Federal Pre-Budget Submission 2021-22

Opportunities to boost women's workforce participation

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Summary

We welcome the opportunity to provide input in the development of the 2021-22 Federal Budget.

Australians who want to participate in the workforce or increase their paid work should be encouraged and supported to do so.

Yet many mothers with young children are deterred from returning to work, or taking on an extra day, because of the cost of childcare. The working patterns established in those first few years after the birth of a child can last a lifetime. Women who have had a child are much more likely to work part-time, even into their 50s and 60s, than women without children.

Making childcare more affordable is the single biggest policy lever the federal government has to support women's long-term workforce participation. And boosting workforce participation is one of the biggest economic growth opportunities for Australia, particularly in the wake of the COVID-19 pandemic.

The government should make incremental reforms to the Child Care Subsidy to reduce work disincentives, as part of its delayed 2020 review of the system.

Options for reform that would support women's workforce participation and economic growth over the medium term include:

- Raising the Child Care Subsidy, flattening the taper, and removing the annual cap.
- Making childcare free for the second and subsequent children.
- A universal 95 per cent subsidy on all childcare with no means testing or annual cap.

Tax-deductible childcare rightly recognises childcare as a working expense. But because the cost of childcare is so high, only about 10 per cent of families with young children would benefit. The remaining 90 per cent would go backwards without the current subsidy. Even an opt-in model, would add substantial complexity to the system for families.

Other options are available to make the subsidy system more accessible for all families, including extending the subsidy to registered nannies.

Boosting women's workforce participation through more affordable and accessible childcare would boost economic growth, underpin Australian living standards for decades to come, and help Australia to 'build back better' after the COVID crisis.

Further detail about the need for and nature of these reforms is provided in the **attached** Grattan Institute report, *Cheaper childcare: A practical plan to boost female workforce participation*.

1 Making childcare more affordable is one of the biggest economic growth opportunities

Government policy decisions over the next few years will determine the path of the economic recovery and the kind of Australia that emerges on the other side of the crisis.

Australia cannot simply rely on business as usual to deliver long-term economic growth.[1] Productivity growth had been low for at least a decade pre-COVID.[2] And Australia's ageing population will reduce workforce participation in decades to come.[3]

In addition to getting the broad macroeconomic settings right in the wake of COVID-19, investment in childcare is probably the single biggest policy lever the federal government has to promote workforce participation and boost productivity.

1.1 Rebuilding after COVID-19

Australia's economic growth in recent years relied heavily on population growth.[4] But population growth is likely to be slow for quite some time given restrictions on migration and declining fertility rates.

Quick and widespread rollout of an effective vaccine could be a game-changer for migration, but even under the best scenarios, Australia's population growth is still expected to remain below pre-COVID trajectories for at least a decade.[5] Reduced migration will make Australia's population both smaller and older than was expected before the pandemic.[6]

This means that workforce participation and productivity will need to do the heavy lifting in driving long-term growth and improving living standards.

Australia's medium- and long-term economic prospects depend on maintaining the pace of the economic recovery, minimising the impact of further outbreaks, and building back better.[7]

1.2 Now is the time to invest in early education and care

Investing further in early education and care makes sense as both a short- and long-term economic response to the pandemic recession.

Accessible, high-quality education and care helps children and the economy.

It has long-term benefits for children's learning and development, including 'school readiness', especially for disadvantaged children.[8]

[1] Even before the crisis, unemployment levels were too high to kick-start inflation and wage growth: Coates and Cowgill (2020); Ellis (2019).
[2] PBO (2020). The PBO suggests 'productivity growth may remain closer to the trend of around 1 per cent on average since 2005, lower than the 1.5 per cent assumed at the 2015 Intergenerational Report'.
[3] Hockey (2015); PBO (2019).
[4] Colebatch (2019).
[5] Treasury Centre for Population (2020).
[6] Treasury Centre for Population (2020).
[7] PBO (2020); IMF (2020).
[8] AEDC (2014); OECD (2017). For a more detailed discussion see Wood et al. (2020a), pp. 14-15.

And affordable childcare helps the economy by providing more choices for parents, particularly mothers, about whether, and how much, they would like to work.

The critical support childcare provides to the workforce participation of parents was recognised early in the crisis.[9] The Federal Government's temporary Relief, Transition, and Recovery Packages for early childhood education and care have largely succeeded in keeping childcare centres open through the crisis so far.

