracts on household labor supply, saving and divorce. Consistently with the patterns observed in the data, the model predicts that community property, in some cases, allows wives to efficiently specialize in home production, allowing her to smooth consumption when going into a divorce.

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# Appendices

## Appendix A: Equivalence between the recursive and sequential formulation of the value functions

This appendix illustrates how one can recursively formulate the sequential marriage problem with participation constraint discussed in section 2.6. Participation constraints are inherently forward looking in the sense that future consumptions are constrained by the current-period participation constraint. Problems of these form generally do not exhibit a recursive Bellman formulation. Marcet and Marimon (2011) show, however, that these problems admit a modified (“saddle-point”) Bellman formulation in the case when the partnership is fully sustainable (i.e., in the case when a contract for which the participation constraints are fully sustainable in *all* states of the world exists). In this paper, we show that the marriage problem with marital dissolution also admits a “saddle-point” Bellman formulation. The argument relies on Marcet and Marimon’s inclusion of the accumulated Lagrange multipliers as a state variable, which allows one to frame the sequential problem in a recursive fashion. It turns out that the same argument can be used to show that a recursive formulation exists in the marriage problem with an outside option by slightly modifying the state space.<sup>9</sup>

### The constrained-efficient sequential problem

Couples in this problem choose a contract at a particular point in time and commit to it.<sup>10</sup> A contract  $\mathbf{a}^t$  chosen in date  $t$  specifies, for any date  $t+k$  with  $k \geq 0$ , a consumption allocation ( $c_{t+k}^j(\cdot)$ ), female labor-force participation in the current period ( $P_{t+k}^j(\cdot)$ ), and individual savings account that each spouses carry on in the next period in the event of a divorce ( $A_{t+k+1}^j(\cdot)$ ). Such contract, at each subsequent period from time  $t$ , is taken to be a function of the history of states up to and including the date  $t+k$ ,  $h_{t+k} = (\omega_1, \dots, \omega_{t+k})$ ; where the primitive state space includes each spouses’ income ( $y_t^j$ ), individual assets ( $A_t^j$ ), and a marital preference shock  $\xi_t$ .

If the state space merely comprises of the primitives ( $z_t^H, z_t^W, h_t^W, A_t^H, A_t^W, \xi_t$ ) then the information needed to construct a contract need no longer admit a Markovian structure. This follows directly from the fact that a marital dissolution is an absorbing state so that a contract must keep track of all previous periods (specifically, periods in which the realized state resulted in a marital dissolution). To remedy this issue, we include the marital status  $O_t$  in each period in time as a state variable and extend contracts to be a function of these states. In this case, all

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<sup>9</sup>Marcet and Marimon’s frame their problem in an infinite-horizon setting. Our model is a finite-horizon model so one other purpose of this appendix is to elucidate Marcet and Marimon’s argument in this setting, which is widely used in the empirical literature of limited commitment.

<sup>10</sup>We are mainly interested in the contracts chosen at the time of marriage. This generalization, however, will be useful in the discussion below.

the information needed for the specified plan in date  $t$  is the primitive state in that date  $\omega_t$  and the cooperative state  $O_t$ . Hence, the specified plan for this date  $c_t^j(\cdot)$ ,  $P_t^W(\cdot)$ , and  $A_{t+1}^j(\cdot)$  can be restricted to depend solely on  $(\omega_t, O_t)$ . Notice that the value of a contract is immaterial during phases when autarky ceases.

We say that a contract  $\mathbf{a}^t$  specified in date  $t$  is *feasible* if it satisfies the budget constraints:

$$(1+r)(A_{t+k+1}^H + A_{t+k+1}^W) = A_{t+k}^H + A_{t+k}^W + (y_{t+k}^W - g_{t+k})P_{t+k}^W + y_{t+k}^H - x_t$$

$$A_{t+k}^j \geq 0, A_T^j = 0, x_{t+k} = F(c_{t+k}^H, c_{t+k}^W) \text{ for } k = 0, \dots, T-t \text{ and } j \in \{H, W\}$$

All optimization discussed in this section is with respect to the set of feasible contracts.