But as economy-wide supports such as JobKeeper and JobSeeker are wound back and the activity test comes back into force,[10] some parents may no longer be able to afford care. History and overseas evidence suggest it will be overwhelmingly mothers who withdraw from work if paid care is out of reach.[11]

Loss of childcare reduces parents' capacity to be 'job ready' and to pick up jobs or additional hours as they become available.

But beyond supporting the economic recovery, cheaper childcare would also boost workforce participation in the longer term.

1.3 Affordable childcare is a critical enabler of both participation and productivity

Financial barriers discourage parents, especially mothers, from returning to work and taking on more paid work.

The combination of tax, welfare settings, and out-of-pocket childcare costs – the 'workforce disincentive rate' – can be particularly punishing for the fourth and fifth day of work.[12] These strong financial disincentives to work hold even after the income tax cuts in the 2020 Budget (Figure 1.1).[13]

As a result, the typical Australian woman with pre-teenage children works 2.5 days a week, and the proportion of Australian women working part-time is higher than almost any other developed economy.[14]

Childcare costs remain the biggest component of the financial barrier to going full-time (Figure 1.2), with many women losing more than they gain by working an extra day.[15]

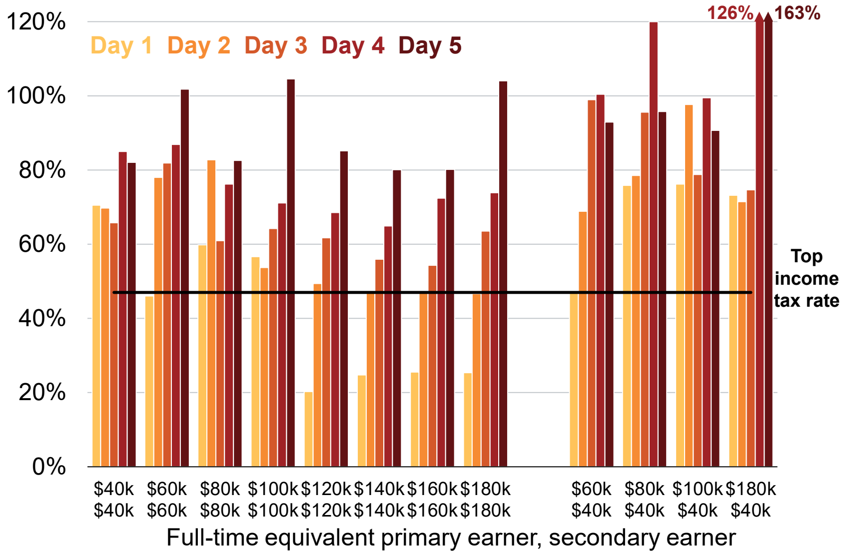
Boosting childcare support is a critical enabler of both participation and productivity. It makes it more affordable for parents, especially mothers, to do more paid work if they want to.

[9] Wood et al. (2020b)
[10] To be eligible for the Child Care Subsidy, both parents must complete a certain number of hours of approved activities, such as paid work, study, or volunteering. This 'activity test' was eased during the pandemic to ensure that families whose employment was affected by COVID-19 were still able to get subsidised childcare. The activity test comes back into force from 4 April 2021: Department of Education, Skills and Employment (2020a).
[11] Wood et al. (2020a)
[12] Wood et al. (2020a), p.1.
[13] Figure 1.1 includes the Stage 2 personal income tax cuts and the temporary LMITO as per the tax settings for the current financial year (2020-21).
[14] Australia has the fourth-highest rate of part-time work among women in the 36 OECD countries: OECD (2020).
[15] Wood et al. (2020a), p.8-10.

And when talented people are prevented from contributing at their comparative advantage it also constrains economic productivity.[16]

Figure 1.1: Disincentives to work are very high for second earners (even after the recent tax cuts)

Workforce disincentive rate 2020-21, second earner with two young children

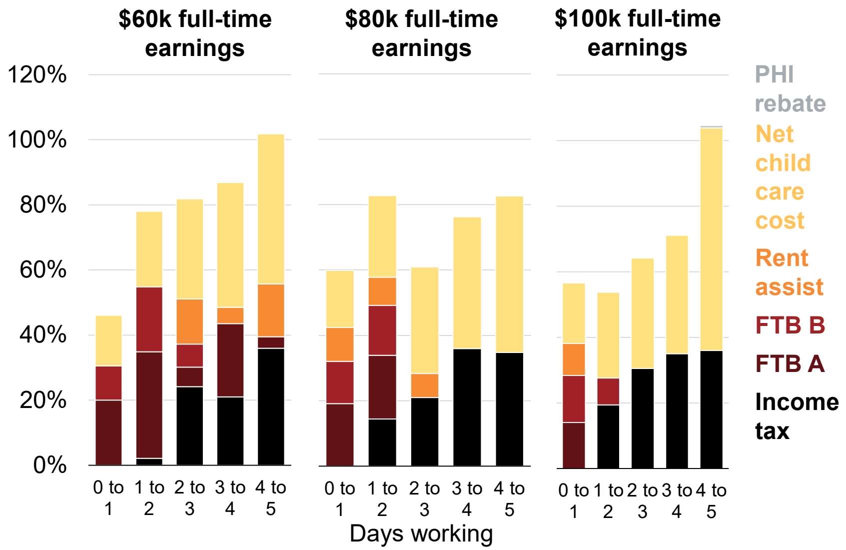


Notes: The WDR represents the financial disincentive from the second earner working an additional day. Primary earner works full time. Shaded area shows cameos of a primary earner with a higher FTE salary than the secondary earner. Two children, both require childcare. Every day of work for the second earner results in exactly one day of approved childcare. Cost of childcare assumed to be $110 per day. Renting, paying sufficient rent to get maximum CRA if qualify under income test. Includes the Stage 2 personal income tax cuts and the temporary LMITO.
Source: Grattan analysis.

More than half of parents who want to do more paid work (two-thirds of whom are women) say childcare is the main barrier preventing them from doing so.[17]

Figure 1.2: Net childcare cost is the major contributor to very high workforce disincentives

Workforce disincentive rate 2020-21, second earner with two young children



Notes: Cameo models with secondary earner earning the same full-time salary as the primary earner. Primary earner works full time. Two children, both require childcare. Every day of work for the second earner results in exactly one day of approved childcare. Cost of childcare assumed to be $110 per day. Renting, paying sufficient rent to get maximum CRA if qualify under income test. Includes the Stage 2 personal income tax cuts and the temporary LMITO.
Source: Grattan analysis.

[16] https://bfi.uchicago.edu/insight/research-summary/the-allocation-of-talent-and-us-economic-growth/

[17] ABS (2019). There are many different barriers within ‘childcare’, the main one being cost, see Wood et al. (2020a), Figure 3.1.

1.4 Out-of-pocket childcare costs remain high in Australia, despite previous reform efforts

Australia's out-of-pocket childcare costs are high by international standards, even with significant government support via the Child Care Subsidy.

Childcare costs absorb 18 per cent of household income for an average-earning Australian couple with two young children. The OECD average in 2019 was 10 per cent.[18]

For a family with income of less than $70,000, getting the maximum subsidy,[19] out-of-pocket childcare costs are still about $8,500 a year for two children in full-time care. For a family where each parent earns $80,000, out-of-pocket childcare costs are about $26,000 a year.[20]

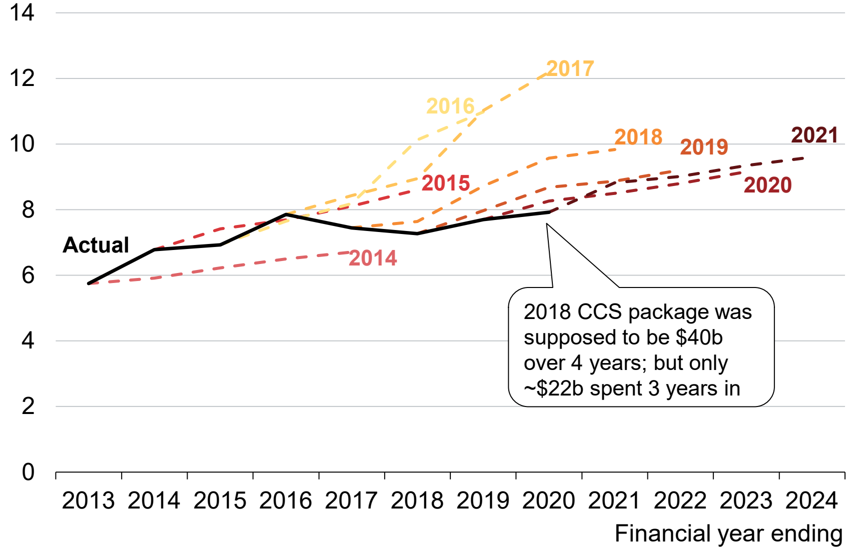
Unsurprisingly, about half of Australian parents with children under 5 say they struggle with the cost of childcare.[21]