We are now in a position to recursively define the cooperative state. We let the cooperative-state process depend on the current state and the cooperative state in the previous period. Hence, the cooperative-state process can be summarized as a function  $O_t : \Omega_t \times \{0, 1\}$ . It then follows that the cooperative state itself is a Markov process since  $\omega_t$  is Markovian. The cooperative-state process is defined as follows:

1. For the terminal period,  $C_T(\omega_T, 1) = 1$  for every  $\omega_T \in \Omega_T$ . Moreover,  $C_T(\omega_T, 0) = 0$  if and only if there exists at least one feasible contract specified in date  $T$  such that

$$u(c_T^j, P_T^j; \xi_t) \geq V^{jO}(\omega_T) \quad (5.1)$$

for each spouse  $i \in \{H, W\}$ .

2. For  $t = 1, \dots, T-1$ ,  $O_t(\omega_t, 1) = 1$  for every  $\omega_t \in \Omega_t$  and  $O_t(\omega_t, 0) = 0$  if and only if there is at least one feasible contract specified at date  $t$ , say  $\mathbf{a}^t$  satisfying:

$$E_t \left[ \sum_{k=0}^{T-t} \beta^k \left( u(c_{t+k}^j, P_{t+k}^j; \xi_{t+k})(1 - O_{t+k}) + V_{t+k}^{jO} O_{t+k}(1 - O_{t+k-1}) \right) \right] \geq V_t^{jO} \quad (5.2)$$

for each spouse  $j \in \{H, W\}$ ; where  $E_t$  denotes the expectation conditional on the state  $\omega_t$  and the contract  $\mathbf{a}^t$ .

Equation 5.2 is spouse  $j$ 's participation constraint at time  $t$ , which takes into account the possibility of a noncooperative state in subsequent periods. As soon as marriage ends in time  $t+k$ , each spouse receives her outside option  $V_{t+k}^{jO}$ , which is the spouses outside-option value in this period.<sup>11</sup> Couples would seek contracts that satisfy these participation constraints whenever

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<sup>11</sup>Notice by construction that

$$\prod_{m=1}^{t+k} O_{t+k}(1 - O_{t+k-m}) = O_{t+k}(1 - O_{t+k-1})$$

possible.<sup>12</sup> Thus, when optimizing over contracts at date  $t$ , couples are bound to the participation constraints:

$$(1 - O_{t+k}) \left( E_{t+k} \left[ \sum_{m=0}^{T-(t+k)} \beta^m u(c_{t+k+m}^j, P_{t+k+m}^j; \xi_{t+k+m}) (1 - O_{t+k+m}) \right. \right. \\ \left. \left. + \sum_{m=0}^{T-(t+k)} \beta^m V_{t+k+m}^{jO} O_{t+k+m} (1 - O_{t+k+m-1}) \right] - V_{t+k}^{jO} \right) \geq 0 \quad (5.3)$$

for every  $k = 0, \dots, T - t$ .

At time of marriage couples choose a feasible contract  $\mathbf{a}^1$  that maximizes the following objective subject to the constraint given in (5.3) for  $t = 1$ :

$$\sum_{j \in \{H, W\}} \theta^j \sum_{t=1}^T \beta^{t-1} E_1 \left[ u(c_t^j, P_t^j; \xi_t) (1 - O_t) + V_t^{jO}(\omega_t) O_t (1 - O_{t-1}) \right]$$

with  $C_0 = 0$ .

This household problem is similar to the dynamic problems with forward-looking constraints discussed in Marcet and Marimon (2011) with the appropriate modification of incorporating the possibility of a marital dissolution. It is well known that these inter-temporal problems are only time consistent up to a modification of the state space. If both spouses were to reevaluate their contract at a later date, it need not be the case that the same household (i.e., a household with the same bargaining weight  $\theta$ ), would choose the same contract that was optimally chosen at the beginning of marriage. In this appendix, we show that such time inconsistent behavior can be characterized as a change in the bargaining weight of the planner and the evolution of these bargaining weight depend on each spouses' outside options. In particular, suppose a planner reevaluates her contract at date  $t$  so that its problem can be aptly described by the following:

$$\max_{\mathbf{a}^t} \sum_{j \in \{H, W\}} \theta^j \sum_{k=0}^{T-t} \beta^k E_1 \left[ u(c_{t+k}^j, P_{t+k}^j; \xi_{t+k}) (1 - O_{t+k}) + V_{t+k}^{jO} O_{t+k} (1 - O_{t+k-1}) \right]$$

s.t. participation constraints in (5.3) for  $H$  and  $W$ ,  $O_{t-1} = 0$

feasibility constraints.

In this case, the optimal contract  $\mathbf{a}^t$  need not be the same as the specified contract that solves the initial marriage problem. The reason being is that the  $t$ -th period problem disposes of earlier

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<sup>12</sup>Note that this is not an assumption but rather a feature of the model. Whenever possible couples would always want to specify contracts so that marriage is sustainable

participation constraints. Indeed, if the optimal contract solved at the time marriage is such that a participation constraint binds for some period  $r < t$ , then the re-evaluated contract must be different from the initial contract promised at the time of marriage. Now, suppose that the planner in time  $t$  changes the way it weighs the spouses so that each spouses' Pareto weight are given by  $\theta^j + M_t^j$ ; where  $M_t^j$  captures the deviation from the initial bargaining stance due to the presence of binding participation constraints. Call the solution to the problem (1.3) with these deviated Pareto weights  $\tilde{\mathbf{a}}^t(M_t^H, M_t^W)$ . We show that the solution to the household problem at the beginning of marriage yields contract from time  $t$  up to the terminal period, say  $\hat{\mathbf{a}}^t$ , such that  $\hat{\mathbf{a}}^t = \tilde{\mathbf{a}}^t(M_t^H, M_t^W)$  for some  $(M_t^H, M_t^W) \in \mathbb{R}^2$ . Moreover, these deviations in the initial Pareto weights can be completely characterized as the cumulated Lagrange multipliers of binding constraints specified by the contract  $\hat{\mathbf{a}}$  from the time of marriage up to the  $t$ -th period. With this in mind, we define the value function associated with this deviated constrained efficient problem at time  $t$  as

$$V_t(\mathbf{M}_t, \omega_t, O_t) = \max_{\mathbf{a}^t} \sum_{j \in \{H, W\}} (\theta^j + M_t^j) E_t \left[ \sum_{k=0}^{T-t} \beta^k u(c_{t+k}^j, P_{t+k}^j; \xi_{t+k}) (1 - O_{t+k}) + V_{t+k}^{jO} O_{t+k} (1 - O_{t+k-1}) \right] \quad (5.4)$$

s. t. the participation constraint in (1.3),  $O_{t-1} = 0$   
and the feasibility constraints

The fact that optimal contracts at the beginning of marriage are consistent up to renegotiation suggest that an inclusion of these deviations in Pareto weight as a state space would aid in providing a recursive formulation. Indeed, the inclusion of these deviations as a state space is important to the reformulation of the household problem in a recursive fashion, which we illustrate in the following subsection.

### The recursive formulation: an ex post constrained efficient household

Since the sequential problem is only time consistent up to some renegotiation in the bargaining weight, a recursive formulation to the sequential problem above must account for these deviation in bargaining weight over time. The households value function must then be defined on the extended state space  $\mathbb{R}_+^2 \times \Omega_t \times \{0, 1\}$  with its typical element denoted by  $(\mathbf{M}_t, \omega_t, O_t)$ . To see how a recursive formulation to the sequential problem above can exist, consider the Lagrangian form of the planner's problem at the time of marriage, where  $\lambda_1^j$  denotes the Lagrange multiplier associated with each spouses' participation constraint at the time of marriage, and suppose that marriage is sustainable at  $t = 1$ .<sup>13</sup>

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<sup>13</sup>With a few algebraic manipulation, one can show that the Lagrangian admits the form given in expression 1.5

$$\begin{aligned}
& \max_{\mathbf{a}} \inf_{\lambda_1} \sum_{j \in \{H, W\}} \left( (\theta^j + \lambda_1^j) u(c_1^j, P_1^j; \xi_1) - \lambda_1^j V_1^{jO}(\omega_1) \right) \\
& + \beta \sum_{j \in \{H, W\}} (\theta^j + \lambda_1^j) E_1 \left[ \sum_{t=1}^T \beta^{t-1} \left( u(c_{t+1}^j, P_{t+1}^j; \xi_{t+1})(1 - O_{t+1}) + V_{t+1}^{jO} O_{t+1}(1 - O_t) \right) \right] \\
& \text{subject to the participation constraints for periods } t = 2, \dots, T \\
& (1 - O_t) \left( E_t \left[ \sum_{m=0}^{T-t} \beta^m u(c_{t+m}^j, P_{t+m}^j; \xi_{t+m})(1 - O_{t+m}) \right. \right. \\
& \left. \left. + \sum_{m=0}^{T-t} \beta^m V_{t+m}^{jO} O_{t+m}(1 - O_{t+m-1}) \right] - V_t^{jO} \right) \geq 0 \text{ and } C_0 = 0.
\end{aligned} \tag{5.5}$$