The Women's Economic Security Statement 2020 identifies childcare as a critical support and notes the government's commitment to increase investment in childcare 'over the next few years to around $10 billion per year'.[22]

But expected investments in childcare over many years have not been realised (Figure 1.3). This is partly because childcare usage has not met government expectations, and partly because of policy changes that restricted eligibility.[23]

Figure 1.3: Expected investments in childcare have not been realised

Real government expenditure on the Child Care Subsidy and earlier childcare schemes, $ billions



Source: Grattan analysis of Commonwealth Budget Papers.

[18] OECD (2020).
[19] The maximum subsidy is 85 per cent for households with income less than $69,390, with an hourly rate cap on costs subsidised.
[20] This assumes full-time care at $110 day (on par with the hourly rate cap). Without any subsidy the total cost for two children in full-time care would be $57,000 per year.
[21] In the 2017 HILDA survey, almost half of parents of children under 5 reported difficulty with the cost of childcare, compared with just over a third in 2002: Wilkins et al. (2019). In the 2019 'Australia Talks' survey, 56 per cent of women with young children and 50 per cent of men with young children reported difficulties with the cost of childcare (ranking it 7-to-10 on a 10-point scale): ABC (2020), sample size 3,073.
[22] Australian Government (2020), p.39.
[23] The 2018 CCS reforms included an activity test.

2 Policy changes that would make childcare more affordable and accessible

There are simple steps that can be taken within the existing Child Care Subsidy framework that would significantly reduce out-of-pocket costs and improve the returns-from-work for the primary carer. There are also ways the current system could be extended to make childcare more accessible for all families.

Several options to make childcare more affordable are summarised in Table 1.

2.1 Boosting the Child Care Subsidy

In a recent Grattan Institute report, *Cheaper childcare*, we modelled a range of reforms to make childcare more affordable and reduce the disincentives to working full-time.

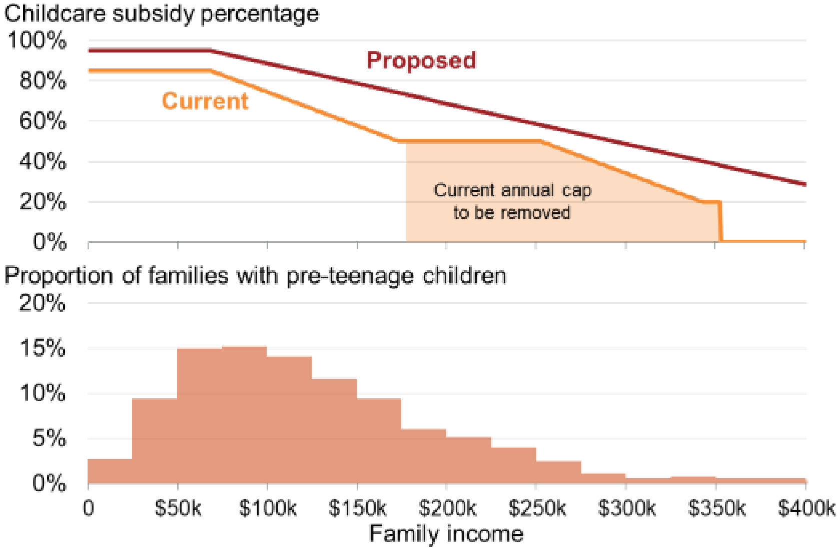
We recommended increasing the maximum Child Care Subsidy from 85 per cent to 95 per cent, flattening and simplifying the taper, and removing the annual cap (Figure 2.1).

This option would reduce most workforce disincentive rates – the proportion of income lost through higher taxes, loss of family benefits, and higher childcare costs – to less than 70 per cent. With the removal of the annual cap, and the simpler taper rules, parents would be better able to understand the impact of additional earnings on their childcare costs.

We estimate that these changes would cost an extra $5 billion a year (not including additional income taxes that would partially offset this) and deliver a GDP boost of about $11 billion a year.

If the Government were looking for a smaller step in the right direction, then slowing the taper rate on the current subsidy would go a long way to reducing the financial barriers to working an extra day for most single parents and 'second earners' in a couple (usually women).