Notice that this problem is not additively separable since minimizing the current-period participation constraint's Lagrangian affects future consumption, as renegotiations carry on to the subsequent periods. If participation constraints slack, then period 1's maximization problem can be treated separately from subsequent period's maximization (subject to the feasibility constraint). The clever insight by Marcat and Marimon is to specify a new state space/Pareto weight in period 2 and account for the evolution of this new weight via  $M_2^j = \lambda_1^j$ . It is no surprise then that the following simultaneously defined recursive value function,  $V_t^R(\cdot)$  and the cooperative-state  $O_t^R(\cdot)$  is analogous to the ones discussed in the sequential framework:

- At the terminal period,  $V_T^R(\cdot) = V_T(\cdot)$  and  $D_T^R(\cdot) = O_T(\cdot)$
- Suppose  $V_{t+1}^R(\cdot)$  has been recursively defined. We define the recursive cooperative state at date  $t$  by  $D_t^R(\omega_t, 1) = 1$  for every  $\omega_t$  and  $O_t^R(\omega_t, 0)$  if and only if there is a feasible allocation such that

$$\begin{aligned}
& \inf_{\lambda_t} \sum_{j \in \{H, W\}} \{ (\theta^j + M_t^i + \lambda_t^j) u(c_t^j, P_t^j; \xi_t) - \lambda_t^j V_t^{jO}(\omega_t) \\
& + \beta E_t[V_{t+1}^R(\mathbf{M}_{t+1}, \omega_{t+1}, O_{t+1}^R) | M_{t+1}^j = \lambda_t^j + M_t^j \forall j] \} \in \mathbb{R}
\end{aligned} \tag{5.6}$$

- The value function in period  $t$  is recursively defined as:

$$\begin{aligned}
V_t^R(\mathbf{M}_t, \omega_t, O_t^R) = & \sup_{\mathbf{c}_t, \mathbf{A}_t, P_t^W} \inf_{\lambda_t} \sum_{j \in \{H, W\}} (1 - O_t^R) \left( (\theta^j + M_t^i + \lambda_t^j) u(c_t^j, P_t^j; \xi_t) - \lambda_t^j V_t^{jO}(\omega_t) \right. \\
& \left. + \beta E_t[V_{t+1}^R(\mathbf{M}_{t+1}, \omega_{t+1}, O_{t+1}^R) | M_{t+1}^j = \lambda_t^j + M_t^j \forall j] \right) + (\theta^j + M_t^i) D_t^R V_t^{jO}
\end{aligned} \tag{5.7}$$

, where the feasibility asset accumulation restricts the evolution of  $\omega_{t+1}$  conditional on the

households action via:

$$(1+r)(A_{t+1}^H + A_{t+1}^W) = A_{t+1}^H + A_t^W + (y_t^W - g_t)P_t^W + y_t^H - x_t$$

$$A_t^j \geq 0 \text{ for } j \in \{H, W\}, \text{ and } x_t = F(c_t^H, c_t^W) \quad (5.8)$$

In this formulation, forward-looking constraints are absent, and the only constraints are that of the asset accumulation and the additional constraint governing the evolution of  $\mathbf{M}_t$ . In particular, the recursive value function embeds these forward-looking constraint into the continuation value via the  $M_{t+1}^j = M_t^j + \lambda_t^j$  for each  $j$ . The marriage sustainability condition and recursive formulation may seem at odds to the formulation described in section 2.6 and in the computational appendix. One can use the complementary slackness condition, however, to show that this condition is equivalent to the following condition.