Figure 2.1: Our recommended approach is a higher childcare subsidy for everyone, with a flatter taper



Notes: The distribution of family income is estimated as at 2019-20 from 2017-18 data. A family is defined as a unique income unit in the ABS Survey of Income and Housing.
Source: Grattan analysis of ABS (2019).

Table 1: Options for reform – the pros (darker) and cons (lighter)

Option	WDR impact	Cost	Economic impact	Complexity for parents	Complexity to administer	'Fairness'
Subsidy boost: lift the subsidy to 95%, flatten the taper	Most WDRs under 70%	$5b	13% hours, $11b GDP	One taper, no annual cap	Same information required as under current system	Similar distribution of benefits to current system
Second child: second and subsequent children free	Most WDRs under 80%	$3b	5% hours, $6b GDP	Can be unclear which child's care is free	Need to collect information about other children in care	Only helps families with multiple children in care
Universal: Universal 95% subsidy	Most WDRs under 60%; many under 40% even with 2 young children	$12b	27% hours, $27b GDP	Net childcare cost is constant across days, unaffected by income	Fewer questions required than under current system	Transfers much more to high earners than current system
Tax-deductible: Deductions *instead of* a subsidy	Increases WDRs	Saving	Negative	Unclear how much care will be subsidised until tax time	Administered through income tax return	Most families are worse off, especially low-income
Opt-in tax-deductible: Deductions *or* a subsidy	Decreases only a small range of WDRs	$0.5b	0.1% hours, $0.4b GDP	Very hard to identify optimum choice, impact of working extra days, and cashflow impacts	Need to capture parents' choice, and maintain two payment systems	Only the highest-earning 10% of families benefit

Notes: Darker colours indicate the option more strongly meets the criteria. Grey indicates the option does not meet the criteria at all. WDRs = workforce disincentive rates. Increase in hours refers to 'marginal worker' and single-parent hours in households with at least one child under 6. A 'marginal worker' is the partner in a couple working less hours. Source: Grattan analysis.

2.2 Second child free

This reform would make childcare free for second and subsequent children.[24] This recognises the fact that childcare is especially expensive for families with multiple children in care.

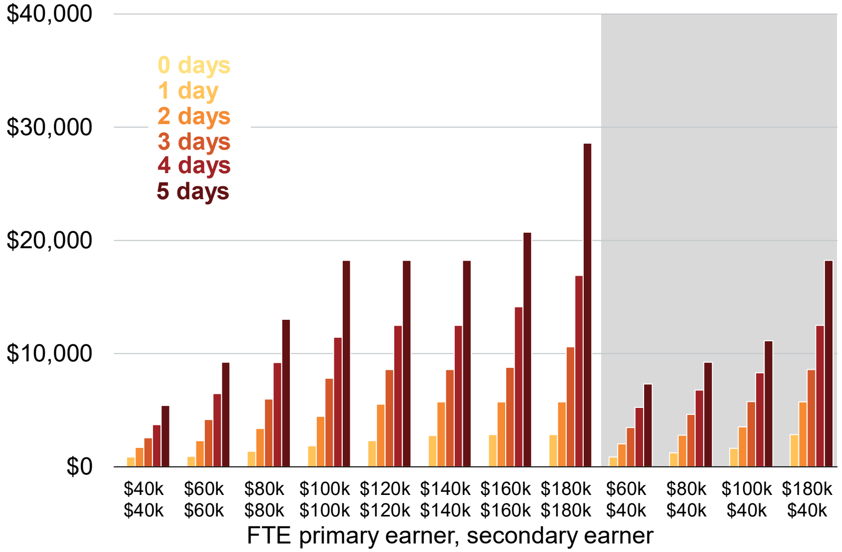
By targeting these families, this option would reduce most workforce disincentive rates to less than 80 per cent. The budget cost would be about $3 billion (not including additional income taxes that would partially offset this), and it would deliver a boost to GDP of about $6 billion a year.

The second child option helps families with multiple children right across the income spectrum (Figure 2.2). It would particularly help families with more than one child under school-age. This situation usually applies for only a few years at most – but these years are important to mothers' longer term workforce participation.[25]

This option would be a little more difficult to administer than the current system. To accurately estimate the appropriate subsidy for a child, a childcare centre would need to know the total cost of all other paid care being used by the child, as well as the total cost of paid care being used by all other children in the family.