There is a feasible consumption allocation for which

$$u(c_t^j, P_t^j; \xi_t) + \beta E_t[V_{t+1}^j(\mathbf{M}_{t+1}, \omega_{t+1}, D_{t+1}^R) | M_{t+1}^j = M_t^j + \lambda_t^j] \geq V_t^{jO},$$

where  $V_{t+1}^j(\mathbf{M}_{t+1}, \omega_{t+1}, O_{t+1})$  denotes each spouses' continuation values if they were to remain remarried at time  $t$ . We first formally define  $V^j(\cdot)$ . At the terminal period,

$$V_T^j(\mathbf{M}_T, \omega_T, O_T) = \begin{cases} V_T^{jO}(\omega_T) & \text{if } O_T = 1 \\ V_T^{jM}(\mathbf{M}_T, \omega_T) & \text{if } O_T = 0 \end{cases}$$

where  $V_T^{jM} = u(\hat{c}_T^j)$  and  $\hat{c}_T^j$  is a solution to the terminal-period marriage problem if marriage is sustainable. For an arbitrary period, one can recursively define  $V_t^j$  as follows:

$$V_t^j(\mathbf{M}_t, \omega_t, O_t) = \begin{cases} V_t^{jO}(\omega_t) & \text{if } O_t = 1 \\ u(\hat{c}_t^j) + \beta E_t[V_{t+1}^j(\mathbf{M}_{t+1}, \omega_{t+1}, D_{t+1}^R) | \hat{a}_t] & \text{if } O_t = 0 \end{cases}$$

where  $\hat{a}$  denotes solves the recursive problem in (1.8).

*Proof.* Since both problems coincide in the terminal period, we have by the complementary slackness condition that

$$V_T^R(\mathbf{M}_T, \omega_T, O_T) = \sum_{j \in \{H, W\}} (\theta^j + M_T^j) V_T^j(\mathbf{M}_T, \omega_T, O_T)$$

Suppose, for the sake of an inductive argument that  $V_{t+1}^R(\mathbf{M}_{t+1}, \omega_{t+1}, O_{t+1}) = \sum_{j \in \{H, W\}} (\theta^j + M_{t+1}^j) V_{t+1}^j(\mathbf{M}_{t+1}, \omega_{t+1}, O_{t+1})$ . Plugging in this identity into the household recursive problem described by equation (1.8) and with some algebraic manipulation, one can reframe the household

problem as:

$$\begin{aligned}
V_t^R(\mathbf{M}_t, \omega_t, O_t^R) = & \\
(1 - O_t^R) \{ \max_{a_t} \inf_{\lambda_t} \sum_{j \in H, W} (\theta^j + M_t^j) (u(c_t^j, P_t^j; \xi_t) + \beta E_t [V_{t+1}^j(\cdot) | M_{t+1}^j = M_t^j + \lambda_t^j]) & \\
+ \sum_{j \in H, W} \lambda_t^j (u(c_t^j, P_t^j; \xi_t) + \beta E_t [V_{t+1}^j(\cdot) | M_{t+1}^j = M_t^j + \lambda_t^j] - V_t^{jO}(\omega_t)) \} + O_t^R V_t^{jO}(\omega_t) & \quad (5.9)
\end{aligned}$$

, where  $\omega_{t+1}$  satisfies to the asset-accumulation constraint given in equations (4.10). From this expression, one sees that the recursive problem is equivalent to the following constrained optimization problem whenever marriage is sustainable whenever  $O_t^R = 1$ :

$$\begin{aligned}
\max_{a_t} \sum_{j \in H, W} (\theta^j + M_t^j) (u(c_t^j, P_t^j; \xi_t) + \beta E_t [V_{t+1}^j(\cdot) | M_{t+1}^j = M_t^j + \lambda_t^j]) & \\
\text{subject to the asset-accumulation constraint (4.10)} & \quad (5.10) \\
\text{and the participation constraint:} & \\
u(c_t^j, P_t^j; \xi_t) + \beta E_t [V_{t+1}^j(\cdot) | M_{t+1}^j = M_t^j + \lambda_t^j] \geq V_t^{jO} \text{ for } j \in \{H, W\} &
\end{aligned}$$

Hence, by invoking the complementary slackness condition once again and by induction, we see that the relation  $V_t^R(\mathbf{M}_t, \omega_t, O_t) = \sum_{j \in \{H, W\}} (\theta^j + M_t^j) V_t^j(\mathbf{M}_t, \omega_t, O_t)$  holds for any period  $t$ , which concludes what needs to be shown. Hence, the representation of the value function given in (4.12) is valid.  $\square$

## An equivalence result

We now formally state our equivalence result:

**Proposition 5.1.** *For every  $t = 1, \dots, T$  and  $(\mathbf{M}_t, \omega_t, O_t) \in \mathbb{R}_+^2 \times \Omega_t \times \{0, 1\}$ , we have that*

$$V_t(\mathbf{M}_t, \omega_t, O_t) = V_t^R(\mathbf{M}_t, \omega_t, O_t).$$

Moreover, the cooperative states coincide  $O_{t+1}(\omega_t, O_t) = O_{t+1}^R(\omega_t, O_t)$  for every  $t = 1, \dots, T - 1$ .

*Proof.* The result is trivial for the terminal period. Suppose, for the sake of an inductive argument, that  $O_{t+1}(\omega_t, O_t) = O_{t+1}^R(\omega_t, O_t)$  and

$$V_{t+1}(\mathbf{M}_{t+1}, \omega_{t+1}, O_{t+1}) = V_{t+1}^R(\mathbf{M}_{t+1}, \omega_{t+1}, O_{t+1})$$

for every  $(\mathbf{M}_{t+1}, \omega_{t+1}, O_{t+1})$ .

Consider the sequential value function in period  $t$  and suppose that  $O_t = 1$ . With some algebraic manipulation and by the law of iterated expectation, we have:<sup>14</sup>

$$\begin{aligned}
V_t(\mathbf{M}_t, \omega_t, 1) = & \max_{\mathbf{a}^t} \inf_{\lambda_t} \sum_{j \in \{H, W\}} \left( (\theta^j + \lambda_t^j) u(c_t^j, P_t^j; \xi_t) - \lambda_t^j V_t^{jO}(\omega_t) \right) + \\
& \beta E_{t+1} \left( \sum_{j \in \{H, W\}} (\theta^j + M_{t+1}^j) E_t \left[ \sum_{k=0}^{T-(t+1)} \beta^k u(c_{t+1+k}^j, P_{t+1+k}^j; \xi_{t+1+k}) (1 - O_{t+1+k}) \right. \right. \\
& \left. \left. + \sum_{k=0}^{T-(t+1)} \beta^k V_{t+1+k}^{jO} O_{t+1+k} (1 - O_{t+k}) \right] \right) \quad (5.11)
\end{aligned}$$

s. t. the participation constraints from periods  $t+1, \dots, T$ ,  $M_{t+1}^j = M_t^j + \lambda_t^j$   
 $O_{t-1} = 0$  and feasibility constraints

Notice that conditional on next periods deviation in the bargaining weight ( $\mathbf{M}_{t+1}$ ), the second summand does not depend on the current-period Lagrange multipliers  $\lambda_t$ . Hence, the specified contracts for periods  $t+1, \dots, T$  can be chosen independent of  $\lambda_t$  when one conditions on the value of next periods weight  $\theta^j + M_{t+1}^j$ . In particular, let  $\mathbf{a}^t = (\mathbf{c}_t, \mathbf{A}_t, P_t^W, \mathbf{a}^{t+1})$ , then, conditional on  $\mathbf{M}_{t+1}$ , the order of of max min between  $\mathbf{a}^{t+1}$  and  $\lambda_t$ , respectively, can be interchanged. This implies the following equivalent description of the household problem:

$$\begin{aligned}
V_t(\mathbf{M}_t, \omega_t, 1) = & \max_{(\mathbf{c}^t, \mathbf{A}^t, P_t^W)} \inf_{\lambda_t} \sum_{j \in \{H, W\}} \left( (\theta^j + \lambda_t^j) u(c_t^j, P_t^j; \xi_t) - \lambda_t^j V_t^{jO}(\omega_t) \right) + \\
& \beta E_{t+1} \left( \max_{\mathbf{a}^{t+1}} \sum_{j \in \{H, W\}} (\theta^j + M_{t+1}^j) E_t \left[ \sum_{k=0}^{T-(t+1)} \beta^k u(c_{t+1+k}^j, P_{t+1+k}^j; \xi_{t+1+k}) (1 - O_{t+1+k}) \right. \right. \\
& \left. \left. + \sum_{k=0}^{T-(t+1)} \beta^k V_{t+1+k}^{jO} O_{t+1+k} (1 - O_{t+k}) \right] \right) \quad (5.12)
\end{aligned}$$

s. t. the participation constraints from periods  $t+1, \dots, T$ ,  $M_{t+1}^j = M_t^j + \lambda_t^j$   
 $O_{t-1} = 0$  and feasibility constraints