Figure 2.2: All families with multiple children would be better off under the 'second child free' option, especially those working more

Annual gain for families with two children in care, 2019-20



Notes: Cameo models with secondary earner earning the same full-time salary as the primary earner unless otherwise specified (shaded area). Primary earner works full time. Two children, both require childcare. Every day of work for the second earner results in exactly one day of approved childcare. Cost of childcare assumed to be $110 per day. Renting, paying sufficient rent to get maximum CRA if qualify under income test.
Source: Grattan analysis.

[24] The 'first child' for the purpose of subsidy calculation would be the child incurring the highest childcare cost. In most cases this will be the child who is in care for the most days. For a family with one child in long-day care and another using out-of-school-hours care, the 'first child' will usually be the one in day care.

[25] Wood et al. (2020a), Chapter 4.

2.3 Universal childcare

A move to universal non-means tested childcare is the most ambitious reform option, providing the biggest boost to workforce participation and significantly simplifying the system for parents.

We modelled a universal option with a small co-payment and an activity test – a 95 per cent subsidy on all childcare with no means testing or annual cap.

This option would have the biggest impact on workforce disincentive rates. They would fall to less than 60 per cent for most families, and to less than 40 per cent for many.

As a result, the universal option would deliver the biggest GDP boost (about $27 billion per year), but it would also be the most expensive (costing about $12 billion a year). One way to reduce the upfront cost would be to phase it in, for example starting with universal care for children aged 3 and 4.

It would be the simplest option for parents to understand (the cost of additional childcare would be very clear). And it would be easier to administer than the current system, because it would require parents to provide less information than at present.

But it also raises questions about fairness. Historically, childcare subsidies have been means-tested. Unsurprisingly, high-income families would get the greatest increase in benefits if the means test was removed. A family with two children and combined income of $360,000 normally receives no subsidy. Under the universal option, they could claim more than $50,000 a year in childcare subsidies if both children were in childcare five days a week. In contrast, families with a combined income of $80,000 would receive an increase of about $8,000 a year compared to the current scheme. Everyone would have access to the same total benefit in absolute terms, but the *change* in benefit may be perceived as unfair.

Making childcare free would probably trigger a very large increase in demand, so such a change would need to be phased in over several years. It would also need to be supported by other policy changes – including to workforce training, and quality standards and assessment – to ensure adequate supply at an appropriate quality.

2.4 Making childcare tax-deductible would benefit very few

Tax-deductible childcare rightly recognises childcare as a working expense. But because the cost of childcare is so high, only about 10 per cent of families with pre-school children pay enough tax to benefit (Figure 2.3).

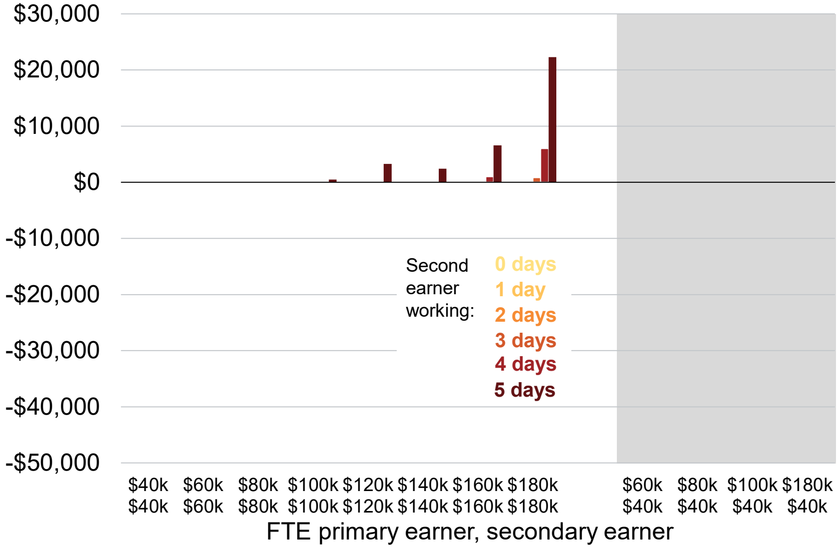
An 'opt-in' model would ensure that no one is worse off[26] (most families would go backwards otherwise). But an opt-in model would also make the system significantly more complex.