, where interchanging the max and expectation operator is permissible since contracts are state-

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<sup>14</sup>For the sake of brevity, we leave the algebraic manipulation out of this appendix. Nevertheless, we want to note that it uses the following identity, which holds immediately by construction of the cooperative state:

$$(1 - O_t)(1 - O_{t+1}) = (1 - O_{t+1}) \text{ for every } t = 1, \dots, T-1$$



contingent.

By our inductive hypothesis, we have that  $V_t(\mathbf{M}_t, \omega_t, 1) = V_t^R(\mathbf{M}_t, \omega_t, 1)$ . Notice that by the claim discussed at the end of the preceding section we have concurrently shown that  $D_t^R = 1$ . The case when  $O_t = 0$  is trivial so that by induction we have shown what is needed.  $\square$

### Implication to the marriage problem

The equivalence result in this appendix (Proposition 4.1) show that marriage problem discussed in section 2 corresponds to an efficient household contracting problem in every period  $t$ . Given this equivalence, a household that behaves ex post efficiently is weakly better off if the corresponding sequential problem affords a more flexible set of contracts in each period. In a community property regime, both spouses split the assets equally, which adds an additional constraint on the law of motion governing each spouses' feasible asset accumulation. The set of feasible contracts that reflect this additional constraint must then be a subset of the initial set of feasible contracts discussed above if outside option valuation are invariant to the regime choice. Consequently, contracts maximized over this more restricted set of contracts can never be strictly preferred by the household, and separation of property is weakly preferred by an ex post constrained efficient household in each period if  $V_t^{jO}(\cdot)$  do not differ across the two regimes. We formally state this insight in the following proposition, which readily follows from proposition 4.1:

**Proposition 5.2.** *Consider the ex post efficient marriage problem that allow for renegotiation (discussed in section 2). Separation of property is the constrained-efficient allocation of the household problem in each period  $t$  provided  $V_t^{jO}(\cdot)$  are invariant to regime the choice.*

*Proof.* Consider the household contracting problem above at an arbitrary time period  $t$  with a new feasibility constraint. In particular, households maximize over state-contingent contracts  $\mathbf{a}^t$  satisfying the following conditions:

$$(1+r)(A_{t+k+1}^H + A_{t+k+1}^W) = A_{t+k}^H + A_{t+k}^W + (y_{t+k}^W - g_{t+k})P_{t+k}^W + y_{t+k}^H - x_t \quad (5.13)$$

$$A_{t+k}^j \geq 0, A_T^j = 0, A_{t+k+1}^H = A_{t+k+1}^W \quad (5.14)$$

$$x_{t+k} = F(c_{t+k}^H, c_{t+k}^W) \text{ for } k = 0, \dots, T-t \text{ and } j \in \{H, W\} \quad (5.15)$$

Clearly, any contract  $\mathbf{a}^t$  satisfying equations 5.13-5.15 is a feasible contract (in the original definition given above where the restriction  $A_{t+k+1}^H = A_{t+k+1}^W$  is omitted for every  $k = 0, \dots, T-t$ ). Thus, the associated value function for this new sequential household contracting problem, say  $\tilde{V}_t(\mathbf{M}_t, \omega_t, O_t)$ , satisfies the following inequality:  $\tilde{V}_t(\mathbf{M}_t, \omega_t, O_t) \leq V_t(\mathbf{M}_t, \omega_t, O_t)$  for any  $(\mathbf{M}_t, \omega_t, O_t)$  provided outside options do not differ across the two regimes. Consider the household recursive formulation above, where the feasibility on asset accumulation restricts the evolution

of  $\omega_{t+1}$  conditional on the households action via:

$$(1+r)(A_{t+1}^H + A_{t+1}^W) = A_{t+1}^H + A_t^W + (y_t^W - g_t)P_t^W + y_t^H - x_t$$

$$A_{t+1}^H = A_{t+1}^W, A_t^j \geq 0 \text{ for } j \in \{H, W\}, \text{ and } x_t = F(c_t^H, c_t^W)$$

Let  $\tilde{V}_t^R(\mathbf{M}_t, \omega_t, O_t)$  be this recursive household problem's value function. By proposition 4.1, we have that  $\tilde{V}_t^R(\mathbf{M}_t, \omega_t, O_t) = \tilde{V}_t(\mathbf{M}_t, \omega_t, O_t) \leq V_t(\mathbf{M}_t, \omega_t, O_t) = V_t^R(\mathbf{M}_t, \omega_t, O_t)$  for any  $(\mathbf{M}_t, \omega_t, O_t)$ .  $\square$

## Appendix B: The Single's Problem

A single person at each period is characterized by the states  $\omega_t^H = (A_t^H, y_t^H)$  and  $\omega_t^W = (A_t^W, y_t^W, h_t^W)$ . We assume that singles do not get matched during retirement years so that the value for a person who remained single during the retirement years and the year preceding the first retirement year, which we denote by  $V_t^{jS}(\omega_t^j)$ , solves the following problem:

$$\begin{aligned} V_t^{jS}(\omega_t) &= \max_{c_t^j} u(c_t^j, 0) + \beta E[V_{t+1}^{jS}(\omega_{t+1}^j) | \omega_t^j] \\ \text{s.t. budget constraint when single: } &A_{t+1}^j(1+r) + c_t^j = y_t^j + A_t^j \end{aligned}$$

In periods preceding the retirement year, singles solve the following problem:

$$\begin{aligned} V_t^{jS}(\omega_t^j) &= \max_{c_t^j} u(c_t^j, 1) + \beta E[V_{t+1}^{j\max}(\omega_{t+1}^j) | \omega_t^j] \\ \text{s.t. } &A_{t+1}^j(1+r) + c_t^j = y_t^j + A_t^j \end{aligned}$$

Here we assume that singles always work and that  $E[V_{t+1}^{j\max}(\omega_{t+1}^j) | c_t^j, \omega_t^j]$  is the continuation value of a single couple, which takes into account the possibility of meeting another single individual in the next period and marrying such individual. During non-retirement years, single individuals meet with probability  $\nu_t$ . Such a match can be described in terms of each person's single state and marital preference  $\xi_t$  (i.e.,  $\omega_t = (\omega_t^H, \omega_t^W, \xi_t)$ ) and will result in marriage if and only if for some  $\theta \in [0, 1]$  the following inequalities hold:

$$V_t^{jM}(\theta, 1 - \theta, \omega_t) \geq V_t^{jS}(\omega_t^j) \text{ for each } j \in \{H, W\} \quad (5.16)$$

This defines a set of marriage admissible matches:

$$\mathcal{M}_t = \{\omega | \exists \theta \text{ s.t. 5.16 holds}\}$$

Similarly for each admissible match  $\omega_t \in \mathcal{M}$  we may define the set of all admissible Pareto weights

$\Theta_t^M(\omega_t) = \{\theta \in [0, 1] \mid \text{s.t. } ?? \text{ holds}\}$  for each  $\omega_t \in \mathcal{M}_t$ . Hence, we define the continuation value for the years up to and including the retirement year  $E[V_{t+1}^{j\max}(\omega_{t+1})|c_t^j, \omega_t^j]$  as follows:

$$\begin{aligned} E[V_{t+1}^{j\max}(\omega_{t+1})|c_t^j, \omega_t^j] &= (1 - \nu_t)E[V_{t+1}^{jS}(\omega_{t+1}^j)|\omega_{t+1}^j] \\ &+ \nu_t \left( \int V_{t+1}^{jM}(\theta, 1 - \theta, \omega_{t+1})dF(\theta|\theta \in \Theta_{t+1}(\omega_{t+1}))dF(\omega_{t+1}|\omega_{t+1} \in \mathcal{M}_{t+1}, \omega_t^j, c_t) \right. \\ &\left. \int V_{t+1}^{jS}(\omega_{t+1}^j)dF(\omega_{t+1}|\omega_{t+1} \in \Omega_{t+1} \setminus \mathcal{M}_{t+1}, \omega_t^j, c_t) \right) \end{aligned}$$

Notice that the value of marriage is integrated over the set of admissible Pareto weights conditional on the match. This distribution is assumed to be uniform with a support that depends on each person's outside option (See figure 2). The distribution of matches are also assumed to be uniform.