Most families would need help to identify the right option for them. Making the right choice between the Child Care Subsidy and tax-deductibility would be particularly tricky where one or both earners have variable earnings (for example for small business owners, sole traders, and casual and shift workers). The choice also becomes more complex for families with multiple children using different kinds of care (day care, after-school care etc.).

[26] Dixon et al. (2019).

Figure 2.3: Under opt-in tax-deductibility, very few families would be better off; for most families there is no change

Dollar impact from proposal, 2019-20



Notes: Under the 'proposed' scenario, instead of the Child Care Subsidy, the cost of childcare would be fully tax-deductible against the lower-earning member of a couple. The WDR represents the financial disincentive from the second earner working an additional day. Primary earner works full-time. Shaded area shows cameos of a primary earner with a higher FTE salary than the second earner. Two children, both require childcare. Every day of work for the second earner results in exactly one day of approved childcare. Cost of childcare assumed to be $110 per day. Renting, paying sufficient rent to get maximum Commonwealth Rent Assistance if qualifying under income test.
Source: Grattan analysis.

Even if families were among the 10 per cent better off under the tax-deductible model, they may still prefer the Child Care Subsidy to avoid the cash flow issues of waiting for a refund at tax time. Full-time childcare in a long day care centre costs about $29,000 *per child* per year ($110/day) without the Child Care Subsidy. Many of the families who would be 'better off' under tax-deductible childcare are currently eligible for an upfront subsidy of 20-50 per cent of this cost.

We estimate that an opt-in tax-deductible model would cost about $550 million and the benefit to GDP would be about $400 million, assuming all families make the right choice. But this model does nothing to alleviate work disincentives for 90 per cent of families with young children.

2.5 Options to broaden access to childcare

In addition to affordability concerns, there is a separate question about whether government support should be made available to a wider range of childcare options. For example, extending the Child Care Subsidy to registered nannies would support access to childcare for shift workers, weekend workers, workers on rotating rosters, and children with special needs.

The Productivity Commission recommended this in 2014,[27] and a trial was conducted in 2016 and 2017. Participating parents reported increasing their working hours, but uptake was initially very low because of substantial out-of-pocket costs.[28] Uptake improved when a more attractive subsidy was offered, but the benefits largely flowed to families already using a nanny.[29]

The Government introduced a targeted In Home Care program instead. That program provides a higher subsidy to a small

[27] Productivity Commission (2014), p.16.
[28] Povey et al. (2017).
[29] Povey et al. (2017).

number of families, but very few places are available.[30] The In Home Care program could be expanded, and/or the Child Care Subsidy could be extended to registered nannies (at the same benchmark price as day care).[31] This would give families more options when day care is not available or is insufficiently flexible to meet their work needs.

Relaxing the activity test or expanding the Child Care Safety Net would also support access to childcare, especially for single parents.[32] There is strong evidence that this would support children's learning and development,[33] but fewer guarantees that it would necessarily boost workforce participation. There may still be longer-term benefits for workforce participation though, because to be 'job ready', parents need reliable access to childcare.

2.6 Expanding the planned review of the Child Care Subsidy

The Federal Government could make changes to the Child Care Subsidy as part of its planned review of the system, originally scheduled for 2020 but delayed because of the pandemic.

Any changes to the Child Care Subsidy should be accompanied by a review of the hourly rate cap, and an ACCC market study of the childcare sector to identify any barriers to competition that could be putting upward pressure on fees.[34]

Further detail about the need for and nature of the policy changes proposed here is provided in the **attached** Grattan Institute report, *Cheaper childcare: A practical plan to boost female workforce participation*.

Boosting women's workforce participation through more affordable and accessible childcare would boost economic growth, underpin Australian living standards for decades to come, and help Australia to 'build back better' after the COVID crisis.

[30] 3,200 places Australia-wide for families who most need affordable, flexible care: Department of Education, Skills and Employment (2020b).
[31] Applying the same benchmark price and taper, as well as the activity test, would stem the flow of benefits to high-income families who might choose to use a nanny anyway, and would reduce the risks of rorting.
[32] As part of the current Child Care Safety Net, low-income families who do not meet the activity test are able to get 24 hours of subsidised care per child per fortnight: Department of Education, Skills and Employment (2020c).
[33] Good-quality early childhood education and care has benefits for children's development, especially vulnerable children: Tayler (2016); Tseng et al (2019); 'Early Learning: Everyone Benefits' campaign (2019).
[34] Wood et al. (2020a), Chapter 5.

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